An Examination of the Debate Surrounding the Implementation of a Canadian National Securities Regulator

by

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Table of Contents

Section 1: Introduction……………………………………………………………………………………1

Section 2: The Current Landscape of Canadian Securities Regulation……………………..4

Section 3: The *Securities Act*……………………………………………………………………...................10

Section 4: The Effects of Geographical Diversity Across the Nation………………………..15

Section 5: Protection of Investors, Enforcement of Regulations, and Fraud Prevention………………………………………………………………………………………………………22

Section 6: Systemic Risk, Efficiency, and Shadow Banking…………………………………….28

Section 7: Foreign Investors and Canada's Foreign Influence……………………………..40

Section 8: The Solution to a National Problem – Joint Cooperation……………………..44

Section 9: Conclusion………………………………………………………………………………….52

Bibliography…………………………………………………………………………….................56

Appendix A………………………………………………………………………………...................58

Note to readers: Please see bibliography for title clarification in footnotes.

Section 1: Introduction

It has been said that a system is only as strong as its weakest link. I believe that one system where this can be applied is the Canadian economy as a whole. In the aftermath of the recent global financial crisis, it seems that Canada has undergone a self-reflection in order to determine any weaknesses or areas that could be improved. One way to improve a country's economy is to look to the success of other nations and the reason for that success. In relative terms, Canada has come through the recent crisis relatively stronger than many other nations, having undergone a less severe recession with strong signs of recovery. Timothy Lane, Deputy Governor of the Bank of Canada, stated, "An important reason Canada fared better than other countries was that our financial system was more robust… No Canadian financial institutions failed… This in turn, reflected, at least in part, Canada's tougher regulatory standards and stricter supervision and oversight."[1] While Canada's economy remains stronger than others, there are many who believe that a major regulatory issue, or Canada's "weakest link," continues to exist. Canada does not have a centralized or national regulatory body when it comes to the securities industry. There has been extensive discussion of this issue with strong beliefs on either side of the argument.

This paper will be a comprehensive examination of Canada's possible movement to a central or national regulator. The information presented in this essay will be a collection of material from authoritative sources. The goal of this essay is to provide detailed information on the arguments for and against a national

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[1] Lane (2013).

securities regulator and to create an educated conclusion and assessment of what I believe to be the best solution. The initial part of the paper will consist of a general outline of the current provincial regulation system and the responsibilities of the provinces and will establish Canada's standing in the global economy under the current system. The next section will examine the recent Supreme Court ruling on the proposed *Securities Act*[2] from 2011, including the Court's reasoning and conclusions and a general commentary on the significance of this ruling. The sections following will examine issues that I believe are central to the possible change to a national regulator. This paper will discuss issues such as the geographical diversity in Canada, including an examination of the differences in markets and potential favouritism aimed at Toronto. An additional issue to be examined is the protection of investors, enforcement of regulations, and fraud prevention, and the debate that a national regulator will improve these concerns.

Another major issue that I will outline includes the need to reduce systemic risk and monitor the shadow banking industry. There are those who believe systemic risk and shadow banking are insufficiently controlled in the Canadian economy under the provincial regulation system. It has been argued that risks and market instability move very quickly between capital and financial markets and this can be mitigated through improved coordination under a national regulator. In addition, it has been argued that a central regulator would create insulation against future risk such that the Canadian economy would have an improved reaction to events such as the recent crisis. The final issue that will be examined is in regards to

[2] Securities Act (2011).

foreign investors and Canada's foreign influence on securities markets and regulation. Those that support a national regulator have suggested that a new system of regulation would solidify Canada's voice on securities regulation from an international perspective. If Canada seeks to be influential at the global level then it is argued that a national regulator is necessary. In addition, promoters of a national regulator may suggest that the current system is messy, confusing, and unnecessarily difficult and thus has deterred foreign investors. As a result, Canada could create a more attractive market to entice foreign confidence and subsequent investment.

The concluding sections of this paper will examine a possible solution to the debate, including the idea of joint cooperation between the provinces and a national regulator. One suggestion was to model the new system after the Canadian Pension Plan Investment Board (CPPIB).[3] This paper will outline the features of the CPPIB that are adoptable for securities regulation and assess the strengths of this proposition. This paper will ultimately conclude with my assessment of the ideal solution based on the evidence discussed and examined throughout the essay. The conclusion will highlight the most important aspects of the argument to focus on as policy initiatives move forward.

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[3] Hockin (2012).

Section 2: The Current Landscape of Canadian Securities Regulation

In this paper, the term "securities" refers to assets such as shares in companies and corporations, bonds, financial derivatives, and other debt instruments, and interests in partnerships.[4] These assets generate monetary flow between those looking to invest and those looking to raise capital. Due to the diversity of the types of assets and the large scale of the markets, regulation of securities is extremely complex.

In order to understand the debate over the move to a national regulator, it is important to examine the current system as a comparison. Every province and territory operates its own securities regulator and these regulators are responsible for administering their respective securities legislation. Some regulators are self-funded and others are entities funded under a larger government department.[5] As it stands today, each province and territory has its own securities laws. As the Supreme Court of Canada describes in the ruling on the proposed *Securities Act*:

> "These agencies exercise a variety of responsibilities, including prospectus review and clearance; oversight of disclosure requirements; takeover bids and insider trading; registration and regulation of market intermediaries; enforcement of compliance with the regime; recognition and supervision of exchanges and other self-regulated organizations; and public education."[6]

For a visual representation of Canada's current securities regulation system created by the Expert Panel on Securities Regulation, please see Appendix A.[7]

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[4] Securities Act (2011) para. 40.
[5] Expert Panel (2009) p. 39.
[6] Securities Act (2011) para. 41.
[7] Expert Panel (2009) p. 73.

