

Dear Mr. Phelps,

Attached is a copy of a paper I recently finished in connection with my Masters of Securities Law at Osgoode Hall Law School. In it, I argue for a federally constituted securities regulator responsible for regulating interprovincial and international securities matters to replace the current structure. Provincial regulators will continue (at their option) to regulate purely intraprovincial transactions, which, it is speculated, will comprise a minimal proportion of capital markets activity. I wish to submit the paper to the WPC not only to promote the regulatory model proposed in the paper, but also because it discusses many of the topics specified in the WPC's "Questions to the Canadian Capital Markets Community" issued in May. Specifically, the following issues are addressed in the paper:

- strengths and weaknesses of the current structure (including reference to regulatory costs, loss of international competitiveness and enforcement issues) - pgs 2 to 16;
- analysis of regulatory structures in other countries (Australia, E.U. and U.S.) - pgs 49 to 56; and
- optimal regulatory structure - pgs 58 to 66.

The paper also includes an assessment of other regulatory models, and how they may compare to the federal model ultimately proposed.

I hope this paper adds to the debate. I certainly enjoyed thinking the issues through and articulating a position. Thank you very much for your consideration of this paper, and best of luck finding a regulatory model which pulls our regulatory system out of its current state.

Yours very truly,

Amy C. Lewtas

A CASE FOR FEDERAL SECURITIES REGULATION

BY: AMY C. LEWTAS

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In November of last year, acting on a request from John Manley, federal Minister of Finance, Harold Mackay suggested that a 6 person “Wise Persons Committee” be struck to explore and recommend an optimal securities regulatory structure for Canada. The debate surrounding Canadian securities regulatory reform resonates broadly within the Canadian financial services community, in which some 40 federal and provincial regulators share jurisdiction over the banking, insurance, trust, corporate, and securities sectors. It is difficult to conceive that the Fathers of Confederation intended the federal and provincial division of powers in the British North America Act of 1867 (the “Constitution Act”) to create this labyrinthine system of overlapping and often duplicative regulation. In the securities context, and given our modest contribution to the global capital markets, Canada cannot sustain a system of regulation which exerts excessive administrative and transactional barriers to entry. We are being left behind.

At root, regulatory reform is about maintaining Canadian market viability in an increasingly competitive global securities scene. As noted by Professor Jeffrey Mackintosh:

In order to harness the tide [of mobile capital] and not lose our ventures, it is imperative that we come to recognize that regulation is a product. Selling our capital markets to the world necessarily means selling our regulatory apparatus. ... We must recognize that the future of our capital markets depends on legislators, securities regulators and stock exchanges taking stock of the fundamental reality that we – and they – are competing for capital on an international stage.¹

This paper advocates a reformed securities regulatory structure sponsored by the federal government. It does so while acknowledging strong opposition to centralization from certain regions across the country. In summary, the proposed model contemplates a federally constituted agency administering a federal securities act applicable to all interprovincial and international securities dealings, leaving purely local

¹ Jeffrey Mackintosh, *Opening Remarks to the Joint Symposium of the Toronto Stock Exchange and the Capital Markets Institute on The Future of Canada’s Securities Regulation: Harmonization or Nationalization?* (March 8, 2002) (the “CMI Symposium”)

transactions to be regulated provincially. As explained below, a vast majority of securities transactions have transprovincial and/or international implications, and would therefore fall under federal jurisdiction. In fact, the increasing irrelevance of provincial borders in securities transactions has stoked the growing perception that Canada's regulatory structure is badly out of step with market reality.

Many participants in the reform debate have dismissed a federally convened centralized securities regulator as politically impracticable, and have instead promoted models preserving a strong provincial legislative and administrative role. Dissatisfaction with Canada's regulatory system is registering on political radars. If indeed there is sufficient momentum for change, we must not approach reform with an expectation of compromise, but instead must implement the best solution for securing competitive, innovative, efficient and fair capital markets.

PART I THE CURRENT REGULATORY LANDSCAPE

Against a backdrop of global market and regulatory consolidation, Canada's regulatory structure remains curiously fragmented. Each province² maintains its own securities laws and regulatory body to administer those laws. While much harmonization of securities laws and regulatory requirements has been achieved, there remain significant substantive differences in securities legislation across Canada and importantly, in the enforcement and/or interpretation of similar legislative provisions. The status and functions of the country's 13 regulators also varies.³ Some are self-funded agencies. Others are agencies with limited provincial budgets. And still others are Crown corporations. Some provincial regulators have rule-making authority, while others continue to rely on legislative change or policy edicts to address needed amendments to their rules. The financial and personnel resources vary dramatically across regulators. As a result British Columbia, Alberta, Ontario and Quebec have emerged as the more significant players in Canadian securities regulation, often setting the agenda for national policy reform. The concentration of market activity in Ontario, the regional character of many of Canada's industries,

² For economy of words, this paper uses the term "provinces" to encompass the provinces and territories of Canada.

³ *Five Year Review Committee Final Report: Reviewing the Securities Act (Ontario)*, March 21, 2003, 30.

and the omnipresent spectre of Quebec sovereignty have exerted significant ongoing tensions among the provincial regulators.

To overcome some of the institutional and legislative impediments to developing a cohesive Canadian regulatory platform, the 13 provincial regulators have convened the Canadian Securities Administrators (the “CSA”), which has made commendable strides toward inter-provincial regulatory coordination and harmonization of securities laws and standards.

1.1 *Advantages of the Current Regulatory Structure*

Many defenders of the status quo rightly suggest that, notwithstanding its cumbersome and fractured structure, the current regulatory system has worked remarkably well. Below is a summary of the perceived benefits of decentralized securities regulation.

Responsiveness

Local regulators have been able to successfully shape legislative and regulatory requirements to the unique characteristics of their constituencies. Close connections and open dialogue with the regulated community can also provide a regulator with valuable information about pressing market issues and feedback about policy or regulatory initiatives. Fears abound that a national and centralized regulator would be insensitive to (or institutionally incapable of responding to) regional economic and market issues. Provincial regulation has yielded some innovative solutions to local issues, which have in the past been broadly adopted across Canada.

It is argued as well that because provincial commissions have developed considerable knowledge about their local markets and their market participants, their surveillance and enforcement functions target and detect wrongdoing more effectively than could be achieved in a diffuse national enforcement strategy.

Cooperative Achievements

The CSA has worked tirelessly pursuing legislative harmonization and enhancing regulatory coordination. The Mutual Reliance Review System (the "MRRS")⁴ established in 1998 enables issuers to deal with a single principal regulator in settling prospectuses, rights offering circulars or applications for discretionary relief filed in multiple provinces. Although a non-principal regulator does not cede jurisdiction under the MRRS and can opt out of the MRRS at any time in respect of a particular filing, the MRRS is a commendable attempt to overcome inefficiencies inherent in the current regulatory environment. The System for Electronic Document Analysis and Retrieval⁵ and the System for Electronic Disclosure by Insiders⁶ (known as SEDAR and SEDI, respectively) are other examples of CSA initiated reforms intended to greatly simplify multi-jurisdictional filings and public access to those filings. The CSA also played a central role in the coordination of the reformulation project whereby certain policies and rulings were redrafted, where possible, as multi-lateral instruments (including rules and policies). Through this often painstaking process, the CSA achieved an unprecedented degree of legislative uniformity, and continues to do so in the context of new multi-lateral policy initiatives. More recently, the CSA has announced its ambitious proposal to develop a uniform securities act and accompanying rules to be adopted by all provinces (the "USL Project")⁷. As part of this initiative, the CSA intends to incorporate measures designed to simplify and streamline regulatory processes. The USL Project has been enthusiastically applauded by many market participants as a means of "eliminating duplication and inconsistency and reducing regulatory risk".⁸

⁴ See National Policy 43-201 – *Mutual Reliance Review System for Prospectuses and Annual Information Forms*, and National Policy 12-201 – *Mutual Reliance Review System for Exemptive Relief Applications*.

⁵ National Instrument 13-101 – *System for Electronic Document Analysis and Retrieval*.

⁶ National Instrument 55-102 – *System for Electronic Disclosure by Insiders*.

⁷ CSA Notice and Request for Comment 11-402 – *Concept Proposal for Uniform Securities Legislation*, 2003 26 OSCB 941.

⁸ Joe Oliver, *Regulatory Reform – Made-In-Canada*, The Canadian Institute Superconference, February 18, 2003.

Regulatory Competition

Many proponents of decentralized regulation theorize that regulatory competition also encourages policy innovation. The pure competition model, as discussed in greater detail below, would provide issuers and intermediaries with an unfettered choice of regulatory jurisdiction, thus compelling regulators to compete among themselves for issuers and intermediaries. In Canada, regulatory streamlining initiatives such as the MRRS designate the principal regulator for any particular issuer or intermediary (based usually on the location of the entity's head office), thereby minimizing the competitive relationships among regulators. There remains, however, a strong commitment by regulators to sustain the competitive advantage of local markets. To be sure, each provincial regulator brings its own market bias to any national policy initiative, thus ensuring a broad ranging and dynamic debate of the relevant issues. Arguably, this process would yield a more informed and broadly applicable solution.

Constitutionality

A key element in the Canadian debate surrounding regulatory reform is the constitutional validity of alternative regulatory models. From the earliest regulation of market trading, the provinces have asserted jurisdiction over securities regulation pursuant to their power under subsection 92(13) of the Constitution Act to enact legislation regarding "Property and Civil Rights in the Province". Provincial jurisdiction over securities regulation under this head of power was first affirmed by the Privy Council in the *Lymburn v. Mayland*⁹ decision, and has been consistently upheld by the courts since then. The existing regulatory structure therefore appears to have constitutional justification. As will be discussed in Part IV of this paper, however, the rationale underlying provincial jurisdiction in the securities sphere has substantially eroded in the decades following the *Lymburn* decision.

⁹ [1932] 2 D.L.R. 6 ("*Lymburn*").

1.2 *Disadvantages of the Current Regulatory Structure*

Excessive Compliance Costs

Many market participants are confounded and frustrated by the complexity and inefficiency which they perceive afflict the Canadian securities regulatory model. The fragmented system causes its users to incur excessive compliance costs. The existence of multiple statutes, rules and policies imposing frequently differing requirements and standards, requires issuers and intermediaries to incur significant legal, accounting, geological and other professional or advisory costs to ensure compliance with each province's legislation. These costs are borne in connection with structuring 'private' transactions, upon entry to the public capital markets (i.e. in the course of an initial distribution) and on an ongoing basis through continuous disclosure requirements. Where the differences among provincial legislation serve no substantive or policy objectives, any costs arising from compliance directly detract from the efficiency of the system, and erect transactional barriers to accessing the market.

In 1996, a group of securities lawyers prepared and delivered a report to the Senate Committee on Banking, Trade and Commerce which attempted to quantify the incremental transaction costs attributable to dealing with multiple statutes and regulators.¹⁰ While the survey distributed by the group to various market participants elicited anecdotal, and not statistical, evidence, the authors concluded that, in the context of market offerings, issuers must bear certain additional costs arising out of decentralized regulation. Among those costs are professional expenses, costs attributable to a delayed receipt of the offering proceeds, and (to a lesser degree) missing a market window of opportunity by virtue of regulatory delay. With respect to continuous disclosure, a strong majority of respondents unsurprisingly viewed decentralization as significantly raising compliance costs. The study concluded that only the creation of a national regulator to replace the provincial regulatory system could effectively eliminate duplication and contain costs.

¹⁰ Grant W. Sawiak, Cameron Wm. Ferris, William J. Braithwaite, Patricia L. Olasker and F. John Durdan, *Report to the Standing Committee on Banking, Trade and Commerce on the Transaction Costs of a Decentralized System of Securities Regulation 1* (1996).

Filing Fees

Market participants bemoan the volume of fees levied in respect of almost all filings by all jurisdictions. While certain jurisdictions have taken steps to reduce filing fees, some critics fear that provincial governments view regulatory fees as a source of provincial revenue. Stephen Sibold, Chair of the Alberta Securities Commission, suggested that this misguided approach amounts to “a stamp tax on the industry.”¹¹ In a response to the Mackay Report, the Commission des valeurs mobilières du Québec (the “CVMQ”) presented statistical evidence that regulatory fees comprise less than 1 % of the aggregate costs of an initial public offering, which, if true, would not justify broad regulatory reform.¹² The study also demonstrated, however, that fees payable to lawyers, auditors, transfer agents and printing services accounted for approximately 25% of the total offering costs. Reducing this latter category of fees through legislative harmonization may yield tangible benefits to issuers.

Even if the conclusions of the CVMQ report are accurate, any perception of regulatory complexity and/or market inaccessibility could be damaging to the Canadian markets. The modest scale of Canadian markets will dictate against Canada being a primary destination market in any significant international offering. Notwithstanding the efficiency enhancing initiatives of the CSA, practice has shown that in certain multi-national offerings, a Canadian tranche has been abandoned once the issuer or investment bankers determine that multiple approvals will be required.

Regulatory Costs

The Canadian securities regulatory system also entails significant regulatory costs. Of the 13 provincial regulators, at least 4 are fully-staffed, comprehensive regulators with overlapping expertise. There is a significant duplication of effort and resources among the regulators. Jamie Scarlett has noted:

¹¹ *Submission of the Alberta Securities Commission to the CMI Symposium.*

¹² *CVMQ, Securities: Effective and Appropriate Regulation, 2002.*

Rather than having a centralized team dedicated to developing a deep understanding of [complex issues], our current system results in the available regulatory resources being spread across numerous commissions with each of them having to learn the same issues together. The result is regulatory knowledge that may be miles wide, but is only feet deep.¹³

As well, coordinating national policy or regulatory initiatives, building consensus thereon, and shepherding them through local implementation processes is often an inordinately cumbersome and time-consuming process. Critics of the current system point to the lost economies of scale inherent in a pluralistic approach to policy development.¹⁴

There are also costs arising from policing and resolving inadvertent breaches of securities laws – where well intentioned market participants unwittingly breach a requirement in one jurisdiction by complying with a related requirement in another jurisdiction. While such inadvertent breaches are typically inconsequential to the market, they are a troublesome by-product of a national regulatory strategy which supports a multiplicity of laws.¹⁵

Loss of Domestic and International Capital

Weighed down by a complex regulatory structure, Canada's markets may be losing ground in the global competition for capital. Deterred by excessive costs and regulatory duplication, foreign issuers are increasingly bypassing the Canadian markets for the deeper and more accessible markets in the United States and elsewhere. Indeed many substantial Canadian issuers are discovering that their capital needs can be met more efficiently in American markets. If not reversed, these trends could have a devastating effect on the vibrancy of our markets. For Canadian investors, there would be a narrower range of

¹³ James D. Scarlett, *Speaking Notes for CMI Symposium*.