Before examining whether or not to move to a national regulator, I felt it was important to determine Canada's standing and performance under the current system. Canada was ranked second for quality of overall securities regulation in a 2006 report from the Organization for Economic Co-operation and Development.[8] In the same report, the United States, which employs a central regulator system through the Securities and Exchange Commission, was ranked fourth. While this report shows the strength of Canada's current system, it is important to note that this was prior to the recent financial crisis. In a separate report, titled the World Bank Doing Business 2008 Report, Canada finished fifth in investor protection, ahead of the seventh place United States.[9]

In addition to the above results, some researchers have argued that Canada has fared well in terms of direct costs of securities regulation. These direct costs in Canada have been reported at $195 per million dollars of capitalization; in comparison, Australia and the U.K. are reported at $369 and $243 per million dollars of capitalization, respectively.[10] If the costs are standardized using the number of corporate listings, Canada's advantage is even greater: "In Canada, the costs stand at $57,500 per company, compared with $139,000 in Australia, $204,000 in the U.K. and $312,200 in the U.S. Based on a comparison of the direct costs of securities regulation, Canada therefore enjoys a net advantage."[11] One argument that can be made is that if Canada is finishing ahead of the U.S., a country to which we are often compared, and that country employs a national regulation

[8] de Serres (2006) p. 19, Lortie (2010), Carpentier (2010) p. 82.
[9] Lortie (2010).
[10] Carpentier (2010) p. 59.
[11] *Ibid*., p. 59, 60.

system, then why is Canada so determined to switch to a similar scheme? Some researchers are of the belief that changing to a national regulator would actually increase the direct costs of securities regulation and would thus be a negative change.[12] I would suggest that the arguments must be strong to justify moving away from a system that has provided solid results and is part of an economy that is considered strong at a global level.[13]

Regardless of where provinces or individuals stand on the issue, I believe there has been a clear shift in attitude that the securities regulation system needs to be improved. The Canadian Securities Administrators (CSA) has implemented tools to increase efficiency in capital markets. These tools include the Mutual Reliance Review System (MRRS) and the Passport System. These systems were implemented in 2000 and 2005-08, respectively.[14] The MRRS was put into place "…to reduce the duplication in the review of filings with multiple securities regulators."[15] This system would apply to those filings submitted in multiple jurisdictions. I would conclude that this demonstrates the existence of a need to adapt the current system to evolving capital markets and thus introduces the idea that the current system is not ideal.

The Passport System was created to improve efficiency in the regulatory approval process such that a single regulator's decisions are respected and recognized in any jurisdiction participating in the system. This is summarized as

[12] Carpentier (2010) p. 60.
[13] Supra Note 1.
[14] Carpentier (2010) p. 70, 71.
[15] *Ibid.*, p. 71.

follows: “Each issuer is governed by a principal regulator, usually the authority in the jurisdiction where its head office is located. Issuers that file a prospectus or apply for an exemption need only deal with their principal regulator and meet the legal requirements in the jurisdiction of the principal regulator.”[16] While this appears to be a positive change in an attempt to improve efficiency, it has been reported that stakeholders believe the system’s application is limited and is insufficient for what is needed in today’s economy. Some problems that have been suggested include that the system is too slow, cumbersome, and expensive.[17] While it is interesting to note that Ontario does not participate in the Passport System, the province does support the harmonization and improved coordination of securities regulation in Canada.[18]

Similar to the MRRS, I believe that the Passport System shows that the securities industry in Canada was looking for a change or adaptation from the current regulatory system in place. I would surmise that these kinds of tools would not need to be put in place if a national regulator was implemented with uniform participation. In all fairness, one must consider that if a national regulation system were currently in place, certain tools could be implemented to improve weak points and this does not mean switching systems is the correct choice. To determine which system is the correct choice means one must determine the costs versus benefits of each system.

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[16] *Ibid.*, p. 72.
[17] Expert Panel (2009) p. 2.
[18] *Ibid.*, p. 39.

One report, written by the Expert Panel on Securities Regulation, enlisted several experts in the field of securities, consulted 100 stakeholders, and commissioned research studies to gather evidence on the nature of securities regulation in Canada.[19] The report outlined many concerns with the current system and the overall conclusion was a recommendation to move to a national securities regulator. One concern was that the fragmented structure of 13 jurisdictions across the country has and will lead to slower reactions to capital market events and systemic risk. In addition, the report concludes that the current structure misallocates resources, which causes regulation to be less efficient and less effective.[20] This concern will be examined in the section discussing systemic risk and efficiency. In addition, the authors explain a concern that the current system and its provincial mandates are insufficiently able to address developments in capital markets at national and international levels.[21] This concern will be discussed in the section on foreign investors and Canada's foreign influence. Lastly, an additional concern is that Canadians receive varying levels of investor protection based on jurisdiction and are forced to pay additional fees due to the fragmented structure.[22] These concerns are addressed in the protection of investors and geographical diversity sections, respectively.

In contrast to the above concerns, there are those who suggest that the change to a national regulator would make Canada's financial sector overly-

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[19] *Ibid.*, p. 1.
[20] *Ibid.*, p. 40.
[21] *Ibid.*
[22] *Ibid.*, p. 41.

centralized and therefore subject to undue industry influence. This is largely because Canada has one of the most highly centralized financial sectors in the world.[23] In addition, Canada's current system has been praised by Canada's Minister of Finance who stated that "'Our economy has been resilient… Our financial system has been widely recognized as the world's strongest.'"[24] With all of the above information in mind, I will now outline the arguments and concerns in consideration of the change to a national regulator.

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[23] Carpentier (2010) p. 97.
[24] *Ibid.*, p. 107.

Section 3: The *Securities Act*

Canada's Minister of Finance, Jim Flaherty, has made it clear that he believes the best direction for securities regulation is to move to a national regulatory body. Moving in this direction, a piece of legislation titled the *Securities Act* (the "Act") was drafted and submitted to the Supreme Court of Canada. This submission was intended to determine the constitutional validity of the legislation and, if the legislation is deemed unconstitutional, to determine what needs to be changed. The Act, dated May 26, 2010, was heard by the Court on April 13 and 14, 2011, and the subsequent judgment was rendered on December 22, 2011. The purposes of the Act are described as providing "…investor protection, to foster fair, efficient and competitive capital markets and to contribute to the integrity and stability of Canada's financial system."[25]

It is important to examine the Act because it represents a clear indicator of Canada's, specifically Parliament's, desired means and ends in terms of instituting a national regulator. Some of the methods to improve regulation which were proposed include disclosure requirements, registration requirements for securities dealers, specific duties for market participants, prospectus filing requirements, civil remedies, a framework for the regulation of derivatives, and regulatory and criminal offences pertaining to securities.[26] One of the most significant features of the proposed system is that provinces and territories would not be forced to participate; instead, they would be given the option to opt-in and partake. The goal would be to eventually create a system which functions as a national regulation

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[25] Securities Act (2011) para. 2.
[26] *Ibid*.

system with uniform participation.[27] In order for the legislation to be deemed constitutional, the federal government must successfully argue that the legislation falls under federal jurisdiction as set out by the laws in the constitution. In this case, the federal government and Ontario argued that securities regulation falls under the general trade and commerce power held by Parliament under s. 91(2) of the *Constitution Act*.[28] In contrast, Alberta, Quebec, and other provinces challenged the formation of a national regulator. They argued that securities regulation falls within s. 92(13) of the *Constitution Act* that refers to the jurisdiction of provinces over property and civil rights.

Within the judgment, the Court outlined that Canada believes securities regulation has evolved from a provincial to a national matter and thus requires a national regulator under Parliament's trade and commerce power.[29] The Court does not agree with this argument, as they state that:

> "…considered in its entirety, the proposed Act is chiefly directed at protecting investors and ensuring the fairness of capital markets through the day-to-day regulation of issuers and other participants in the securities market. These matters have long been considered local concerns subject to provincial legislative competence over property and civil rights within the province. Canada has not shown that the securities market has so changed that the regulation of all aspects of securities now falls within the general branch of Parliament's power over trade and commerce."[30]

I recognize the Court's ruling that Canada must show there has been a clear, undeniable development in the securities market to make it federal jurisdiction. I view this scenario as a case where securities regulation contains both national and

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[27] *Ibid*.
[28] *Constitution Act, 1867*.
[29] Securities Act (2011) para. 4.
[30] *Ibid*., para. 6.

provincial dimensions. The Court has the duty to protect the rights of the provinces as specified by the *Constitution Act, 1867* and therefore cannot take away provincial rights or jurisdiction simply because it is an easy solution to the debate. The Court makes this clear, stating "Parliament cannot regulate the whole of the securities system simply because aspects of it have a national dimension."[31]

To summarize, the preamble states that the purpose of the Act is to create a single Canadian securities regulator.[32] In addition, the Act provides for a single set of laws and rules that would enable uniform regulation and enforcement at a national level. As explained in the judgment, the goal of this is to create integrity and stability in Canada's markets at a national level.[33] Canada is seeking the approval of those against national regulation, as the proposed system is an opt-in scheme with the hope that all provinces and territories will eventually participate.[34]

One of the more convincing arguments in favour of a national regulator, proposed by Canada in favour of the Act, is that the securities market has evolved over time and moved from local markets to markets that are increasing in scope to national and international levels.[35] This development is central to systemic risk. Markets have expanded, especially through the development of technology, and I agree that this has resulted in securities regulation having taken on a national dimension. In essence, while the new system would clearly move many of the responsibilities currently held by the provinces to the national regulator, Canada

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[31] *Ibid*., para. 8.
[32] *Ibid*., para. 29.
[33] *Ibid*.
[34] *Ibid*., para. 31.
[35] *Ibid*., para. 33.

argues that the current market is not contained within the current provincial responsibilities. This lack of control is manifested by the increased systemic risk across Canadian capital markets. The new system, including the proposed Act, would contain "…provisions for the control of systemic risk and data collection on a nationwide basis, something Canada argues cannot be accomplished at the provincial level."[36]