¹⁴ Jeffrey G. Mackintosh, *A National Securities Commission for Canada?*, in T. Courchene and E. Neave, Eds, *Reforming the Canadian Financial Sector: Canada in Global Perspective* (1997), 194 at 218 ("Mackintosh, 1996").

¹⁵ *Ibid*, p 218.

available investments on local markets. This concern is not new. Each of the previous regulatory reform proposals (summarized in Part II below) cited the potential for Canada's dwindling relevance in global markets as a factor compelling reform. Professor Cally Jordan speculated that one of the more recent reform proposals failed because the "forces of internationalization of capital markets acting upon 'domestic incumbents', while intensifying rapidly in our opening economy, had not yet reached the critical level required to overcome the political resistance to change."¹⁶

Canadian market activity represents approximately 2% of global market activity. Shifting political and economic climates throughout the world have resulted in the emergence of new market based economies which are becoming increasingly competitive in attracting investment capital. As noted by David Brown, Chair of the Ontario Securities Commission (the "OSC"): "Canadian issuers and investors have the freedom to access marketplaces where liquidity pools are deepest, costs of capital are cheapest, and efficiency greatest."¹⁷ In addition, technological innovation has revolutionized the accessibility of global investments in debt and equity markets. Canada's regulatory and market structures must reflect and effectively respond to these emerging economic realities.

Comparing the Canadian situation to the economic power and market might of the United States and the European Union which "have such a large share of the market that they can afford to run excessively burdensome regulatory regimes without losing a lot of securities-related business",¹⁸ Professor Mackintosh noted:

This is another way of saying that we are price takers, not price setters. And economics teaches us that in a perfectly competitive market, a price taker cannot afford to shade its price upward even a smidge, without catastrophic loss of business to its competitors.¹⁹

¹⁶ Cally Jordan, *Comment on "An Alternative Regulatory Model for Canada": A View from Afar*, 2001 Queen's Business Law Symposium, 59, at 60.

¹⁷ David Brown, *Dialogue with the OSC – Keynote Address*, November 20, 2001.

¹⁸ *Supra*, Note 1.

¹⁹ *Ibid.*

Global Market and Regulatory Consolidation

During the last decade, there has been significant market and regulatory consolidation, both domestically and internationally – the rationalization of Canada’s stock and commodity exchanges, the consolidation of European countries into the European Union, and the emergence of a single national securities regulator in Australia, to name a few. It appears increasingly anachronistic to operate a regulatory structure along provincial borders when market activity is patently transprovincial and international in character.

Canada’s cooperative and communal approach to regulation may be functionally incapable of generating timely and coherent responses to rapidly changing market conditions and new investment products.

Lack of an International Voice

Critics of the current system also lament the absence of a unified Canadian voice in the international securities regulatory setting, particularly in bilateral dealings with the United States’ Securities and Exchange Commission (the “SEC”). Instead provincial delegates articulate regional perspectives in international policy debates or negotiations, which necessarily lack the authority or credibility of a national position. For example, each of Ontario, Quebec, British Columbia and Alberta are participating members of the International Organization of Securities Commissions (“IOSCO”), with only Ontario and Quebec having voting rights. These delegates represent only a portion (albeit a significant portion) of Canada’s markets, leaving the rest of Canada without representation in IOSCO. Harold Mackay found among market participants a concern that the international image of Canada’s markets suffers from the multiplicity of regulatory regimes, with a resulting loss of international investor confidence and participation in Canadian markets.²⁰

²⁰ *Letter of Harold Mackay to the Honourable John Manley, P.C., M.P.*, November 15, 2002 (the “Mackay Report”).

Enforcement

The current regulatory structure presents many unnecessary obstacles to an effective pan-Canadian market surveillance and enforcement strategy. In their final report (the “Crawford Report”)²¹, the Five Year Review Committee views effective domestic and international enforcement mechanisms as critical to maintaining Canada’s market credibility globally.²² While Canada has not been directly tarred by the rash of corporate meltdowns in the United States (i.e. Enron and Worldcom), Canadian markets have their share of blemishes (i.e. Bre-X and Livent). Legislators and regulators alike must vigorously pursue market integrity and restore the investor confidence which inevitably buckled under the weight of the American scandals. While the current and highly publicized debate focuses on appropriate corporate governance mechanisms, developing a rational regulatory structure which can implement and enforce policy or legislative initiatives is a fundamental prerequisite to successful regulation.

A majority of securities related malfeasance has extraprovincial, if not international, dimensions, resulting in a domestic need for interprovincial and international coordination of the surveillance and investigative function, and of ongoing information sharing among regulators. Currently the investigative powers of securities commissions differ significantly, with each provincial statute laying out the appropriate approval process for obtaining investigation orders, and the threshold of proof to establish the need to make the investigation. A multi-jurisdictional investigation would thus require each regulator to secure the necessary approvals to proceed. While courts have broadly upheld the extraprovincial reach of local investigative powers,²³ provinces must often fend off challenges to their jurisdictional authority to participate in, or cooperate with, an investigation initiated elsewhere. This tactic diverts considerable resources from the enforcement function, and is often wielded as a means of stalling proceedings.

Furthermore, multi-lateral enforcement of orders by a provincial regulator raises constitutional and practical problems. While a jurisdiction may, by mutual agreement, enforce orders issued by another

²¹ *Supra*, Note 2.

²² Crawford Report, 6.

²³ See *Global Securities Corp. v. British Columbia (Securities Commission)*, [2000] 1 S.C.R. 494.

jurisdiction, such enforcement may raise civil liberties issues, as the subject of the order has been given no hearing in the jurisdiction enforcing the order. In addition, mutual enforcement will be undertaken on a necessarily ad hoc basis and likely only when there is a perceived local benefit to ensuring enforcement of an order, as provincial commissions lack the resources to monitor compliance with all orders issued by other provinces.²⁴

To overcome some of the hurdles of enforcement in the context of transprovincial wrongdoing, provincial regulators have, where the circumstances so warrant, conducted joint hearings. These hearings are a stark example of the duplicative effort required to achieve a uniform objective under our system. As well, without uniformity of procedural requirements and standards of due process, these hearings become unnecessarily complex procedurally.

Lastly, surveillance and enforcement personnel are distributed unevenly across Canada. Only the four most influential regulators have sufficient resources to maintain fully functioning enforcement units, to the obvious detriment of those provinces with less market activity.

Limitations of Cooperative Initiatives

Notwithstanding the CSA's laudable attempts to foster interprovincial regulatory cooperation, serious flaws and structural inefficiencies continue to plague CSA initiatives. For example, the MRRS does not address several systemic inefficiencies. Because each regulator retains its statutory discretion with respect to each filing, and must be satisfied with the principal regulator's disposition of the filing, there is a duplication of regulatory effort. The MRRS lacks certainty, as jurisdictions can, and do, opt out of the system in respect of contentious filings. Experience has demonstrated that the MRRS tends to break down in the context of novel or complex transactions. In such circumstances, jurisdictions are more reluctant to rely on the principal regulator's scrutiny of the filings and identification and/or resolution of the significant capital markets issues. As the MRRS does not address the problems associated with

²⁴ Mackintosh 1996, 216 and 217.

divergent legislation, issuers still incur significant advisory costs ensuring compliance with a multiplicity of statutes. Multiple filing fees must still be paid.

While the USL Project would address many of the deficiencies afflicting the MRRS, the efficacy of the USL Project will be severely undermined by the fractured regulatory structure in which it will operate. It is difficult to conceive that uniformity in regulatory approach and outlook will survive long after CSA negotiations produce the draft legislation and rules. Enactment of the uniform legislation by provincial legislatures is bound to elicit debate and quite possibly political demands for amendment. Once the USL is enacted, any significant amendments, whether through the legislative or rule-making processes, are likely to evoke divergent views as regional pressures and local constituencies weigh into the debate.²⁵ Interpretation and enforcement of USL provisions by the various regulators will likely be uneven across the country. To be successful, the USL initiative must have broad regulatory and political commitment. British Columbia's tepid response to the USL Project and its concurrent commitment to its local deregulation project do not bode well for the universal adoption of USL.²⁶

Limitations of the CSA

In its call for a national securities regulator, the Five Year Review Committee noted that certain institutional characteristics of the CSA necessarily limit its effectiveness as "a vehicle to coordinate Canadian securities legislation".²⁷ Majority decisions are not binding on CSA members, such that each jurisdiction remains free to pursue its own regulatory or policy approach. Consensus building through the national policy and rule-making process is time-consuming and bureaucratic, and therefore may

²⁵ Commenting on the USL Project, Pierre Godin, Chair of the CVMQ, observed that USL "has to take into account the specific needs of the regional markets, and especially the needs of the Quebec market towards our issuers and brokers." *Madly off In All Directions, Canadian Business* (May 26, 2003) 93 at 96.

²⁶ In a recent speech, Doug Hyndman, Chair of the British Columbia Securities Commission, summarized his position as follows: "However, we don't think that achieving uniformity alone will meaningfully reduce the regulatory burden on industry. We think it's important to use the golden opportunity provided by the USL Project to simplify and update a system of regulation that has grown too complex and has failed to keep pace with a rapidly changing market." *Regulation that works for our markets* (January 30, 2003) Cordilleron Roundup 2003, at 16.

²⁷ Crawford Report, 53.

ultimately be unresponsive to market demands. The CSA lacks enforcement powers, such that multi-lateral coordinated enforcement proceedings must be undertaken on an ad hoc basis. The CSA is accountable to no one, and its success is entirely dependent on the commitment of its members. Lastly, it has become apparent that there is an emerging divergence of regulatory philosophy as between CSA members, as starkly evidenced by British Columbia's deregulation initiative, and Doug Hyndman's resignation as Chair of the CSA due to the incompatibility of his regulatory vision with that of his colleagues.

PART II HISTORICAL OVERVIEW OF REFORM PROPOSALS

It is somewhat disheartening to learn that fundamental securities regulatory reform has been a recurrent item on the political agenda, but has never garnered sufficient enthusiasm to overcome regional and/or political resistance. It may be that the Canadian regulatory system has operated remarkably well. To be sure, Canada has not been jolted by significant "exogenous" events which have dramatically exposed our regulatory flaws (such as the Australian financial scandals which precipitated radical centralization of the regulatory function²⁸, or the creation of the European Union which created a geo-political context for the European Commission). Instead, Canada has been feverishly trying to adapt its convoluted regulatory structure to the rapidly changing global markets.

Below is a summary of the five most significant initiatives to reform Canada's securities regulatory system. Each reform proposal recognized and attempted to respond to the perceived drawbacks of the existing structure, including the inefficiencies resulting from disparate securities legislation across Canada, the duplicative efforts of multiple regulators, the inadequacy of extra-provincial enforcement mechanisms, and the increasingly marginalized status of Canada's markets internationally.

²⁸ Citing numerous significant corporate failures in Australia during the 1980s and the market destruction wrought by a relatively small group of promoters and financiers, Alan Cameron, former Chair of the Australian Securities and Investments Commission, stated that "... what motivated Australia to establish the single national securities and companies regulator was the need for effectiveness, as a criterion which overwhelmed the parochial preference for regionally relevant regulation." *Keynote Luncheon Presentation* delivered at CMI Symposium, 2 ("Cameron").

2.1 *The Porter Report - 1964*

The Porter Report²⁹ contained one of the earliest calls for a national securities regulator. It focused on the need for uniform securities legislation that is “soundly conceived and intelligently enforced”³⁰ by closely cooperating regulators. To this end, it advocated either the establishment of a federal regulatory agency to act as facilitator of interprovincial cooperation or interprovincial coordination to develop uniform legislation. Under the former scenario, the federal agency would initially assume jurisdiction over registering interprovincial and international issues and over enforcement of securities related Criminal Code offences, but would largely be responsible for setting high and uniform regulatory standards for the provinces to follow. The provinces would retain jurisdiction over intraprovincial issues of securities and registration of local salespersons. The Porter Report speculated (perhaps rather naively) that competent federal leadership would induce provinces to cooperate and ideally delegate their regulatory jurisdiction to the federal agency.

The regulatory reform proposals in the Porter Report never took flight, in part because of skepticism in the securities industry that rationalization and efficiencies can be achieved by adding another layer of regulation. In addition, the recommendations were broadly cast, with no articulated strategy for overcoming the political, legal and practical hurdles to reform.

2.2 *CANSEC – 1967*

In 1967, the OSC proposed in more specific terms the creation of the Canada Securities Commission (“CANSEC”) to which the federal and provincial governments would delegate the administration of their respective securities legislation.³¹ CANSEC would be a three-tiered agency. A Council of Ministers comprised of the responsible provincial Ministers or their delegates would be responsible for setting the operating budget of CANSEC, hiring senior staff and discussing broad policy and legislative issues. The Commission would be comprised of full and part-time commissioners resident across Canada and

²⁹ Royal Commission on Banking and Finance, *Report 561* (1964).

³⁰ Porter Report, 348.

³¹ *CANSEC: Legal and Administrative Concepts*, November 1967, 1967 OSCB 61, (“CANSEC”).

responsible primarily for ensuring nationally consistent application of provincial securities laws. Finally, the administrative staff would be the foot soldiers of CANSEC. The proposal envisioned a head office in Ottawa, a chief executive office in Toronto, and regional offices in cities with a substantial volume of securities business.