In defense of provincial regulation, Alberta, Quebec, Manitoba, and New Brunswick made it clear that they opposed the Act. Unlike their counterparts, these provinces believed that the legislative jurisdiction of provincial regulation remains local and private in nature.[37] This would fall under provincial jurisdiction as dictated by s. 92(16) of the *Constitution Act, 1867* and this includes the regulation of contracts, property, and professions.[38] Contrary to Canada's argument, the provinces believe that the Act is simply an attempt by Parliament to "…regulate a particular industry – the securities industry."[39] The provinces of British Columbia and Saskatchewan were in a unique circumstance as they did not oppose the idea of a national securities regulator, but rather opposed the Act itself. These provinces are of the belief that a national regulation scheme that respects the division of powers can be implemented.[40] The key to a solution for these provinces is a system of cooperation between federal and provincial parties.[41]

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[36] *Ibid*., para. 102.
[37] *Ibid*., para. 34.
[38] *Ibid*., para. 3.
[39] *Ibid*., para. 34.
[40] *Ibid*., para. 35.
[41] *Ibid*.

While it is true that Canada and Ontario failed to prove that the scope of securities regulation has developed completely beyond the jurisdiction of the provinces, this does not mean Parliament has nowhere to go from here. The Court wants to avoid a duplication of provincial powers such that a national regulator is not simply doing the same duties as the current provincial regulators.[42] The provinces are in clear control of securities regulation, however there is no current mandate to monitor market stability at a national level within the securities industry. The Court also suggests that there is no assurance that provinces can handle the prevention of systemic risk by themselves on a sustained basis.[43] Though the Act was deemed unconstitutional, the ultimate conclusion by the Court is that there is room for cooperation between the provinces and Parliament. To be specific, "…a cooperative approach that permits a scheme that recognizes the essentially provincial nature of securities regulation while allowing Parliament to deal with genuinely national concerns remains available."[44] As a result, Parliament has been given an outline of what is within their jurisdictional bounds and while the situation is complex, a national regulatory system is by no means out of reach.

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[42] *Ibid*., para. 101.
[43] *Ibid*., para. 120.
[44] *Ibid*., para. 130.

Section 4: The Effects of Geographical Diversity Across the Nation

One aspect of Canadian securities regulation that is unique to the nation is the geographical diversity of major cities and major capital markets. There are many questions that arise when this aspect of the nation is considered, such as whether regulation should be left to the provinces due to significant differences in the markets. The counter opinion to this is that it might be possible to achieve a better overall outcome by moving to a national regulator and unifying these diverse markets. In addition, the diversity of markets in Canada has led people to question whether the larger markets, generally thought to be Toronto and Ontario as a whole, would be favoured over other markets when it comes to the specific terms and policies of a new national regulation scheme. As well, it is important to question whether the current system negatively influences domestic investment across jurisdictions due to the inefficiency and difficulties of having to deal with multiple regulating authorities. In consideration of these issues, one could argue that moving to a single, national regulator would reduce unnecessary duplication and complexity that might exist in the current system.

An article written in March of 2013 in *Canadian Business* suggested that Finance Minister Jim Flaherty was going to be successful in his venture to establish a national securities regulator. The author outlines his belief that the existing system is inefficient, stating that "[Canada is], in fact, the only major industrialized economy without a national securities regulator: the existing system of 13 provincial and territorial fiefdoms is an antiquated contraption bilking money from corporations

by forcing them to pay fees in multiple jurisdictions."[45] Though strongly worded, this view illuminates the fact that Canada has seemingly fallen behind the modern economic trend of centralization. My initial thoughts were that Canada is extremely unique in the sense that it is a large geographical land with a relatively low population. In addition, the country is rich in natural resources and this drives the economy, such that the major markets are spread out according to these factors. Therefore, one could argue that Canada should not blindly rush to mirror other economies simply because it works for them. Instead, the uniqueness of this nation could mean the best choice is to do the opposite. The essence of this debate is that there are trade-offs no matter which side of the argument is favoured.

The Supreme Court summarizes the diversity of the nation in the proposed *Securities Act* judgment as follows:

> "…routine securities regulation is mainly concerned with the regulation of securities as an industry. It all confirms the local nature of much of Canada's securities industry… Mining listings compose approximately two thirds if the securities market in British Columbia. About half of Ontario's securities market is attributable to large financial services companies. Alberta is the dominant national market for oil and gas and roughly a quarter of technology listings emanate from Quebec."[46]

If Canada is aware of the effects of geographical diversity and the diversity of markets in this country, common sense would suggest that this must be considered in the change to a single regulator. It might be possible to implement some sort of initiative to minimize any negative affects on individual markets as a result of the change. Implementing an initiative could help to dissuade the concerns of those provinces that seem to be unsure of the right direction, such as British Columbia and

[45] Cowan (2013).
[46] Securities Act (2011) para. 127.