Importantly, delegation by the provinces to CANSEC would be voluntary and could be withdrawn at any time. According to its authors, the CANSEC structure “offers Canadians a chance to bypass the tortuous path of constitutional amendment and to achieve immediate beneficial results in the security field without derogating from the constitutional position of any cooperating jurisdiction.”³² Also significant, the CANSEC proposal did not call for substantive uniformity of provincial securities rules, but rather for modest amendments in provincial statutes “to provide for similar schemes of administration.”³³

All powers then vested by statute in the provincial Ministers would remain intact, and Ministers would remain accountable to their constituents for the effective and responsible oversight of the provincial securities business. In practice, individual ministerial control over the staffing, operations and budget planning of the agency would be lost, and replaced with a collective system of administration through the Council of Ministers. The CANSEC proposal speculated that Canadians would “accept limitations on the power of provincial Ministers concerned with securities regulation individually in the interest of improved nationwide administration.”³⁴

The CANSEC proposal faltered on several grounds. It was criticized as providing an unstable regulatory structure from which a disgruntled province could withdraw, failing to promote legislative harmony and providing Ontario with inordinate representation in its governance structure. Critics noted that the decentralized governance structure of CANSEC would diffuse the responsibility for effective market regulation and oversight over many regulatory layers, and would dilute provincial ministerial accountability to an unacceptable degree.

³² CANSEC, 70.

³³ CANSEC, 66.

³⁴ CANSEC, 69.

2.3 1979 Proposals

An extensive critical analysis of the Canadian securities markets led to the publication of a three volume report advocating fundamental regulatory reform through the establishment of a federal securities agency to administer federal securities legislation with jurisdiction over interprovincial and international securities matters.³⁵ The report contained draft federal legislation, an accompanying commentary, and an impressive collection of background research and policy papers. Concluding that intraprovincial securities matters constitutionally fell within the exclusive jurisdiction of the provinces, the 1979 Proposals called for the retention of provincial regulatory bodies with significantly reduced mandates, and vigilant federal-provincial cooperation to minimize duplication.

The federal government never pursued the reforms recommended by the 1979 Proposals. In part, the Proposals were intrinsically incomplete, as they did not provide a strategy for implementation, instead urging federal and provincial consultation to devise an optimally coordinated and efficient regulatory structure. Likely there was also skepticism about the necessity of federal intervention and fears of regulatory monopolism. As well, it was feared that the costs and potential complexity of interposing another body to divvy up the regulatory pie may overwhelm any benefits to be derived from structural reform. Lastly, there was likely little political appetite for the constitutional confrontation which would likely ensue upon the federal government's assertion of jurisdiction. In fact, the 1979 Proposals silenced the debate regarding regulatory reform for almost 15 years.

2.4 1994 Proposal

With little enthusiasm, the OSC published a draft memorandum of understanding (the "1994 MOU")³⁶ initiated by the federal government, contemplating the statutory birth of a "uniform securities regulatory

³⁵ Proposals for a Securities Market Law for Canada, (1979)

³⁶ *Memorandum of Understanding Regarding the Regulation of Securities in Canada*, 17 OSCB 4401 (1994).

structure which will apply comprehensively within and across all participating provinces.”³⁷ Under the 1994 MOU, the federal legislature would enact federal securities legislation derived in large measure from existing provincial legislation. Each participating province would repeal its existing securities legislation, enact the federal statute as its own, and delegate authority to the Canadian Securities Commission (the “CSC”) to administer the provincial legislation. In compensation for lost regulatory revenues, the federal government would allocate among the participating provinces a one-time payment of up to \$150 million. As with the CANSEC proposal, provincial jurisdiction over securities regulation would be preserved, and a province could opt out of the national regulatory structure at any time. The 1994 MOU provided that the Chair of the CSC would report to the federal Minister of Finance, and that the CSC would play a role in the development of financial sector policy within the federal government. In addition to the Chair, the CSC would consist of ten Vice-Chairs and a slate of part-time commissioners to be drawn from the participating provinces in numbers reflecting the relative volume of securities transactions generated by such provinces or regions. The CSC’s head office would be in Toronto, with regional offices in B.C., Alberta and the Atlantic provinces (Quebec having indicated its unwillingness to participate in the 1994 MOU).

Participating jurisdictions would retain jurisdiction over intraprovincial securities matters, and could develop and maintain their own exemptions for primary offerings that are consummated solely within the province.

The 1994 MOU generated much interest. To its proponents, it represented a constitutionally palatable compromise capable of reducing regulatory and legislative duplication in pursuit of the principles of “investor protection, capital market efficiency and integrity, fostering of the capital markets, and respect for jurisdiction and regional characteristics.”³⁸ To its detractors (among them former Chair of the OSC Ed Waitzer) it represented an unnecessary and unwanted federal incursion on provincial powers.³⁹ Mr. Waitzer was of the view that incremental coordinated change through the mechanisms of the CSA was

³⁷ 1994 MOU, Preamble.

³⁸ *Letter of Nick LePan, Assistant Deputy Minister, Department of Finance, to Ed Waitzer, September 9, 1994.*

³⁹ *Letter of Ed Waitzer to the Honourable Bob Rae, Premier of Ontario, May 16, 1994 (“Waitzer Letter 1994”)*

making positive strides toward dismantling regulatory barriers and reducing costs. He also lamented that by simply adopting provincial legislation as the template for the national securities act, the federal government was squandering a valuable opportunity for much needed policy and legislative reform, including a reconsideration of whether separate corporate and securities laws should be maintained. Mr. Waitzer feared that a federal agency would be beholden to the federal Ministry of Finance, the Office of the Superintendent of Financial Institutions and the partisan politics they generate. In addition, with the likelihood that certain provinces would decline to participate, the CSC would be another regulatory player in an already complicated structure with the potential of further diffusing political accountability and responsibility. By focusing on regional representation, the CSC risked enshrining regional or provincial issues which, Mr. Waitzer suggested, may not be truly regional and may, in fact, hijack the more paramount issues relevant to investors and issuers generally. Lastly, he chided the 1994 MOU for providing inadequate details both of effective ongoing coordination mechanisms between the CSC and the non-participating provinces and of measures to ensure a smooth and well-managed transition process.

Other critics focused on the \$150 million compensatory payment to the provinces, predicting that such debt would be borne by the fledgling CSC. This could severely curtail the CSC's ability to reduce regulatory fees for a considerable time, thus undercutting one of the principle objectives of regulatory reform. The 1994 MOU, in fact, floundered over negotiations regarding the quantum of the compensatory payment. Interest in the 1994 MOU was briefly rekindled in the Throne Speech of 1996, in which the federal government indicated its commitment to work toward a federal securities commission with willing provinces.

2.5 *The Mackay Report – 2002*

Since the 1994 MOU was resurrected in 1996, there has been considerable academic and industry consideration of alternative regulatory models. The Mackay Report underscores the importance of efficient, fair and vibrant capital markets not only to individual investors, but also to the economic vitality of Canada. In addition to reciting the now familiar perceived weaknesses of the Canadian securities

regulatory system, Mr. Mackay highlighted the pressures on our markets emanating from the United States. Not only are Canadian markets increasingly losing domestic and international investment capital to the United States, but also the SEC, through the implementation of the Sarbanes-Oxley Act and its potential withdrawal from the Multi-Jurisdictional Disclosure System, is demonstrating a more bullish confidence in the extraterritorial reach of its regulatory jurisdiction. Canadian brokers and investment bankers are feeling the squeeze of growing competition as their American counterparts are gaining significant local market share. Lastly, Canada's fragmented regulatory structure severely compromises Canada's ability to negotiate bilateral enforcement mechanisms with the SEC.

Referring to failed reform attempts in the past, Mr. Mackay detected in his consultations with market participants a renewed, vigorous and broadly-based commitment to regulatory reform – a “public chorus for improvement.”⁴⁰ Mr. Mackay urged that the examination should be undertaken in a “zero-based process.”⁴¹ “We need to ask what is best for Canada and for Canadians, from coast to coast. We need to do so in a fresh fashion, setting aside old bromides.”⁴²

While Mr. Mackay was careful not to prejudge the Wise Persons Committee's recommendation, he suggested that the Committee assess the relative merits of at least two alternative models – the “single passport model” which would build upon existing interprovincial initiatives of administrative cooperation and mutual reliance/recognition, and the single commission model in which participating governments would pool their authorities to administer a single set of securities rules. These models will be described in greater detail below.

In a recent release, the Wise Persons Committee has solicited input from market participants regarding an assessment of the efficacy of the current regulatory model, as well as prescriptions for reform.⁴³ The Committee will also conduct or commission research “so as to ensure a rigorous, empirically supported

⁴⁰ Mackay Report, 2.

⁴¹ Mackay Report, 5.

⁴² Mackay Report, 5.

⁴³ *Questions to the Canadian Capital Markets Community*, May 8, 2003 (“WPC Letter”)

analysis of the issues.”⁴⁴ Notably, the reform structure to be advocated by the Committee will include “a governance model and accountability framework.”⁴⁵ The Minister of Finance has requested the Committee’s recommendation by November 30, 2003.

PART III PRINCIPAL OBJECTIVES OF REGULATION AND REFORM

Before embarking upon reform, the basic principles of securities regulation and objectives of reform must be clearly understood. It is unlikely that any model will fulfill all principles and objectives, but the optimal structure should provide a framework embracing and balancing as many of the fundamental principles as possible. Below is a summary of critical objectives of securities regulation and regulatory reform against which a national regulatory strategy must be measured.

Investor Protection

It is trite that investor protection is a cornerstone principal of securities regulation. Our statutes are replete with mechanisms designed to ensure that investments are made and held on the basis of full and clear disclosure of all relevant information, brokers are qualified and deal fairly and honestly with their clients, conflicts of interest are neutralized, asymmetries in access to relevant information are addressed, and malfeasors are pursued, sanctioned and, if necessary, banned from the markets. Securities regulation not only sets the rules through which investor interests are protected, but also provides the oversight and enforcement structures to promote those interests.

Efficient Capital Markets

Often balanced against the principle of investor protection is the legislative and regulatory commitment to promoting efficient capital markets. In an efficient market, the costs associated with participation are rationally proportionate to the reasonable regulatory objectives of the market and do not serve as an impediment to entry. Efficient markets also provide effective price discovery mechanisms, maximize

⁴⁴ WPC Letter, 1.

⁴⁵ WPC Letter, 1.

returns on investment, and ultimately ensure that investment capital is allocated to its best, lowest cost use in the economy. They ensure access to innovative and wide-ranging investment products. Pursuing a regulatory agenda dominated by investor protection issues may compromise the efficiency and accessibility of the market. However, domestic and international confidence in the markets is only earned when an efficient and vibrant market adequately protects its investors. Regulation plays a central role in finding the appropriate balance between these intertwined, but often competing, principles. As Mr. Mackay observed:

At its best securities regulation fosters investor participation through appropriate rules and supervision. In so doing, and by minimizing unnecessary impediments to transactions and market participation, it encourages innovation, growth and efficiency of capital markets.⁴⁶

Responsiveness

A successful regulatory model must be able to understand and respond to the different industry and economic conditions which define the markets in regions across Canada. Proponents of regulatory decentralization insist that a national regulator would be disinterested in and unresponsive to local issues, thereby losing the benefit of local market innovation.⁴⁷ Critics of the status quo, on the other hand, doubt whether such issues are, in fact, uniquely regional.⁴⁸ A start-up mining operation in B.C. would, so the argument goes, face the same market challenges as one operating in northern Quebec. Approaching the regulatory issues on a regional basis diverts resources from developing a coherent national approach to the resource sector. The truth likely lies somewhere in the middle. Regional economies have developed

⁴⁶ Mackay Report, 3.

⁴⁷ See Doug Hyndman speech, *supra*, Note 26, and Stephen Sibold speech, *supra*, Note 11.

⁴⁸ Responding to suggestions that a national regulator would be insensitive to local market issues, Jamie Scarlett wrote: "... I have yet to hear or read a compelling set of examples of what those issues might be. The mandates of securities commissions consistently speak in terms of protecting investors from unfair, improper or fraudulent practices and fostering fair, efficient and vibrant capital markets. Can someone tell me how or why the discharge of this mandate should be significantly different in any jurisdiction in this country?" *Notes on Joyce Maykut's Paper: "An Alternative Regulatory Model for Canada"*, 2001 Queens' Business Law Symposium, 67.

somewhat differently and pose local challenges which may call for specialized insight and tailor-made responses. This does not, however, justify a patchwork approach to regulation. It merely underscores the need for adopting a regulatory framework within which local voices from across Canada can contribute in a vital and meaningful way to the development, implementation and enforcement of regulatory policy.

Phil Anisman described the difficult balance to be struck in a regulatory strategy which concurrently pursues legislative harmony and regional distinctiveness:

Once uniformity and diversity are accepted as intermediate goals and means rather than ends, it is readily apparent that an undue emphasis on either may be counterproductive. Uniformity of legislation may, for example, avoid duplication and delays and enhance the effectiveness of substantive regulation, but an overweening commitment to it may enable a strong province to advance its own interests unduly or may lead to the adoption of laws that are misguided or represent the lowest common denominator of interprovincial compromise and may result in the stifling of innovative solutions to new problems. On the other hand, while local autonomy may enable experimentation through the adoption of diverse policies by provincial legislatures, the differences may permit easy evasion of stricter laws through forum shopping or may themselves create impediments to the operation of the market.⁴⁹

An effective securities regulator must also remain alert and responsive to changing market forces and new securities products, both domestic and international. This presents particular challenges in today's markets as technology has revolutionized the dissemination of investment information and the mechanics of trading. To retain a competitive edge, Canada's markets must also accommodate their entrepreneurial elements within clearly defined, but not stifling, parameters. Providing timely and effective solutions to

⁴⁹ Philip Anisman, *The Regulation of the Securities Market and the Harmonization of Provincial Laws*, in *Harmonization of Business Law in Canada*, Ronald C.C. Cuming ed, (1966), 77, at 81.

market challenges requires a regulatory structure that not only is adaptable, but also is operated by professionals with a sophisticated and pragmatic understanding of current market issues.

Stability

A paper prepared by the Capital Markets Institute in the wake of its October, 2002 symposium on regulatory reform (the “CMI White Paper”) defined stability as follows:

The regulatory structure should have structural permanence, and should not permit strategic behaviour by participating provinces who might credibly threaten to withdraw if their demands on administrative or policy issues are not met.⁵⁰

At its best, cooperative federalism yields policy which furthers Canada’s national interests both at home and abroad, without compromising regional development or local institutions. At its worst, competing regional objectives overshadow legitimate national interests, resulting in a sub-optimal solution for all.