Saskatchewan,[47] and may help to encourage a change in stance from those provinces strictly against removing the power from the provinces, such as Alberta, Quebec, Manitoba, and New Brunswick.[48] In addition, this initiative would help to decrease any issues that may arise in the attempt to regulate diverse markets on a national scale. The focus of provinces across Canada is different: Alberta's strength is their natural resources such as oil and gas, Ontario is home to a large financial sector, British Columbia has a strong mining sector, and Quebec has a large number of small technology companies.[49]

From the perspective of those in favour of a national regulator, creating an initiative to minimize potential geographical issues under a national regulator is anything but simple. The goal is to create a system under one authority while maintaining the ability to address local and provincial needs. In addition, this system must strive to avoid providing an advantage to any individual market. As the system stands currently, provinces have undertaken initiatives in order to improve regulation in a way that is specific to their jurisdiction. For example, Quebec employs a stock savings plan, Alberta instituted a capital pool companies program, and Ontario created a special status for issuers in order to facilitate the financing of private companies.[50] To clarify this point, "These examples of regulatory experimentation show how local authorities were able to take advantage of their autonomy to formulate and experiment with initiatives designed for their specific

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[47] Ibid., para. 35.
[48] Ibid., para. 34.
[49] Carpentier (2010) p. 30.
[50] *Ibid.*, p. 8.

clientele."[51] In consideration of this information, it appears to me that a national regulator system would take away this advantage unless the new scheme is able to replicate this type of local market service.

Those in favour of a national regulator may argue that the level of service provided by local regulation is less important than the issue of cross-jurisdictional transactions and regulation. This point has been closely examined by certain researchers whose work is aimed at showing that Canada's transactions across capital markets are less interjurisdictional than they appear. The general conclusions are that the scope of a large percentage of listed Canadian companies is mainly local and generally involve a limited number of securities regulators.[52] Their argument is that the Canadian market is composed of small companies that tend to favour local jurisdictions and thus would not benefit from a national regulator.[53] To be specific, "…almost 60% of exchange listings involve no more than three securities commissions. On the other hand, less than 15% of listings involve 10 commissions or more. Only 6.6% of exchange listings involve the 13 securities commissions."[54] As well, to put this in relative terms, 84% of the smallest transactions involve no more than three commissions and only large initial offerings involve 10 or more commissions.[55] It is important to note that the largest listings make up a significant portion of market capitalization.

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[51] *Ibid.*, p. 8.
[52] *Ibid.*, p. 16.
[53] *Ibid.*, p. 18.
[54] *Ibid.*, p. 65.
[55] *Ibid.*, p. 65.

The authors of this research do not disagree that large companies make up a significant portion of the securities markets in Canada; however, their work is attempting to show that a national regulator should not be instituted simply to favour these larger companies. They report that over 63% of head offices of public and private companies are not located in Toronto.[56] In addition, British Columbia and Alberta are the home of 58% of issuers, dispelling the notion that the majority of issuers are located in Ontario.[57] In fact, Alberta's capital market is only second to Ontario in terms of aggregate public company market capital.[58] While Ontario is home to the majority of large companies, "Only 7% of Canadian companies can be described as large or very large companies according to international standards; 79% are very small companies."[59]

These issues have not been ignored or discounted by those in favour of the change to a national regulator. In a report released by the Expert Panel on Securities Regulation, they recommended a new regulation structure that would maintain high levels of local service that are currently being provided under the system in place. In addition, their recommended national regulation system would supposedly continue to meet the diverse needs of these distinct markets.[60] One of the ways this will be accomplished is through their recommendation for regional offices in major

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[56] *Ibid*., p. 20.
[57] *Ibid*., p. 22.
[58] *Ibid*., p. 22.
[59] *Ibid*., p. 23.
[60] Expert Panel Commentary (2009).

financial centers.[61] The goal of these offices would be to specialize in the regulation of specific sectors according to the popular industries of that region. As well, "The regional and local offices should initially consist largely of staff from existing provincial securities regulators to ensure the continuity of regulatory expertise and to provide uninterrupted regional and local service."[62] This suggestion seems like a logical transition mechanism, as it would ensure experienced people are working towards maintaining the same levels of service.

The Panel believes that, in addition to instituting local offices, the use of uniform performance measures should be used across the country and made publicly available.[63] While this recommendation does not appear to be explicitly intended to solve the geographical diversity issue, I believe it would be a very important tool. Uniform performance measures would ensure that national regulation is attempting to provide all regions with a similar level of service. If performance levels were not equal, measuring this would allow for necessary changes to be made in order to obtain uniform performance. My belief is that this structure would allow for local customization under a national regulator as the region-specific problems that occur would be tracked and subsequent adjustments would be made. I envision a scenario where uniform performance is the end and the means can be adjusted based on region. If this structure is successful, I view this as optimal as a national regulation system would be in place without a severe decline in local services.

[61] Expert Panel (2009) p. 43.
[62] *Ibid.*, p. 43.
[63] *Ibid.*, p. 15.

In consideration of the overall issue, Parliament is well aware of the need to cater to Canada's diversity. They have outlined in the Budget of 2013 the their goal is to create a model that would maintain "…regulatory offices in each participating jurisdiction, with the capacity and resources to serve market participants locally.'"[64] Whether or not these offices would be able to serve local markets as successfully as the current provincial regulators is difficult to predict.

[64] Budget 2013 p. 142.

Section 5: Protection of Investors, Enforcement of Regulations, and Fraud Prevention

A major area of concern in light of the recent financial crisis is ensuring the protection of investors in Canada. Lack of assurance and lack of confidence in Canada's ability to protect their investors discourages investment and does not foster financial development. Two of the largest contributing factors to protecting investors are the ability to enforce the regulations in place and to deter and prevent the occurrence of fraud. These considerations are important to this paper as an argument can be made that a single national regulator will be able to achieve a higher level of protection, stronger enforcement, and increased fraud prevention. In contrast, it can be argued that a provincial regulator is better able to achieve these same goals since the provincial regulator has a smaller scope of focus. This section will examine these arguments.