From a national perspective, stability also implies full and continuing participation by all provinces. A regulatory structure representing only a portion of Canadian markets will face many of the issues afflicting the current fractured system. Administrative coordination and legislative harmonization will remain critically important goals in such a structure to maintain a competitive position for Canadian markets globally. Arguably, the resources required to project an image of regulatory cohesiveness and efficiency on an intrinsically divisive regulatory structure would be more beneficially devoted to pursuing the more fundamental issues arising out of rapidly changing market structures, increasingly complex securities products, and crises of investor confidence, to name a few.

⁵⁰ Doug Harris, *White Paper: A Symposium on Canadian Securities Regulation: Harmonization or Nationalization*, October, 2002, ii.

Smooth Transition

Any model advocating substantial reform must recognize the need for a “well managed transitional process”⁵¹ to minimize the market disruption and regulatory dislocation that will undoubtedly occur. The implementation schedule for reform must give sufficient time to all jurisdictions to enact new legislation and to develop the regulatory structures, if any, to administer the new statutes. On the other hand, setting an overly generous time frame within which to accomplish the transition would be detrimental to Canada’s regulatory processes and capital markets, by diverting significant regulatory and political resources during this period from market regulation and oversight, and exacerbating any market uncertainty which may occur as a result of reform. A reformed structure must borrow expertise heavily from existing regulators, especially if the adopted model involves a federal agency wading into the waters of securities regulation for the first time. Prior to the effective date of reform, any reallocation of jurisdiction or responsibilities among regulatory bodies must be fully and clearly communicated to market participants and relevant organizations.

Constitutionality

A proposed regulatory framework must have a strong constitutional foundation. In the current national climate, if some or all jurisdictions will be stripped of a majority of their regulatory responsibilities (and the fees they generate), the constitutionality of the reformed body will undoubtedly be challenged. Many have speculated that reform has not proceeded in the past in large measure because of the federal government’s reluctance to defend a constitutional challenge to its jurisdiction. Johnston and Rockwell write that a court challenge,

... would bring the entire Canadian securities regulatory system into disrepute and disarray. A constitutional challenge by the provinces would take several years and incalculable resources. This jurisdictional uncertainty would harm the Canadian capital markets.⁵²

⁵¹ Waitzer Letter 1994.

⁵² David L. Johnston and Kathleen D. Rockwell, Canadian Securities Regulation, 2d Ed. (1998), 268.

With respect, this is no longer a justifiable excuse. Canada's economic health relies on finding an optimal regulatory structure which fosters fair, efficient, vibrant and entrepreneurial markets, while honouring constitutional principles. Once devised, the optimal structure must be implemented and, if necessary, defended in the courts.

Transparency and Accountability

The responsibility for proper and competent oversight of the capital markets should rest clearly with elected officials. Where political accountability is blurred, the regulatory function may be pursued less vigorously. Similarly, a regulatory structure should be transparent, allowing public scrutiny of its administrative processes, transactional decisions and policy or legislative initiatives. While regulatory activity must be undertaken primarily in pursuit of the regulator's legislative mandate, transparency exerts a discipline on the regulator to deal with its constituents in a fair and consistent manner.

On a related note, a securities regulator must retain independence from the political environment within which it operates.⁵³ Its pursuit of its mandate should be unconstrained by partisan politics and unfettered by bureaucratic restraints. Much of this can be achieved by implementing an institutional structure which maximizes autonomy (i.e. self-funding). However, the political masters of the agency must refrain from politicizing its operations and regulatory agenda. Such disengagement from the agency must be delicately balanced with the overall accountability of elected officials for the vigilant oversight of the capital markets.

⁵³ Waitzer Letter, 1994.

PART IV CONSTITUTIONAL ISSUES

4.1 *Provincial Jurisdiction Over Securities Regulation*

As noted above, the provinces derive their authority to regulate securities transactions and market participants from their constitutional power to enact laws in relation to “property and civil rights within the province.” Three preliminary points merit mention. First, this head of power must not be confused with issues relating to civil liberties. It refers instead to proprietary, contractual and tortious rights as between persons. Second, this head of power was intended to give provincial governments the power to regulate legal relationships between persons, and not to regulate relationships between persons and government agencies, which latter power was broadly reserved for the federal government through section 91 of the Constitution Act. Notwithstanding this original intent, as legal relationships between persons grew in complexity and warranted government intervention, this neat theoretical dichotomy began to break down. As noted by Dean Hogg, “the evolution of our laws has now swept much public law into the rubric which was originally designed to exclude public law.”⁵⁴ The growth of securities regulation, and its tentacular extraprovincial reach are symptomatic of the broadening of the provincial property and civil rights power. Third, certainly through much of the 20th century, the courts pursued a decentrist agenda in constitutional jurisprudence. In the context of overlapping jurisdiction and/or conflicting federal and provincial legislation, the courts demonstrated a strong bias toward protecting provincial jurisdiction. In the securities regulatory context, this has provided defenders of the status quo with a formidable arsenal of caselaw affirming provincial jurisdiction.

The seminal decision in this area was the *Lymburn* case⁵⁵, in which the examination and investigative powers under Alberta’s Security Frauds Prevention Act were challenged as being an invalid incursion into the federal government’s criminal law powers. It was argued as well that the statute’s registration framework should be declared ultra vires as against federally incorporated companies, which are more properly the subject of federal regulation. The Privy Council rejected these arguments, holding instead

⁵⁴ Peter Hogg, *Constitutional Law (1997)* (“Hogg 1997”), 21-3.

⁵⁵ *Lymburn*, supra, Note 9.

that the regulation of securities is a valid exercise of the provincial property and civil rights power. Lord Aiken wrote:

There is no reason to doubt that the main object sought to be secured in this part of the Act is to secure that persons who carry on the business of dealing in securities shall be honest and of good repute, and in this way to protect the public from being defrauded ... The Provisions of this part of the Act may appear to be far reaching: but if they fall, as their Lordships conceive them to fall, within the scope of legislation dealing with property and civil rights the legislature of the province, sovereign in this respect, has the sole power and responsibility of determining what degree of protection it will afford to the public.”⁵⁶

A series of cases have upheld the extraprovincial reach of securities regulation. In Gregory & Co. v. Quebec (Securities Commission),⁵⁷ the petitioner challenged the Quebec Securities Commission’s power to sanction the publication and dissemination of a weekly bulletin containing investment advice and stock quotations to only non-residents of Quebec, and the subsequent consummation of stock trades with such non-residents. Interestingly, this case was intended to include a constitutional challenge of the province’s power to regulate what the petitioner described as solely extraprovincial activities, but for technical procedural reasons, the constitutional challenge was abandoned. In upholding the Quebec Securities Commission’s jurisdiction, the Supreme Court of Canada (the “SCC”) affirmed that it is a valid exercise of a provincial regulator’s investor protection mandate to ensure that the activities and conduct of its market participants do not defraud persons within the province or elsewhere.

The Gregory case is also significant insofar as it draws a distinction between securities regulation, in which provinces have dominated regulation, and marketing schemes, over which the federal government has successfully asserted often overlapping jurisdiction with the provinces. Federal marketing legislation has been upheld as a valid exercise of the federal government’s trade and commerce power under

⁵⁶ Ibid.

⁵⁷ [1961] S.C.R. 584.

subsection 91(2) of the Constitution Act, as marketing schemes involve the interprovincial flow of goods from a producer to the consumers.⁵⁸ In addition, courts have approved federal regulation of local aspects of a marketing scheme where such regulation is an incidental aspect of a primarily interprovincial legislative purpose.⁵⁹ Justice Fauteux, in dismissing the marketing decisions as irrelevant to the facts at issue in the *Gregory* case, commented that the primary thrust of securities regulation is to establish controls and supervision over conduct in the province, even though such conduct may have significant extraprovincial effect.

The extra-territorial effect of securities legislation was explored further in *R v. Mackenzie Securities Ltd. et al.*,⁶⁰ in which the Attorney General of Manitoba accused Toronto resident brokers of unlawfully trading in securities in Manitoba without a registration. The accused solicited a Manitoba resident by mail and phone to purchase securities through its brokerage. The appellant's argument that the Manitoba Securities Act was ultra vires as it purported to regulate interprovincial trade (which is under the exclusive legislative authority of the federal government), and was therefore inapplicable against the impugned transactions, was rejected by the Manitoba Court of Appeal. In his judgment, Justice Freedman wrote:

The Securities Act of Manitoba is not designed to reach out beyond provincial borders and to restrain conduct carried on in other parts of Canada or elsewhere. Its operation is effective in Manitoba and nowhere else. For a person to become subject to its restraint, he must trade in securities in Manitoba ... If the activities of ... a non-resident can fairly and properly be construed as constituting trading within the Province, then they fall within the purview of the Act.⁶¹

Leave to appeal was denied by the SCC.

⁵⁸ See *P.E.I. Marketing Board v. Willis Inc.*, [1952] 2 S.C.R. 392.

⁵⁹ See *Re Agricultural Products Marketing Act*, discussed below.

⁶⁰ (1966), 56 D.L.R. (2d) 56.

⁶¹ *Ibid*, 62 and 63.

This notion of how the local focus of securities legislation can have extra-territorial impact was articulated again by the British Columbia Court of Appeal in the recent *Donald Pearson et al. v. Boliden Limited et al.*⁶² case. The complaint in that case arose in the context of an environmental crisis which beset a key mining asset of Boliden, allegedly due to the deficient construction of a tailings dam. The plaintiffs, recent purchasers of Boliden securities pursuant to a national public offering, commenced a statutory class action claiming, among other things, that the prospectus contained misrepresentations which were known, or ought to have been known, by the issuer and certain other defendants at the time. For technical reasons, certain plaintiffs that resided outside of British Columbia wished to proceed under the statutory civil liability provisions of the British Columbia Securities Act. In holding that such plaintiffs cannot rely on the British Columbia statute, but must instead proceed under the local securities laws which were applicable to other aspects of the offering, Justice Newbury wrote for the court:

In a very real sense, then, the [provincial securities] Acts are analogous to consumer protection legislation. The conduct in the provinces of issuers, brokers and other market intermediaries, wherever they may reside or carry on business, is regulated in order to protect the public, and the integrity of the market ... In this way, each province protects the investing public from misconduct in its territory, but at the same time, honours the principle of comity by respecting the legislative authority of other provinces to do likewise.⁶³

Acknowledging that provincial securities legislation often has extra-provincial affect, Justice Newbury viewed the court's disposition of the jurisdictional issue as providing "a principled way through the thicket of the many extra-provincial aspects that will be involved in any national securities distribution."⁶⁴

⁶² 2002 B.C.C.A. 624.

⁶³ Ibid, para. 63.

⁶⁴ Ibid, para. 66.

In the recent *Global Securities Corp. v. British Columbia (Securities Commission)*⁶⁵ case, the SCC gave arguably wider application to provincial regulatory scope. In that case, the plaintiff argued that a provision in British Columbia's Securities Act which authorized the securities commission to order a registrant to produce documents "to assist in the administration of the securities laws of another jurisdiction"⁶⁶ was an invalid exercise of provincial jurisdiction, as it was clearly extraprovincial in tenor and effect. Writing for the SCC, Justice Iacobucci upheld the provision as falling clearly within subsection 92(13) of the Constitution Act. Justice Iacobucci found that the pith and substance of the impugned provision was clearly to facilitate enforcement of British Columbia's securities laws through: (a) permitting cooperation with an extraprovincial securities body which is essential to ensuring reciprocal assistance when required to pursue local malfeasors; and (b) discovering information regarding out of province misconduct by British Columbia residents, which is relevant information to local surveillance and enforcement personnel.

It is clear from the discussion above that the courts have given considerable latitude to securities regulation, emphasizing that many extraprovincial aspect of such regulation are necessary and incidental to achieving a constitutionally valid provincial purpose.

4.2 Basis for Federal Jurisdiction

Notwithstanding relatively consistent judicial support for provincial jurisdiction, strong arguments can be made to buttress a federal securities legislation operating across Canada. From a practical perspective, it is difficult to understand why there is a considerable movement to perpetuate our balkanized regulatory system. As noted by Anisman and Hogg in their background paper to the 1979 Proposals:

⁶⁵ [2000] 1 S.C.R. 494.

⁶⁶ S. 141(1)(b), British Columbia Securities Act, R.S.B.C. 1996, c. 418.

That the functions performed by the securities market transcend provincial boundaries is undeniable and economists have long recognized that the financial market in Canada is national in scope.⁶⁷

Professor Mackintosh gives a vivid illustration of the jurisdictional quagmire which is created by our regulatory system:

Consider, for example, the case of a company headquartered in B.C. and trading on the Montreal Stock Exchange, with 20% of its shareholders in Ontario. Suppose that a resident of Great Britain agrees to purchase a controlling block of shares currently held by a resident of Manitoba. This change in control may materially affect the welfare of shareholders wherever situated. Do any of the provincial commissions have jurisdiction to regulate the transaction?⁶⁸

It is reasonable to conclude that securities regulation fell under provincial competence originally due to the intensely local character of the industry at that time. The national and international development of capital markets has strained the credibility of characterizing securities regulation as primarily intraprovincial. The judicial broadening of the ambit of the provincial property and civil rights power to accommodate securities regulation seems increasingly artificial. As Professor Jacob Ziegel remarked:

As sections 91 and 92(10)(a) of the Constitution Act, in my view overwhelmingly, show, the founding fathers believed strongly that the central government should sit in the driver's seat in organizing the legal underpinnings of the combined economies for the benefit of the emerging Canadian federal state.⁶⁹

⁶⁷ Philip Anisman and Peter Hogg, *Constitutional Aspects of Federal Securities Law*, 1979 Proposals, v. 3 ("Anisman and Hogg"), 139.

⁶⁸ Mackintosh 1996, 195.

⁶⁹ Jacob S. Ziegel, *Must We Settle for Second Best? Comments on Ed Waitzer's Paper*, 1994 Queen's Annual Business Law Symposium, 132.