To begin, one of the popular comparisons for Canada's securities regulation industry is the comparison to the United States under the Securities and Exchange Commission (SEC). While this paper has shown many differences between the Canadian and American economies, such as geographical diversity, there is still something to be learned from the experience of the U.S. under a national regulator. One paper, written by Carpentier and Suret, examined securities enforcement within the United States. The authors found that "The general message is twofold. The federal commission in the U.S. is not the primary securities enforcer, and the states are crucial partners."[65] Along these lines, the authors come to the conclusion

[65] Carpentier (2010) p. 11.

that it is unlikely that a national regulator would have a major impact on securities enforcement.[66] The authors' research that supports this conclusion examines the number of enforcement actions and the number of monetary sanctions in the U.S. led by the SEC and by other, smaller organizations across a number of years.[67] The number of actions by the SEC is never above 18% of the percentage of total actions.

In addition to this research, the authors report testimony from a member of the North American Securities Administrators Association. This testimony explains that because:

> "…local offices are often the first to receive complaints from investors, state securities regulators serve as an early warning system, working on the front lines, investigating potentially fraudulent activity… After identifying a problem, many states can take immediate enforcement action without the time-consuming need to obtain formal agency orders… Proximity is one of the reasons for the important role played by state regulators."[68]

This is a very strong argument that any system in place needs to ensure the existence of the ability to monitor at a local level. As made clear in the geographical diversity section, Canada's capital markets are diverse and spread out, possibly more so than most other nations in the world. As a result, there is a case to be made that a national regulator would not improve investor protection and enforcement without local market influence and this should be considered in anyone's conclusion.

A potential belief is that Canada could possibly design a national regulation system that would better enforce regulations than the SEC. I agree with Carpentier

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[66] *Ibid*.
[67] *Ibid*., p. 88, table 21.
[68] *Ibid*., p. 90.

and Suret that a counter argument could be made through their research which reveals that the cost of pursuing fraudsters and enforcing regulations is often too high to warrant given a national regulators' limited resources.[69] In my opinion, it would make the most sense to create a system similar to that of the courts in Canada. For smaller issues, allow local offices to enforce regulations by providing them with the legislative authority to do so. For those issues that are too large in scale for local offices, use a national enforcement authority of some kind. This would help to efficiently use the resources available as national enforcement authorities would not be wasting time on issues that are manageable by local authorities. In addition, local offices are in the best position to provide an initial response to violations of securities law.

The Expert Panel on Securities Regulations proposed a specific approach for enforcement of regulations. In order to maintain fairness in regulatory matters, the Panel proposed the establishment of an independent adjudicative tribunal.[70] Their beliefs are that this would reduce any concern over fairness, especially across provinces, by maintaining independence and impartiality.[71] This is a concern because the current provincial securities commissions conduct regulatory, adjudicative, and enforcement functions and thus there is no separation between the regulators and adjudicators.[72] In addition, the Panel believes that a national

[69] *Ibid*., p. 94.
[70] Expert Panel (2009) p. 2.
[71] *Ibid*., p. 29.
[72] *Ibid*.

tribunal would provide greater consistency in decisions and would promote investor protection and economic efficiency.[73] To be specific:

> "We [the Panel] recommend the establishment of an independent adjudicative tribunal. However, we believe that the securities regulator should retain jurisdiction over certain decisions, such as discretionary exemptions from securities regulations and rules, as well as matters regarding contested takeover bids. The securities regulator has the policy expertise and the quick response capability to properly address these matters in a more timely fashion, which in our opinion outweigh the benefits of referring these decisions to an independent tribunal."[74]

Similarly, the International Organization of Securities Commissions (IOSCO) has suggested that protection of investors is essential. IOSCO has created very clear and authoritative principles of securities regulation, and they have stated that the protection of investors is one of the three IOSCO core objectives of securities regulation.[75] Their recommendation is that "Investors should have access to a neutral mechanism (such as courts of other mechanisms of dispute resolution) or means of redress and compensation for improper behavior."[76] I would argue that the independent adjudicative tribunal suggested by the Expert Panel would fit the recommendation of IOSCO as it could be considered a neutral mechanism due to its separation from the regulatory body.

My initial criticism returns to the point made by Suret and Carpentier, such that relying on a national tribunal would be more costly than it would be efficient. However, if the new system established local offices and gave

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[73] *Ibid.*, p. 30.
[74] *Ibid.*, p. 30.
[75] IOSCO (2011) p. 11.
[76] *Ibid.*

adequate authority to these offices, then it is possible that some issues would not need to be referred to the tribunal. A difficult issue that would face the architects of a new regulatory system would be determining the level of power to give to local offices and therefore the amount cases referred to the tribunal.

In addition to the suggested tribunal, the Panel reports that stakeholders believe the scope of enforcement activities is insufficient to deter wrongdoing. Ultimately, the action that is taken is often ineffective at prosecuting those wrongdoers.[77] As discussed in following sections, the Panel reports that economic studies have shown that the cost of equity is higher in countries where investors receive less protection. In accordance with this, "[Flaherty] has pointed out that Canada is the only major industrialized country without a single regulator, increasing costs to businesses seeking to raise money in Canada and making enforcement and prosecution of fraud more difficult."[78] The Panel argues that the establishment of a national securities regulator would better align and lead to improved cooperation with federal and international criminal enforcement authorities.[79] The goal would be to improve enforcement and reduce the cost of equity for Canadian investors. In addition, as discussed, improved cost of equity and better investor protection and enforcement would entice foreign investment due to improving assurance and confidence in Canadian markets.

[77] Expert Panel (2009) p. 51.
[78] Canadian Press (2013).
[79] Expert Panel (2009) p. 52.

An additional perspective comes from a recommendation provided by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank"). This legislation suggested that one way to improve investor protection was to encourage whistleblowers. To be specific, the legislation created a program within the SEC to "…encourage people to report securities violations, creating rewards of up to 30% of funds recovered for information provided."[80] I would argue that a reward system would be one of the most effective incentive tools as this would allow those within the industry to help regulators monitor for illegal activity. In addition, this may help to provide a perspective that is unique and unattainable by the enforcement agencies. The question, then, is whether the current structure of securities regulation in Canada would be able to implement a system similar to this. One could argue that a national regulator would have the resources to provide necessary compensation compared to the smaller provincial regulators. In addition, it is very possible that any illegal activity would be interprovincial rather than intraprovincial. If this were the case, it would be easier to report to a single regulator rather than trying to coordinate the efforts of multiple regulators. With this in mind, I believe a single regulator would be more able to encourage whistleblowers.

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[80] Dodd-Frank Summary (2010) p. 13.

Section 6: Systemic Risk, Efficiency, and Shadow Banking

To understand the issue of systemic risk in the Canadian capital markets, it is important to establish the meaning and the nature of systemic risk. As stated by the Supreme Court, systemic risk can be defined as risks "…that occasion a 'domino effect' whereby the risk of default by one market participant will impact the ability of others to fulfill their legal obligations."[81] In addition, systemic risk has been defined as:

> "…the risk that the failure of one participant in a transfer system, or in financial markets generally, to meet its required obligations will cause other participants or financial institutions to be unable to meet their obligations (including settlement obligations in a transfer system) when due. Such a failure may cause significant liquidity or credit problems and, as a result, might threaten the stability of financial markets."[82]

Upon hearing expert evidence from Canada in the proposal of the *Securities Act*, the Court suggests that the issue of systemic risk is present, ill-suited to local legislation, and may need to be addressed through the eventual implementation of a national regulator.[83] The Court summarizes their views by stating: "Prevention of systemic risk may trigger the need for a national regulator empowered to issue orders that are valid throughout Canada and impose common standards, under which provincial governments can work to ensure that their market will not transmit any disturbance across Canada or elsewhere."[84] I believe that this is an interesting point, considering the fact that the ability of provinces to respond to issues of systemic risk is not clear. I would argue that regardless of the provinces'

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[81] Securities Act (2011) para. 103.
[82] Carpentier (2010) p. 106.
[83] Securities Act (2011) para. 104.
[84] *Ibid*.

abilities, a system under a national regulator would be better equipped to handle these issues. The Expert Panel on Securities regulation outlines that the key components to reducing systemic risk are through increased monitoring, coordination, and crisis management.[85] A national regulator would be more capable at providing these components than any of the individual provinces or a combined effort of the provinces.[86] I would also suggest that components such as financial resource and clear leadership would be essential to handling these issues.

It appears clear that Flaherty will make a change to ensure systemic risks are reduced, with or without the agreement of the provinces. In fact:

> "…if a 'timely agreement' cannot be reached, [the government] would go ahead with legislation dealing with areas of jurisdiction as defined by the [Supreme Court]. 'This will include the capacity to monitor, prevent, and respond to systemic risks emerging from capital markets'…"[87]

To understand the seemingly rushed desire for change, it is important to understand what can happen in negative situations. The Expert Panel on Securities Regulation outlines two instances where Canada's current regulatory structure lagged behind other nations in their response.[88] In September of 2008, the U.S. and U.K. restricted the short-selling of certain stock as a temporary stability measure. Though Canada's response lagged behind, what was even worse was that the response was not uniform across provinces. This example was used to show the lack of coordination between provinces in the current system, a concern for many when considering the

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[85] Expert Panel (2009) p. 11.
[86] Securities Act (2011) para. 120, 121.
[87] Canadian Press (2013).
[88] Expert Panel (2009) p. 40.

possibility of systemic risk. A second example provided was the crash of the Asset-Backed Commercial Paper market. The lack of a quick response caused the Panel to conclude "…the fragmented securities regulatory structure is prone to foster slow securities regulatory responses, which makes Canada vulnerable to market and reputational risks."[89]

One group of supporters for the change to a national regulator is the Canadian Bankers Association (CBA). The CBA is a well-established business association whose members have been described as dominating the securities industry.[90] The CBA has argued that the current provincial system is extremely inefficient and has created unnecessary duplication and complexity.[91] In my opinion, I am not certain a national regulation scheme would necessarily reduce the complexity of the scheme itself. In one sense, the design of the scheme would likely be more complex due to the sheer amount of coordination and coverage of the regulator. In addition, while one of the goals of the national scheme is to make the process easier on firms and investors, there are other factors that must be maintained. A new system cannot be less complex if it means losing or decreasing the quality of features such as investor protection. It will not garner much support if the presence of favouritism or unfair treatment across markets and across provinces and territories is a result of decreased complexity.