Ironically, in the face of increased uniformity through CSA-led harmonization initiatives, securities regulation is developing an increasingly national and uniform flavour. In the *Multiple Access v. McCutcheon*⁷⁰ case, which is understood as affirming provincial competence to regulate the securities markets, Justice Dickson threw a constitutional bone to those favouring federal involvement:

Parliament has not yet enacted any comprehensive scheme of securities legislation. To date the Canadian experience has been that the provinces have taken control of the marketing of securities, differing in this respect from the United States where the Securities and Exchange Commission has regulated trading and primary distribution of securities. I should not wish by anything said in this case to affect prejudicially the constitutional right of Parliament to enact a general scheme of securities legislation pursuant to its power to make laws in relation to interprovincial and export trade and commerce. This is of particular significance considering the interprovincial and indeed international character of the securities industry.⁷¹

Below is a discussion of the constitutional bases, and their limitations, for federal competence over securities legislation. Given the scope of this paper, the following discussion addresses the constitutional validity of a federal regulatory scheme generally. It must be remembered, however, that a constitutional challenge will likely impugn particular provisions of a federal statute. Each feature of such legislation must therefore have constitutional grounding in a federal head of power. This will require that a rigorous examination of applicable constitutional principles and jurisprudence be undertaken with respect to each statutory provision.

The Trade and Commerce Power

The most frequently cited head of power which may legitimize a federally run comprehensive securities regulatory scheme is the power to make laws applicable to “trade and commerce” pursuant to subsection

⁷⁰ [1982] 2 S.C.R. 161.

⁷¹ Ibid, 793.

91(2) of the Constitution Act. As in the securities context, this head of power often conflicts with the provinces' property and civil rights power, as trade and commerce are effected by means of contracts which prima facie fall within the provincial legislative domain. The challenge for the courts has been to define when activities undertaken within a province become part of a scheme or business which is interprovincial or international in fundamental character so as to warrant federal regulation. The Privy Council developed a very restrictive interpretation of the trade and commerce power, repeatedly striking down entire statutes which were predominantly concerned with interprovincial dealings, but incidentally purported to regulate intraprovincial transactions. Any invasion into the provincial property and civil rights realm was sufficient to taint the entire validity of the statute.

The pivotal Privy Council decision in *Citizens' Insurance Co. v. Parsons*⁷² divided the trade and commerce power conceptually into two categories – interprovincial trade and commerce and general trade and commerce. These categories are explored below.

Interprovincial Trade and Commerce

The SCC breathed new life in the interprovincial trade and commerce power, holding generally that where the predominant purpose of a federal statute is the regulation of interprovincial business, trade or commerce, any incidental regulation of intraprovincial aspects of that undertaking is valid. A stark example of this departure from the Privy Council cases is *re Agricultural Products Marketing Act (1978)*,⁷³ in which a federal statute, which was one element of a cooperative federal and provincial network of regulation, fell under attack. The impugned statute regulated many aspects of Canadian egg marketing, despite evidence that demonstrated that approximately 90% of eggs produced are consumed in the province of production. Notwithstanding the overwhelmingly local character of the egg industry, the SCC upheld the federal statute. It is apparent that the court took into account the uniquely cooperative scheme in which the statute operated, and the complex network of complementary statutes and regulatory bodies

⁷² (1881) 7 App. Cas. 96.

⁷³ [1978] 2 S.C.R. 1198.

which the provinces and federal government had mutually established to achieve effective agricultural regulation.

The cases have not, however, applied the principles of predominant purpose and incidental effect evenly. Subsequent to the *Agricultural Products Marketing* decision, the SCC in *Dominion Stores v. The Queen*⁷⁴ struck down a provision of a federal foods standards statute which, although made in the context of an otherwise valid federal undertaking, was deemed an unwarranted incursion into the provincial property and civil rights domain.

Notwithstanding this lack of clarity regarding the validity of intraprovincial aspects of primarily interprovincial federal regulation, the caselaw provides a credible foundation for an assertion of federal jurisdiction to enact laws regarding interprovincial and international securities regulation. Securities trading can be analogized to the interprovincial traffic of commodities. Securities represent a property interest in an undertaking, and are traded contractually often across provincial, if not international, boundaries. Similarly, most securities brokers transact business irrespective of provincial borders. The consolidation of Canadian stock exchanges along functional, as opposed to regional, lines has further 'nationalized' trading activity.

The more problematic question is whether these cases would support federal regulation of a comprehensive scheme which includes intraprovincial elements. The argument would emphasize that intraprovincial regulation is a legitimate and ancillary aspect of an otherwise valid interprovincial scheme designed to ensure consistency of standards and regulatory requirements for all securities trading in Canada. The apparent judicial waffling referred to above makes it far from certain whether such a comprehensive regulatory scheme could withstand a constitutional challenge.

⁷⁴ [1980] 1 S.C.R. 844.

General Trade and Commerce

The other branch of the trade and commerce power articulated in the *Parsons* decision is “the general regulation of trade and commerce affecting the whole dominion.”⁷⁵ In the *McDonald v. Vapor Canada Ltd.*⁷⁶ case, the SCC attempted to define the scope of the general trade and commerce power, noting that the legislation must relate to a matter of general concern to the country, such that it is transprovincial in scope. Chief Justice Laskin suggested that the creation of a federal regulatory agency to oversee a general regulatory scheme would be credible (although not sufficient) evidence of the generality or national significance of the regulated subject matter. He also echoed previous decisions affirming that the regulation cannot target a particular industry, but must concern trade as a whole.

Chief Justice Dickson adopted and embellished the *Vapor* test in developing his own criteria for assessing the validity of regulation under the general trade and commerce power in *General Motors v. City National Leasing*⁷⁷. The *General Motors* test contains five elements: (1) there must be a general regulatory scheme; (2) there must be oversight by a regulatory agency; (3) the scheme must relate to trade as a whole rather than a particular industry; (4) the legislation should be of a nature that the provinces, jointly or severally, would be constitutionally incapable of enacting; and (5) the failure to include one or more provinces or localities in the legislative scheme would jeopardize the successful operation of the scheme in other parts of the country. Not all elements of the test need necessarily be satisfied, but “the five indicators are themselves barometers of how much the federal scheme intrudes upon provincial powers.”⁷⁸

As noted by Anisman and Hogg in 1979 (with reference to the *Vapor* decision), a federal securities regulatory scheme could easily satisfy the first three elements of the *General Motors* test.

⁷⁵ *Supra*, Note 67, 113.

⁷⁶ [1977] 2 S.C.R. 134.

⁷⁷ [1989] 1 S.C.R. 641.

⁷⁸ Mackintosh 1996, 194.

A federal securities act would be directed not at a particular business or trade in the provinces, but rather at the capital-raising function by issuers throughout Canada and would be designed to facilitate the allocational efficiency of the primary market, the capital raising mechanism, by increasing investor confidence in the securities market generally. Although this function necessarily involves transactions in securities, the aim in the legislation would be at distributions and issuers throughout Canada as a whole and not at specific transactions. Such legislation would clearly be “transprovincial in scope” ... This characterization would be reinforced by the fact that a regulatory authority of some sort would be required to administer and to enforce the provisions of the act.⁷⁹

Satisfying the fourth and fifth elements of the *General Motors* test may be more difficult. Although the courts have, as discussed above, consistently upheld provincial power to enact securities laws, it must be stressed that the regulation has, in general, been upheld insofar as it protects and pursues valid local interests, albeit often in the context of extraprovincial transactions. Chief Justice Dickson’s judgment in the *General Motors* case provides another useful analytical framework for assessing the constitutionality of a federal or provincial law. The first step is to determine what the “pith and substance” – the dominant or most important characteristic – of the impugned provision is, and what head of federal or provincial power it validly falls under. If the law is within the appropriate constitutional domain, the inquiry need go no further. “If, on the other hand, the legislation is not in pith and substance within the constitutional powers of the enacting legislature, then the court must ask if the impugned provision is nonetheless a part of a valid legislative scheme. If it is, at the third stage the impugned provision should be upheld if it is sufficiently integrated into the valid legislative scheme.”⁸⁰ The latter two prongs of this test have been collectively referred to as the ‘ancillary doctrine’ – where the incursion into federal or provincial domain, as the case may be, is necessary to achieve, and rationally connected to, the constitutionally valid purpose of the legislation.

⁷⁹ Anisman and Hogg, 165 and 166.

⁸⁰ As summarized by Justice Iacobucci in the *Global Securities* case, supra, Note 61, 494.

The application of this test of constitutionality to a comprehensive federal scheme could yield diametrically opposite conclusions. It is arguable that the increased transprovincial fluidity of the capital markets necessitates regulation of both intraprovincial and interprovincial aspects of securities to promote regulatory consistency, certainty and efficiency.

Arguably, only the federal government can constitutionally regulate transactions involving a significant out-of-province element, or in which there is at least a preponderance of multi-jurisdictional elements.⁸¹

On the other hand, courts may continue to build upon existing jurisprudence characterizing securities law as fundamentally local in nature and to view the extra-provincial aspects as ancillary. In the author's view, this perspective fails to appreciate not only the interprovincial nature of a vast majority of capital markets transactions, but also the national character of the institutions defining and operating the markets. It is far from certain, however, how a court would decide if faced with a constitutional attack on a comprehensive federal securities regime.

The fifth element of the *General Motors* test that the legislative scheme would be jeopardized by the non-participation of any province or territory would be difficult for the federal government to argue credibly, as it has demonstrated its willingness to pursue regulatory reform with fewer than all provinces participating (CANSEC, 1994 MOU). Indisputably, a national legislative scheme would operate most effectively with full provincial participation. However the federal government's previous negotiating positions may amount to an admission that comprehensive application across Canada is not critical to the efficacy of the regulatory scheme.

⁸¹ Mackintosh 1996, 196.

Peace, Order and Good Government

Another federal head of power which is frequently suggested as legitimizing federal assertion of jurisdiction over securities regulation is contained in the opening language of section 91 of the Constitution Act, conferring on the federal government authority,

... to make laws for the peace, order and good government of Canada, in relation to all matters not coming within the classes of subjects by this Act assigned exclusively to the Legislature of the provinces ... (the “p.o.g.g. power”).

Three branches of the p.o.g.g. power have evolved: (a) the “gap branch” which encompasses laws for which there are no available enumerated powers or for which the applicable enumerated power is incomplete; (b) the “national concern branch”, described below; and (c) the “emergency branch” which is reserved for laws responding to unusual matters of national urgency – i.e. war, terrorism, inflation.

The National Concern Branch

As a preliminary matter, to fall within the p.o.g.g. power, a law must not fit within provincial competence pursuant to section 92 of the Constitution Act. In an early analysis of the reach of the p.o.g.g. power, the Privy Council conceded that,

... some matters, in their origin local and provincial, might attain such dimensions as to affect the body politic of the Dominion, and to justify the Canadian Parliament in passing laws for their regulation or abolition in the interest of the Dominion.⁸²

Legislation which has been validly upheld under the national concern branch of the p.o.g.g. power include acts relating to aeronautics, the national capital region, marine pollution, and narcotics trafficking. The courts have struggled with defining appropriate parameters around the concept of “national concern” or “national dimension” to avoid sweeping into the federal domain valid provincial laws which necessarily

⁸² *A-G Ont. v. A-G Can. (Local Prohibition)*, [1896] A.C. 348.

regulate matters of national significance. Dean Hogg has suggested that at least two features of the national concern branch have emerged which circumscribe the p.o.g.g. power. The first focuses on provincial inability to achieve coordination or uniformity which is essential to addressing a national problem.

It seems, therefore, that the most important element of national concern is a need for one national law which cannot realistically be satisfied by cooperative provincial action because the failure of one province to cooperate would carry with it adverse consequences for the residents of other provinces.⁸³

The second feature is that the law “must have a singleness, distinctiveness and indivisibility that clearly distinguishes it from matters of provincial concern.”⁸⁴

As argued above, effective securities regulation is clearly of national importance, and clearly transcends geographic boundaries. It is also arguable that, because the provinces are constitutionally limited to regulating intraprovincial activity, a transnational regulatory platform is intrinsically beyond the reach of provincial competence. However, as years of coordinating and harmonizing initiatives led by the CSA have demonstrated, the provinces could argue that cooperative regulation can overcome many of the concerns that a federal act would address. In light of the SCC’s expressed antipathy for an expansive interpretation of the national concern branch of the p.o.g.g. power, it may not be a reliable source of federal jurisdiction over securities regulation.

Sanctions and Remedies

The federal government’s criminal law power in subsection 91(27) of the Constitution Act would likely support the investigation and prosecution of offences carrying penal sanction in a federal securities act, and in fact may be administered alongside existing fraud and improper market conduct Criminal Code

⁸³ Hogg 1997, 17-7.

⁸⁴ *R. v. Zellerbach*, [1988] 1 S.C.R. 432.

offences. Historically federal law enforcement agencies have generally been reluctant to pursue white collar criminal offences, instead leaving securities commissions to lead the offensive against market impropriety. This has been puzzling in light of the jurisdictional limitations of a provincial regulator's investigative and enforcement functions. Apparently addressing this issue, the Government of Canada announced on June 12, 2003 new measures to deter capital markets fraud, including the creation of six Integrated Market Enforcement Teams (stationed in Vancouver, Toronto and Montreal) to be comprised of RCMP personnel, lawyers and other investigative experts dedicated to the detection and investigation of capital markets crimes. Other proposed measures include creating a new Criminal Code offence for insider trading, protecting whistle-blowers and increasing penalties for white collar crime. It is evident from these proposals that the federal government acknowledges it has a valuable role to play in the coordination and operation of an effective national enforcement strategy.

Another vital component of the regulatory enforcement arsenal is the administrative civil liability remedy for certain violations of statutory provisions – such as providing misleading disclosure in certain key documents, and insider trading and tipping. In pursuing such administrative remedies, a regulator has wider investigative berth and need satisfy a lower threshold of proof than under a criminal prosecution. These remedies are also viewed as having both strong deterrent value to market participants and providing regulators with necessary punitive flexibility to optimally tailor the sanction to the circumstances of the alleged wrongdoing. The extension of civil liability to material misrepresentations in most continuous disclosure documents and oral statements, which is before the Ontario Legislature and being debated elsewhere in Canada, indicates the perceived utility of such remedies to the effective administration of a securities regime. Civil liability remedies are essentially sanctions for tortious acts and would therefore, at first glance, fall within the provincial property and civil rights power. The courts will, however, uphold a civil liability remedy which is rationally and functionally connected to an otherwise constitutionally valid federal scheme – in other words, where the inclusion of civil liability remedies are necessary to effectuate the objectives of the legislative policy.⁸⁵

⁸⁵ See the *General Motors* case, supra, Note 74.

Delegation and Incorporation by Reference

Many proponents of a single Canadian securities regulator support a delegation model under which provinces would delegate the administration of their securities legislation to either a federal regulatory agency or a single body convened by the provinces. As discussed below, the delegation model's principal appeal is that it avoids the constitutional confrontation that federal assertion of jurisdiction would likely elicit. While Parliament and the provinces do not have the authority to inter-delegate legislative powers, administrative inter-delegation between levels of government has been given judicial blessing.⁸⁶ This approach recognizes the expedience of combining into one administrative agency regulatory powers which are derived from both federal and provincial laws and are applicable to a discreet regulated activity. Provincial legislation could, therefore, delegate the administration of that legislation to a federal or other regulatory body which is authorized to accept the delegation.

The courts have also upheld the technique of incorporation by reference which allows a legislature to adopt the legislation of another jurisdiction.⁸⁷ Similarly, anticipatory incorporation by reference, whereby the laws of one jurisdiction, as they are in existence from time to time, can be adopted by another jurisdiction, has judicial support.

PART V ALTERNATIVE REGULATORY MODELS

Below is a discussion of the alternative regulatory models being debated for Canadian securities reform.

5.1 *The Status Quo*

Notwithstanding wide-ranging criticism, the current regulatory structure has a strong cabal of supporters. Much of this paper has been dedicated to exploring the weaknesses and inefficiencies which hobble the current structure, and need not be repeated here. Supporters of maintaining the existing regulatory system and achieving change through CSA processes, bristle at the costs and uncertainties which will, in

⁸⁶ *P.E.I. Potato Marketing Board v. Willis*, [1952] 2 S.C.R. 392.

⁸⁷ Hogg 1997, 14-20.

some measure, be attendant upon regulatory transformation. Creeping, incremental change, it is argued, will yield a more evolved, mature and stable regulatory framework than will radical reform. Regional flexibility and regulatory responsiveness, which are said to be vital to the unique economic circumstances of Canada, may be lost in a centralized structure. Likely driving a considerable amount of reluctance to change is the instinctive protection of bureaucratic and political turf. In any event, the voices extolling the virtues of the current regulatory system are being drowned out by those clamouring for change. Mr. Mackay found virtual consensus that the “current system, as presently operated, must be improved significantly and in a prompt fashion.”⁸⁸

5.2 *The Federal Commission Model*

Much of the current debate revolves around how much power, if any, should be either ceded by the provinces to a federal agency or asserted by the federal government as its constitutional right. In its purest form, a federal regulatory model would entail a federal securities act applicable comprehensively across Canada and administered by a federal agency. In the author’s view, this strategically is the optimal model, as it would most effectively address the dysfunction and duplication of our current system, while positioning Canada’s markets to realize their potential internationally. However as discussed above, this model may be legally unrealistic in light of the provinces’ valid constitutional authority over legislation pertaining to intraprovincial commerce. Many commentators dismiss any model in which the federal government has significant control as politically unrealistic and inexpedient, as regional interests will vigorously oppose and attempt to subvert a federal exercise of power.⁸⁹ This paper endorses a model of regulation with a strong (but not comprehensive) federal component. The positive and negative attributes of a federally dominated regulatory framework are explored below in Part VII.

⁸⁸ Mackay Report.

⁸⁹ In a speech delivered at the CMI Symposium, Jamie Scarlett said: “... I would encourage everyone to give up the search for the holy grail. We will not achieve a single national regulator ... Quebec has a real political context that we should respect – it cannot cede jurisdiction in this area to any level of government.” *Supra*, Note *, at p. 10. See also Maxime Bernier, *A Canadian passport system for issuers instead of having one national securities commission*, February 18, 2002 (prepared for the CVMQ).

5.3 *The Delegation Models*

While the mechanism of delegation provides for considerable flexibility in devising a regulatory scheme, this paper will focus on the two delegation models which have attracted interest. The principal appeal of the delegation models to their proponents is twofold: (a) they can achieve a measure of rationalization and efficiency of the regulatory function while avoiding a constitutional showdown; and (b) they preserve a strong provincial regulatory role. Joyce Maykut, a proponent of the inter-delegation model discussed below, argued that the objective of reform must be “continuing to formulate solutions that maximize regulatory efficiency and effectiveness on a national scale, without dismantling the independence and influence of provincial securities authorities.”⁹⁰

The Inter-Delegation Model

Under this regulatory structure, “the governing legislation for each securities regulator would authorize the delegation of powers to regulators in other jurisdictions and the acceptance of delegated powers from those other regulators.”⁹¹ Also referred to as the “single passport” model, the inter-delegation system would ensure that an issuer or intermediary would, in respect of most filings, deal with only one jurisdiction (likely the jurisdiction in which its head office is located), which would make a decision on behalf of all jurisdictions in accordance with the delegation. This cross-commission delegation model is an evolutionary progression from the concept of mutual reliance, but is built upon the principle of mutual recognition or acceptance of other regulators' decisions. A Steering Committee of provincial Ministers of Finance (the “Steering Committee”), which was convened last year to address regulatory reform, recently issued a discussion paper which advocates the adoption of a passport system of securities regulation.⁹²

⁹⁰ Joyce Maykut Q.C., *An Alternative Regulatory Model for Canada*, 2001 Queen’s Annual Business Law Symposium, 29, at 44.

⁹¹ *Ibid.*, 34.

⁹² Steering Committee of Ministers, *Securities Regulation in Canada: An Inter-Provincial Securities Framework*, (June, 2003) (“Discussion Paper”).

In so doing, it rejected those regulatory structures which involve federal participation as not respecting “provincial responsibility for the area of securities.”⁹³

Greater legislative uniformity is a precondition to an effective inter-delegation model.

In the absence of uniformity, the delegatee would be faced with the overwhelming task of applying each province’s different regulatory regime to the decision or transaction under consideration.⁹⁴

In fact, the Steering Committee acknowledges in its paper that if securities laws were not substantially harmonized, “there would be greater potential for jurisdictions to decline to join or to withdraw from the passport framework because of dissatisfaction with the application of different laws.”⁹⁵

While an inter-delegation model or passport system would undoubtedly be a more politically palatable and therefore pragmatic structure, and would improve regulatory efficiency by reducing duplication and costs, it would continue to be plagued by some of the limitations of our current system. Importantly, the fundamental rubric of our regulatory structure remains unaltered, with the result that any significant legislative, policy or administrative initiative must be debated by 13 regulators and, where necessary, subjected to differing provincial legislative processes. Effective and responsive regulation is severely compromised by this multi-lateral approach. Critics of this model also suggest that its implementation will be forbiddingly complex. Notwithstanding uniformity of legislation, interpretation and/or enforcement of such legislation will continue to vary across regulators. The passport system advocated by the Steering Committee specifically provides for legislative and/or policy departures from harmonized standards to accommodate local or regional market issues. While such measures preserve local innovation, they will

⁹³ Discussion Paper, 9.

⁹⁴ Anita Anand, *Harmonizing Canadian Securities Laws: Considering Alternatives*, Queens’ Annual Business Law Symposium 2001, at p. 56.

⁹⁵ Discussion Paper, 9.

add further complexity to the administration of the passport system, with inconsistent availability of local measures to market participants. A provincial delegation can be withdrawn at any time, and, significantly, the threat of withdrawal may enable a regulator to extort compromise on an initiative which would otherwise benefit the public interest. There are also concerns that a delegation model weakens the accountability of provincial politicians for the quality of local securities regulation where such regulation has, in fact, been delegated elsewhere. Finally, Canada would still lack a unified voice in the international securities forum.

The Steering Committee clearly appreciates the limitations of the current regulatory system. However, by attempting to expand the existing cooperative sentiment among regulators to remedy the system's dysfunction will, in the author's view, entrench many of the structural deficiencies of our fragmented model. A more radical fix is needed.

The Single Regulator Model

Trumpeted by David Brown, among others, the "Pan Canadian" approach would involve the delegation by provincial legislatures of the responsibility to administer their securities laws to a single commission convened by the provinces.⁹⁶ Variations on this theme include delegation to a federal body or to a joint federal-provincial body. Again, legislative uniformity across the provinces is likely critical to the efficacy of this model. The Pan Canadian model would answer many of the deficiencies of the inter-delegation model by centralizing the regulatory function and avoiding the incremental costs of "supporting a multitude of regulators and regulating bureaucracies."⁹⁷ However, it would remain subject to: (a) provincial legislative involvement in statutory amendments; (b) the instability of provinces revoking their delegation; and (c) blurred lines of political accountability. Furthermore, under this model the provinces retain their legislative authority for securities regulation, but lose their local regulatory expertise which historically has been a significant resource on which the provincial legislatures have relied.

⁹⁶ David Brown, *Keynote Address at Dialogue with the OSC*, November 20, 2001.

⁹⁷ *Ibid.*

As the Pan Canadian commission model demonstrates, regulators are devising creative strategies for overcoming the perceived legal and practical obstacles to regulatory reform. They are twisting our unwieldy system into knots to create a “virtual” national commission with a uniform statute. If, as Mr. Mackay suggests, there is grassroots momentum for fundamental change, why not pursue a truly national strategy that does not rely on existing regulatory constructs?

5.4 *Competitive Federalism*

The regulatory competition model has attracted considerable academic interest, but has yet to inspire much industry enthusiasm. Under this model, issuers and intermediaries would be free to choose a governing jurisdiction, and would be subject to the laws and administrative apparatus of only that jurisdiction. A system of mutual recognition would be implemented whereby compliance with the requirements of the chosen principal jurisdiction would satisfy the similar requirements of the other provincial regulatory authorities. Motivated by both the direct benefits (i.e. filing and transaction fees) and indirect benefits (i.e. increased economic activity in the province and increased economies of scale in the regulatory function) of securities regulation, provinces would vigorously compete among themselves to develop securities requirements and an administrative structure most likely to attract securities-related business to their jurisdictions.

Critics of competitive federalism fear that provinces overeager to lure issuers and intermediaries will enact laws that are beneficial to the managers (i.e. generous executive compensation disclosure requirements or lax conflict of interest rules) to the potential detriment of investors. A race to the bottom will ensue, resulting in both a national collection of securities legislation reflecting lowest common denominator standards and a consequent international avoidance of Canadian capital markets.

Its proponents insist that competition will inspire jurisdictions to develop, among other things, the best substantive rules, the most responsive and efficient regulatory apparatus, reasonable fees and effective enforcement. The theory suggests that investors will only part with their investment capital when satisfied that the regulatory framework applicable to issuers and intermediaries provides optimal security for their investments. Issuers and intermediaries will choose to be governed, therefore, by legislation which

inspires investor confidence and yields cost-effective and responsive regulation. It is said that lessons can be drawn from the experience in the United States where corporate law is legislated at the state level, and a considerable degree of competition has developed among states in their quest for attracting corporations. Studies have revealed that corporations that reincorporate under the laws of Delaware (arguably the state with the most stringent corporate laws) experience an uptick in their stock price.⁹⁸ Delaware is home to approximately 60% of Fortune 500 and New York Stock Exchange listed corporations, suggesting that many corporations will voluntarily opt to be governed by a sophisticated code of laws.

While the competitive federalism model holds certain intellectual appeal, it is not the optimal solution for Canada's regulatory dilemma. Competition among regulators would likely exacerbate the resource disparity among those regulators with significant market activity and those without - potentially resulting in the dismantling of regulatory oversight in those jurisdictions in which maintaining a regulatory apparatus is no longer financially feasible. Although issuers and intermediaries in such jurisdictions will continue to be subject to another jurisdiction's regulation, it is reasonable to assume that enforcement efforts may be applied unevenly across provinces. As well, legal issues surrounding the extra-provincial enforcement of local securities laws will continue to bedevil the efficacy of interprovincial securities enforcement. A competitive model will perpetuate our complex and fragmented regulatory culture with a multiplicity of securities laws and regulatory agencies. Implementation may prove potentially difficult, with jurisdictions being reluctant to recognize legislation and regulatory standards that may significantly differ from their own. Competitive federalism would undoubtedly entrench regional sentiments. Canada would remain bereft of a national voice in international securities policy debates. Perhaps most troubling, this model may pervert the fundamental mandate of securities regulation of pursuing the public interest and capital market integrity, by focusing on the financial and economic implications of successful regulation. As David Brown commented: "regulatory competition is demeaning to a regulator who is mandated to protect the public interest."⁹⁹

⁹⁸ Jeffrey Mackintosh, *The Future of Canadian Securities Regulation* (powerpoint presentation prepared for CMI Symposium).

⁹⁹ CMI White Paper, 72.

PART VI LESSONS FROM INTERNATIONAL REGULATORY EXPERIENCES

6.1 *The Australian Experience*

The History

The Australian journey to national securities regulation holds many intriguing lessons for Canada.¹⁰⁰ Like Canada, Australia's regulatory landscape was originally dominated by state and territorially run regulators administering local legislation. This local power over both corporate and securities regulation developed with judicial sanction, notwithstanding the constitutional Commonwealth power to enact laws with respect to "trading or financial corporations formed within the limits of the Commonwealth." Attempts at legislative uniformity in the 1960s and 1970s, while initially successful, gradually floundered as the individual states enacted divergent amendments designed to address local issues and reflect local regulatory perspectives. As well, there was no concurrent initiative to achieve administrative uniformity among the states, thus likely fostering independent local interpretation and enforcement of uniform legislation.

A growing interest in securities regulation in the 1970s resulted in the introduction in the Commonwealth Parliament of a federal corporations and securities bill intended to apply to federally constituted corporations. While the bill failed upon the demise of its proponent political party, the sentiment for regulatory reform led to an agreement by three states in 1975 to pursue greater harmonization of their corporate and securities laws, and to pool their regulatory resources into a single agency, the Interstate Corporate Affairs Commission.

The Commonwealth Parliament stepped up to the regulatory plate again in the late 1970s, devising what was known as the Cooperative Scheme. Using its plenary power to make laws for Commonwealth territories, Parliament enacted a model corporations and limited securities statute, which was then incorporated into state law by reference. A national regulator (the National Companies and Securities

¹⁰⁰ The following historical information is derived primarily from: Ralph Simmonds, *Australia's Transition to a National Corporations and Financial Products Regulator: Lessons for Canada?*, prepared for CMI Symposium ("Simmonds"); and Cameron.

Commission) was established to administer the new legislation, but was required to devolve as much power and function to the state regulators (now known as Corporate Affairs Commissions) as possible. Overseeing the scheme was a Ministerial Council for Companies and Securities, constituted by agreement among the Commonwealth, the states and the territories, and comprised of local Ministers responsible for corporate and securities matters. The Ministerial Council was responsible for approving any amendments to the model legislation and generally overseeing the operation of the scheme. Several elements of this scheme were roundly criticized: (a) the diffusion of Ministerial accountability through the Council; (b) the inherently duplicative and inefficient nature of a 3-tiered regulatory structure; and (c) the perception that legislative uniformity yielded compromised, as opposed to optimal, solutions to market issues. It was feared that each of these factors was undermining domestic and international confidence in Australian markets. In response, Parliament enacted in 1989 federal corporations and securities legislation based in large measure on the existing legislation developed under the Cooperative Scheme, to be administered by the newly established Australian Securities Commission. Several states launched successful constitutional challenges against the new legislation. Two significant aspects of the corporate legislation were found by the High Court to be invalid exercises of Commonwealth power. The legislation in its entirety was repealed.

Undeterred by its lack of success, Parliament introduced in the early 1990s a new road map (to be known as the National Scheme) to national corporations and securities regulation. Borrowing from certain structural features of the Cooperative Scheme, the initial version of the National Scheme involved Commonwealth legislation, incorporated by reference at the state level and administered by a single federal regulator, the Australian Securities Commission (the "ASC")¹⁰¹. A Ministerial Council for Corporations was established to oversee the operation of the scheme, and while it was responsible for approving amendments to certain corporate law provisions of the governing statute, the Commonwealth retained exclusive jurisdiction over other aspects of the legislation. Unlike the earlier Cooperative Scheme, the regulatory function was centralized in the ASC and regional offices served only an administrative and clerical function. The complexity (and ultimately the undoing) of the National Scheme

¹⁰¹ The expansion of the ASC's mandate to include the regulation of all financial products (including, for example, certain insurance products and retirement plans) pursuant to the new Corporations Act 2001 (Commonwealth), led also to the renaming of the ASC to the Australian Securities and Investments Commission ("ASIC").

lay in a network of cross-vesting legislative provisions designed to provide federal agencies and/or courts with jurisdiction to hear any matters arising under the legislation, regardless of the constitutional foundation of the breached provision. The result was a system in which a matter falling clearly within the state legislative domain under the Australian Constitution would be heard in a federal setting with federal administrative law and criminal procedure laws applied. Throughout the 1990s the federal court emerged as an experienced and effective adjudicator in these matters. However, two constitutional challenges invalidated the cross-vesting provisions, with the court holding that “only matters falling within federal legislative jurisdiction can properly be made a responsibility of a federally created executive agency.”¹⁰²

While awaiting a constitutional amendment to validate federal occupation of the corporations and securities fields, the states have referred to the Commonwealth state legislative power under the Constitution for the purposes of restoring federal capacity to administer most aspects of the legislation.

Lessons to be Drawn from the Australian Experience

The Australian regulatory model would likely not be sustainable in the Canadian context. This is due primarily to the prohibition against interdelegation of legislative powers between Parliament and the provinces. However, several useful lessons can be gleaned from the often unsteady path to Australian national securities regulation.

1. Most notably, it is imperative to identify at the outset and vigilantly pursue the optimal regulatory structure. Commonwealth and state legislators tried enhanced harmonization, cooperative regulation and, ultimately, centralized federal regulation. While each regulatory model may have represented a stage in the evolution of discovering the optimal structure, the complexity and uncertainty of the reform processes caused much domestic and international skepticism of the health and credibility of Australian markets. Sharing with Australia a low proportion of global market activity, Canada cannot afford to alienate foreign and domestic capital by undertaking regulatory reform in half measures.

¹⁰² Simmonds, 11.

2. The proposed regulatory structure must be constitutionally sustainable. The Australian litigation bears witness to the presumption that disenfranchised Canadian provinces will attack the validity of any centralized regulatory scheme.
3. Successfully overhauling Canada's securities regulatory structure will require significant sustained political will. In the face of several failed reform attempts, the Commonwealth Parliament demonstrated remarkable "determination to achieve the vision of ... a single corporate, securities and futures law for Australia, under one national regulator."¹⁰³ In effect, two decades were dedicated to devising reform strategies, conducting inter-governmental negotiations, penning agreements, defending challenges and adjusting to new structures. While it is hopeful that Canada's reform process will unfold more smoothly, politicians must enthusiastically embrace the policy objectives compelling reform and steel themselves to a potentially adversarial process.
4. Centralized federal regulation is possible even where strong regional sentiments and local market-driven perspectives exist. Regional bias in securities regulation was pervasive in Australia, as demonstrated both by the constitutional challenges to Commonwealth regulatory control and by anecdotal evidence of protracted and difficult negotiations among the Commonwealth and the states.¹⁰⁴ However, successful regulation in a regionally fragmented nation "must still consider allowing for forms of regional ownership of the regulatory arrangements ... It probably has to mean at least a regional management presence of the regulator that allows for higher level local stakeholder input into the process of design of regulatory policy (*and enforcement*) decision-making, including both strategic and individual decisions."¹⁰⁵
5. The Canadian solution should be as simple as possible, structurally and legally. Those Australian initiatives that were overly complex derailed; those built upon a network of legal contrivances became constitutionally vulnerable, and those which created overlapping jurisdiction and

¹⁰³ Simmonds, 7.

¹⁰⁴ Alan Cameron, former Chair of ASIC recounted that strong-arm tactics were necessary to bring the state of Western Australia into the fold of the National Scheme. The Commonwealth threatened withdrawal of certain guarantee funding from the Perth branch of the Australian Stock Exchange. As well, it took almost 7 years to conclude an agreement reflecting the structure of the National Scheme, as the states tirelessly pursued an improved position in the reformed structure. See Cameron.

¹⁰⁵ Simmonds, 18.

functionally duplicative governance structures were pilloried for their impracticability. As suggested by Alan Cameron, former Chair of ASIC, to a Canadian audience: “I do recommend, whatever solution you finally adopt, that it be straightforward, well resourced and designed to last well into the future.”¹⁰⁶

6.2 *The European Model*

In 1999 the European Parliament adopted the Financial Services Action Plan (the “FSAP”) designed to achieve by 2005 a single, integrated capital market in the E.U. characterized by sophisticated prudential rules. The FSAP outlines legislative and other measures necessary to reach this objective, and describes the anticipated political and industry involvement in the process. Notwithstanding considerable success, implementation of legislation under the FSAP at the local level proved to be time-consuming and gave rise to divergent interpretations, as many nations demonstrated reluctance to dismantle age-old market barriers borne out of protectionist sentiments. To address these issues, a Committee of Wise Men on the Regulation of European Securities Markets, chaired by Alexandre Lamfalussy, was struck and delivered a widely acclaimed report (the “Lamfalussy Report”) to the E.U.’s Economic and Finance Ministers in early 2001¹⁰⁷. The Lamfalussy Report recommended, among other things, a structured communal approach to the development and implementation of securities legislation, and transparency (through substantial public consultation) throughout the regulatory and legislative processes.

In the regulatory framework prescribed by the Lamfalussy Report, the Council of the European Union and the European Parliament decide the core political principles and the key political orientation for a particular issue, and provide certain guidance regarding the implementation of such principles. Subsequently, the European Commission, in consultation with the newly established E.U. Securities Committee, determine technical implementation measures for the governing framework principles. Another newly struck committee, the European Securities Regulators Committee, is responsible for ensuring consistent implementation and application of regulation at the national level. While this

¹⁰⁶ Cameron, 14.

¹⁰⁷ *Final Report of The Committee of Wise Men on The Regulation of European Securities Markets*, February 15, 2001.

framework is intended to operate as an overlay to the highly segmented regulatory structures currently in place throughout Europe, the Lamfalussy Report strongly acknowledges the need for regulatory convergence.

The E.U. model represents a reasoned attempt to ensure consistent adoption of harmonized principles by all member nations. Its success, however, will ride on the commitment of each participating nation to the broader vision of a unified European market. While it is a credible road map for unifying the market policies and mechanics of sovereign countries, it is not tenable as a template for Canada's regulatory system. Such model would see a provincially or federally constituted securities body issuing broad securities or market related directives to be implemented locally, under the scrutiny of a designated body to ensure consistent provincial adoption. This is not significantly unlike the existing harmonization initiatives undertaken at the behest of the CSA, and will be plagued with many of the same shortcomings as described in detail above. As opposed to institutionalizing structures intended to maximize legislative uniformity and regulatory cooperation within a fragmented system, Canada should focus on regulatory convergence and simplicity. It would be unfortunate if Canada's securities regulatory structure could be no more streamlined or efficient than a structure designed to facilitate market integration amongst the many member nations of the E.U., several of which host markets with significantly more trading volume than those in Canada.

6.3 *The American Model*

Securities legislation in the United States was initially enacted along state lines, yielding a series of differential requirements that have survived (with some modifications) to this day under the moniker "blue sky laws." Federal regulation of securities markets was introduced as part of President Roosevelt's New Deal legislative strategy and in response to the catastrophic market tumult of 1929 and the Depression that ensued thereafter. While the critical federal statutes pertaining to securities are the Securities Act of 1933 (dealing primarily with initial distributions of securities) and the Securities Exchange Act of 1934 (dealing broadly with post distribution trading), other aspects of securities regulation are drawn from statutes respecting public utilities, trust indentures, investment companies, investment advisors and investor insurance. The SEC administers the federal securities code, and through its rule-making

capacity has supplemented existing laws with arguably the most comprehensive and complex network of prescriptive rules pertaining to the capital markets. In an attempt to simplify the dual system of securities regulation which developed as a result of the coexistence of state and federal securities laws, Congress passed the National Securities Markets Improvement Act of 1996 which, among other things, preempted the operation of state laws with respect to certain securities, broker dealers and investment advisers. Notwithstanding this significant dismantling of the blue sky laws and the predominant role of the federal government in securities regulation, a dual regulatory structure with often overlapping jurisdiction persists in the United States.

Critics of a Canadian securities model which advocates a non-exclusive role for the federal government point to the complexity of the American system and question the wisdom of adopting such a structure. They also point to the significant differences between the American and Canadian capital markets and caution against importing regulatory structures which may be intrinsically ill-suited to addressing the small and medium cap issuers which comprise a substantial segment of our market. The Porter Report speculated, however, that “a Canadian federal agency, supported by the existing self-regulatory associations, would be able to avoid some of the excesses of detail and delay that have been experienced by the SEC.”

While undoubtedly Canada must implement a regulatory system tailored to effectively address Canadian market issues, several points merit mention. First, it is facile to assume that centralization of the regulatory function implies adoption of the American regulatory model. The inefficiencies of the American system stem in large measure from the duplicative and/or supplementary nature of the blue sky requirements. A principal objective of Canadian reform is to streamline a system already beset by significant duplication. Second, while Canadian markets, issuers and intermediaries are distinct from their American counterparts, the interrelationships between the Canadian and American economies cannot be underemphasized. The common regulatory philosophy underpinning American and Canadian securities laws is only one aspect of a relationship characterized by extensive shared cultural, economic and political traditions. Canadians must accept the economic reality that the fortunes and policies of the deeper and more sophisticated markets to the south will inform the development of market and fiscal

policy domestically. As well, economic globalization has prompted a reorientation of political and economic identities along regional lines (for example the North American Free Trade Agreement, the European Union and the introduction of the Euro currency). To remain a credible economic partner in bi-lateral or multi-lateral dealings, Canada must develop a regulatory structure which promotes and enhances, as opposed to obscures, its economic and industrial strengths.

PART VII THE PROPOSAL - THE SHARED JURISDICTION MODEL

7.1 *The Model*

Under this proposed model, a federally constituted, self-funded regulatory body would be responsible for administering a federal securities statute applicable to interprovincial and international securities matters. A vast majority of Canadian securities transactions have an extra-provincial element and would therefore fall under the jurisdiction of the federal commission. Federal assertion of power in this domain is not only legally defensible, but is, in practical terms, the right result given the geographically neutral character of Canadian securities transactions and the national significance of ensuring competitive, efficient, fair and vibrant capital markets in Canada.

The federal act would borrow heavily from the draft legislation developed by the USL Project, with necessary modifications defining the parameters of the statute's jurisdiction. Some critics of previous reform proposals have lamented the lost opportunity of addressing critical regulatory issues which require legislative attention. Where practicable the federal legislation should reflect current perspectives and facilitate a modern and streamlined regulatory approach. This too is a stated objective of the USL Project. But this is not an appropriate time to attempt to resolve historically contentious policy debates, which could derail the adoption of the statute and delay the transition to the federal agency. Similarly, while British Columbia's deregulation project raises provocative issues concerning the approach and scope of securities regulation, consideration of the initiative should be deferred until after the transition. Absorbing structural regulatory change will be sufficiently challenging for markets and market participants.

The provinces would retain jurisdiction over intraprovincial securities issues. It is contemplated that they would revoke their existing legislation, and adopt the federal securities act (again with modifications defining jurisdiction), as it is constituted from time to time. However, the provinces would be able to supplement their provincial statutes with policies, rules, requirements and/or exemptions applicable to securities transactions consummated entirely within the province by issuers with only local securityholders. This would enable provincial regulators to pursue initiatives responsive to local market conditions and to sanction wrongdoing which is local in scope. Ideally there would be coordination or consultation with the federal agency's policy branch in the development of local initiatives, to ensure that an issuer's graduation to federal regulation is not disruptive to the issuer's business or investors.

It is anticipated that these provincial regulatory bodies will be small and specialized operations. In fact there are likely several provinces with insufficient local market activity to justify the expense of maintaining a securities regulator. Accordingly, the federal and provincial statutes should be structured to allow delegation of provincial securities regulation to the federal agency.

Under the 1994 MOU, a compensatory one-time payment to the provinces was contemplated. Such a payment need not be made in respect of interprovincial and international securities regulation, as occupation by the federal government of this field merely reflects evolving market and economic realities. In any event, the levying of fees (excluding certain financial penalties imposed in enforcement proceedings) in excess of the operating costs of the provincial regulatory structures was arguably opportunistic. Similar logic applies in the intraprovincial context, in which fees should be tailored to (and not exceed) operating expenses of the regulator. The loss of fee revenue resulting from delegation of the intraprovincial regulatory function will be offset by the savings attributable to not running an administrative agency. Accordingly, no compensatory fee is warranted. This conclusion also ensures that the federal agency is not encumbered with an initial debt load that may subvert its ability to reduce filing and transaction fees for market participants.

The head of the federal commission will be a federally appointed Chair, operating as chief executive officer of the agency. The Chair will report to the federal Minister of Finance at least annually regarding

the financial status of the agency, the significant regulatory achievements of the agency and the priorities and goals for the upcoming year, all of which information will be publicly available. Reporting to the Chair will be an Executive Director responsible for the administration of the agency. A board of no more than 10 full time Vice Chairs will be responsible for overseeing policy initiatives and acting as commissioners. Part-time commissioners resident across the country will participate on panels issuing discretionary relief from regulatory requirements and hearing enforcement proceedings. The Vice Chairs and commissioners will be drawn from qualified candidates across Canada in a proportion that both reflects the volume of capital markets activity in any given province, and ensures meaningful regional representation. An intelligent and balanced formula for representation should allay concerns about Ontario domination of a federal regulator. The Chair, Vice Chairs and commissioners should meet at least once per month to consider significant administrative and policy issues facing the agency, but the commissioners should convene weekly in panels to consider applications for discretionary relief. Staff in the head and regional offices will perform the administrative and policy roles of the federal agency.

Because the securities markets are only one component of Canada's national economic platform, the federal government must develop mechanisms to ensure Commission input in the development of fiscal, market, corporate and/or economic policy. While maintaining institutional and political independence is essential for the Commission (as described above), it is nonetheless important to facilitate discussion aimed at ensuring that Commission initiatives are complementary to other related policies pursued by the government.

This model also contemplates the establishment of an advisory board to the federal commission, drawing on persons with securities related legal, accounting and industry expertise. Again, the advisory board should be constituted in a manner which ensures regional representation. The advisory board would be responsible for initiating and/or commenting on policy or legislative proposals or changes in regulatory structure and process, and should be accessible to staff of the agency seeking input on current or contentious issues affecting the capital markets.

The head office of the federal agency would be in Toronto, where the clear majority of Canadian capital markets activity occurs. Local offices would be in Vancouver, Calgary, Montreal and Halifax, and would be responsible for surveillance of local markets and investigations of local market participants. It may also be prudent to maintain at each local office a limited number of staff persons with sufficient seniority and experience to meet with market participants and their advisors for the purposes of discussing complex pre-filing matters and transaction related issues. While file related decisions must be made in consultation with head office personnel, providing a local face of the national regulator may facilitate the disposition of complex, contentious or time sensitive matters. The local offices should also be given a prominent role in policy development, and should maintain a strong network with policy personnel across Canada to ensure that, where possible, local concerns inform and are addressed by a national policy strategy (i.e. national initiatives concerning the natural resource sector or small businesses). While an effective regulator must hear and respond to local concerns, it is imperative that the policy process and regulatory function not be compromised by divisive regional politics.

7.2 Measuring the Model Against the Principal Objectives of Regulation and Reform

As argued below, the centralization of a lion's share of the regulatory function in a single national agency will facilitate the achievement of regulatory objectives. However, the attainment of those objectives is largely dependent on how the agency is structured, staffed and funded. For instance, the reduction of filing fees is an often touted objective of reform, but will only be achievable if the federal agency, among other things, adopts a fee schedule which responsibly and realistically reflects the rational administrative costs relating to the filing. The following discussion presumes that intelligent minds will bring their expertise to bear upon the design and function of the agency to maximize the potential rewards of centralization and simplification.

Investor Protection

Ultimately a regulator will be judged for its ability to foster fair and efficient capital markets which instill investor confidence domestically and internationally. The federal statute will draw from existing legislative mechanisms promoting market fairness and investor protection. A single regulator with cross-provincial

jurisdiction will be able to mount a vigorous national surveillance and enforcement strategy, and provide consistent application of regulatory requirements and standards across Canada. Ideally, coordination between the securities regulator and the RCMP and/or the recently announced Integrated Market Enforcement Teams could strengthen a campaign against white collar crime, further protecting shareholders from fraud and other market misconduct.

Efficient Capital Markets

The reduction of regulatory and legislative duplication will all but eliminate the excessive costs of compliance and multiplicity of fees which are deterring participation in our markets. The rationalization of the regulatory function will also ensure that regulatory personnel can be allocated in a manner which fosters a sophisticated appreciation of market issues. While capital market efficiency is influenced by many forces, moving to a national securities model can remove or minimize any institutional regulatory impediments to efficiency.

Responsiveness

A centralized regulatory system will undoubtedly face challenges in ensuring that regional voices contribute to the regulatory fabric. The governance structure of the proposed model is intended to provide a framework for regional representation. Once a centralized regulator becomes responsible for market development and oversight across Canada, it must take into account the variations among national markets, and is responsible for shareholder welfare and market integrity everywhere. A fraud perpetrated on shareholders by an Alberta based issuer reflects poorly on the Canadian markets and regulatory system generally. There is, therefore, little basis for the suspicion that local market challenges will have no resonance with an Ontario based national regulator.

There is little doubt that a single regulator can be more responsive to changing market conditions than in our fragmented structure. The countervailing argument, however, suggests that a centralized structure could become overcome by bureaucratic inertia. This argument ignores the discipline exerted by the

international competition for capital, which will compel legislators and regulators to foster markets which are adaptable to new products and encourage innovation, while remaining responsible and fair.

Stability

An important advantage of the proposed regulatory structure over the delegation models is the structural permanence or stability of the system. Provinces cannot opt out and cannot threaten withdrawal to force legislative, policy or administrative concessions. In addition, because legislative authority rests with a single branch of government, statutory amendments (through the rule making process or otherwise) and policy initiatives need not be approved by multiple legislatures.

Transition

The transition to a new regulatory model will be greatly facilitated by the opportunity to piggyback on the legislative harmonization efforts of the USL Project. It is submitted that the transition to the new structure should be no more than 6 months after the final draft of the USL legislation is prepared. This should give sufficient, but not excessive, time to the federal and provincial legislatures to enact the necessary legislation and implement regulatory agencies. To minimize disruption and a loss of expertise, the federal commission should draw its members and staff from existing provincial securities regulators. In addition, upon publication of the draft uniform legislation, a “user’s guide” for the new regulatory system should be made available. This guide should clearly identify for market participants and their advisors the functional responsibilities of each branch of the federal regulator. It should also provide guidance concerning how to determine whether an issuer is provincially or federally regulated.

Accountability and Transparency

The political accountability for proper and vigorous oversight of the capital markets becomes concentrated in the federal Minister of Finance under this model, as opposed to being dispersed among 13 provincial ministers. It may be that the federal Minister is more remote from users of the capital

markets than his/her provincial counterparts. However, a clear accountability structure is in place, and the potential for political “distance” in no way diminishes the Minister’s responsibilities. In fact, given the debate surrounding regulatory consolidation of financial services generally, adding securities regulation to the federal Minister’s portfolio may stimulate a more fundamental reassessment of how to regulate the Canadian financial services sector. The transparency of the structure will depend entirely on the extent to which it communicates relevant information to the public, and solicits input on policy or other initiatives.

Constitutionality

This paper has argued that the proposed model has a strong constitutional foundation in the division of powers under the Constitution Act. However, the outcome of constitutional litigation is never certain, and the preponderance of caselaw justifying either side of the debate makes the outcome more unpredictable. Ultimately, if faced with a constitutional challenge, the courts will be making a policy decision regarding how best to facilitate a cohesive, vibrant and internationally competitive securities strategy. And the jurisprudence demonstrates that there is room for flexible interpretation of judicial tests or standards to justify a particular preferred outcome. As noted by Chief Justice Dickson in the *General Motors* case:

In determining the proper test it should be remembered that in a federal system it is inevitable that, in pursuing valid objectives, the legislation of each level of government will impact occasionally on the sphere of power of the other level of government; overlap of legislation is to be expected and accommodated in a federal state. Thus a certain degree of judicial restraint in proposing strict tests which will result in striking down such legislation is appropriate.¹⁰⁸

To be sure, it would be best to keep this debate out of the courtroom. But the fear of a constitutional battle should not make legislators cower from pursuing the best regulatory solution for Canadian capital markets.

¹⁰⁸ *Supra*, Note 74, 669.

7.3 *Is the Model Too Complex?*

This proposal may draw criticism that it adds another layer of regulation on top of provincial legislation. The model is, however, distinguishable from certain previous calls for a national regulator such as the Porter Report in which provincial legislation would continue to apply to a broad range of securities transactions. Under this proposal, an unlisted issuer with only local security holders would fall under provincial regulation, and only for so long as the entity and its shareholders remain entirely in the province. Federal and provincial jurisdiction do not overlap – they abut. There should be no duplication of regulatory effort or inconsistency as between the federal and provincial regimes.

7.4 *The Political Context*

Whether the federal government attempts to negotiate with the provinces the creation of a federally dominated securities regulatory regime, or whether it declares jurisdiction unilaterally, it is likely that a political dogfight will ensue. The political dynamic in Canada has long been characterized by ongoing federal-provincial competition for power and funding. Quebec and the western provinces have consistently dismissed federal regulation as politically unattainable. The ascendancy to power of the Quebec Liberal Party may not significantly change Quebec's fundamental aversion to federal assertion of securities jurisdiction. Although an avowed federalist, Premier Jean Charest has indicated that he will promote "provincial interests [whenever they] intersect with the national good."¹⁰⁹ Voluntarily delivering regulatory jurisdiction to the federal government in the early days of Liberal rule would risk reigniting local sensitivities to the perceived indifference of the federal government to Quebec institutions and identity. Certainly in the near term, Premier Charest's success will depend upon keeping separatist sentiment at bay.

While not in the securities context, the recent fisheries dispute demonstrates how fragile a federalist political structure can be. Roger Grimes, the Premier of Newfoundland, has called for a renegotiation of the constitutional status of Newfoundland in connection with gaining more control over the operation of

¹⁰⁹ Michael Den Tandt, "Charest won't want single regulator," *Globe & Mail*, April 17, 2003, B2.

the fisheries industry. His initiative was warmly applauded by resource-rich Alberta (with obvious interest in a redefinition of Ottawa's role in resource exploitation, distribution and marketing), and was summarily dismissed by Ottawa. It has been suggested that Ottawa will gain control over securities only if it yields to the provinces jurisdiction in other domains which it values less. Such horse-trading of powers must be avoided. Not only will it mire the negotiations with staggering complexity and wholly irrelevant considerations. But also, more fundamentally, it fails to recognize the impetus for reform. This is not a power grab by Ottawa. It is a sorely needed readjustment of jurisdiction to respond to the needs of markets which have long since shed their local orientation and are under immense pressure from international markets and sophisticated trading technologies. Regulators and politicians must be made to understand that, in these circumstances, federal assumption of securities regulation will benefit the provinces by opening local markets, attracting investment capital, enhancing Canada's position within international market and/or securities organizations, and dismantling unwieldy barriers to effective market surveillance and enforcement.

PART VIII THE NEED FOR RESEARCH

The CMI White Paper called for additional research to be conducted in certain key areas to “develop the factual record that would prove or disprove key preconditions that underlie the various reform proposals, thereby giving legislators and other policy makers the information they require in order to ensure that any decision in the future structure of Canadian securities regulation is based on a thorough, inclusive and rigorous empirical analysis.”¹¹⁰ In particular, the CMI concluded that empirical data was necessary to more fully understand the following aspects of the reform debate:

- the importance and role of local and regional interests in Canada's regulatory structure;
- the costs associated with the current fragmented structure, and the extent to which alternative reform proposals would reduce those costs;
- the benefits and risks of regulatory competition; and

¹¹⁰ CMI White Paper, iv.

- the ways in which the Australian model accommodates local or regional interests in the federal structure and the techniques employed by the various levels of government in Australia to build and sustain consensus among politicians and regulators notwithstanding significant resistance to regulatory consolidation over a considerable period of time.

Undoubtedly research regarding the nature of regional interests, the costs of a balkanized regulatory system and certain aspects of the Australian experience would better inform the reform debate. In fact, as noted above, the Wise Persons Committee has solicited public input on these and other issues. To this list should be added a comprehensive analysis of the constitutional strengths and vulnerabilities of the competing regulatory models, updating the work accomplished by Anisman and Hogg in 1979. For the reasons noted in section 5.4 above, and given the pressing need for completing the foregoing research in a timely manner, research resources should not be expended on pursuing the feasibility of a competition model.

PART IX IN CONCLUSION – A NEW OPPORTUNITY

The issues being explored by the Wise Persons Committee were precipitated by largely the same concerns which initiated previous reform attempts, and will likely be plagued by the same political and regional forces that undermined those opportunities. On the other hand, it may be that our markets have so fundamentally outgrown our divisive and jurisdictional style of regulation, and that international capital and regulatory pressures have both exacerbated the dysfunction of our regulatory model and jeopardized the vitality of our markets that reform may be achievable.

To be successful, any bid for reform must hail from the federal and provincial legislatures. Only strong political will and commitment can overcome the politics of regionalism and parochialism which define and necessarily limit the efficacy of our current structure. In turn, politicians will assume the mantle of regulatory reform only if a broadly based constituency of market participants urges it upon the political agenda. The securities industry, issuers and their advisors, and investors must offer intelligently articulated arguments emphasizing the central role which a cogent regulatory strategy can play in the

success of domestic markets and Canada's financial policy generally. We are, in effect, asking our provincial politicians to adopt a policy of enlightened self-interest – yield substantial legislative and regulatory jurisdiction to a federally managed regulatory structure which, in the long run, will foster more robust domestic markets and generate spin-off benefits to local economies. Pragmatically, this may be seen as politically naïve. The Australian experience, however, demonstrates that political parochialism can be overcome in the face of a sustained, rational and compelling campaign for regulatory reform. If there is, as Mr. Mackay suggests, a ground swell of discontent gaining momentum, market participants broadly bear the responsibility to ensure that this opportunity for reform is not squandered.

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