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[89] *Ibid*.
[90] Greenwood (2012).
[91] Canadian Bankers Association (2011).

I believe that one of their stronger arguments revolves around the threat of systemic risk. This is explained in a statement from their website:

> "Since 2007, international financial developments have changed the financial landscape substantially. It is now clear that financial risks move easily and quickly between capital markets and financial markets. This means that the regulatory system governing the capital markets in Canada needs to be focused, with efficient and timely coordination of efforts between capital and financial market regulators. In Canada, this coordination is more difficult because we have 13 different securities regulators."[92]

Examining this issue in more detail, the focus is that the current scheme of multiple securities regulators inevitably creates an inefficient structure when it comes to coordination. As has been mentioned earlier in this paper, one viewpoint is that "The regulatory morass leads to endless chatter when swift policy action is required (as in the 2007 asset-backed commercial paper crisis)."[93] I understand that certain provinces and territories may want to maintain their autonomy when it comes to regulating the securities industry. However, I agree with the above statements and conclude that an inevitable trade-off will occur. In comparison to a system under a national regulator, provinces are poorly equipped at handling issues, including systemic risks, which may effect multiple jurisdictions simultaneously or may spread from one to another quickly. The CBA follows up their beliefs with a good summary of this issue, stating:

> "The international financial market turbulence in recent years has highlighted the need for regulators, including securities regulators, to have a structure to deal quickly and effectively with systemic risk, that is, risk that affects the financial system as a whole. The regulatory structure

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[92] *Ibid*.
[93] Cowan (2013).

> in Canada seems well suited for this in all respects except securities regulation."[94]

In addition to the belief that the current system is ill equipped to sufficiently deal with systemic risk, the CBA have argued that the inefficiency of the provincial system has negatively affected smaller firms. The CBA have argued that the current structure means that small issuers are facing higher costs as a result of having to register in multiple jurisdictions. While the CBA is invested in the state of securities regulation, not all researchers agree with their findings. As explained in a previous section, there have been studies that refute these beliefs and show that 60% of new listings involved no more than three securities commissions in Canada.[95] While this may go to show that the level of efficiency is difficult to measure, the CBA's proclamations on efficiency are not necessarily certain.

The Expert Panel on Securities Regulation agreed that a national regulator would be a better solution to the problem of systemic risk in comparison to the current regulatory structure. One of the more unique points made by the Panel is that the financial markets have developed and popularized new instruments such as collateralized debt obligations and credit default swaps. These new instruments are changing the way risk is transferred and thus pose a challenged for financial regulators.[96] This idea is mirrored in a speech presented to the International Council of Securities Associations. Paul Tucker, Deputy Governor for Financial Stability at the Bank of England, stated "…innovations can take a nasty turn in financial markets

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[94] Canadian Bankers Association (2011).
[95] Carpentier (2010) p. 9.
[96] Expert Panel (2009) p. 5.

when they outgrow their supporting infrastructure."[97] The development of technology and financial instruments requires a mirrored development by securities regulators.

In consideration of the previous point, the Panel also reveals the idea that the banking industry and major financial institutions are overseen and coordinated under the national bodies of the Bank of Canada and the Office of the Superintendent of Financial Institutions. Both of these authorities have national mandates of financial stability, while in comparison there is no existing securities regulator with a specific mandate for reducing systemic risk.[98] The Expert Panel is of the belief that systemic risk is not simply a banking issue and has developed beyond the banking sector.[99] This change has occurred largely because it is easier to access capital directly from capital markets compared to banking institutions that have safeguards in place.[100] It appears to me that both of these issues are leaving Canadian capital markets susceptible and vulnerable to the possibility of systemic risk. What is important to note is that while each province and territory employs a securities regulator, there is no regulator to prevent systemic risk at a national level. Provincial regulators can only be expected to nurture markets within their own jurisdiction, meaning potential national issues are left unaddressed.

I believe that one interesting issue to examine is the possibility that the presence of systemic risks and the supposed inefficiency of the current system have

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[97] Tucker (2011) p. 6.
[98] Expert Panel (2009) p. 5.
[99] *Ibid.*, p. 11.
[100] *Ibid.*

influenced investors to move away from domestic markets and concentrate more on foreign markets. In a July 2012 publication by Statistics Canada, it was reported that Canadian investment in foreign securities has increased.[101] While it is difficult to attribute this information to a specific cause, and though it is possible this investment growth is simply due to a growing economy, the possibility of a shift in direction for domestic investors leads me to fear that Canada is not doing enough to encourage domestic securities investment.

Looking at the situation from a different perspective, the idea of a single agency has garnered attention from the Bank of Canada (BOC), an authority that attempts to pursue the best for the nation as a whole. In an article from one of the BOC's publications, the authors outline certain advantages and disadvantages of a single agency system. The authors believe that a single agency system would lead to efficiency gains for the country, through economies of scale and scope, reduced regulatory costs, the ability to allocate regulatory resources more efficiently, and lowered monitoring costs on firms.[102] In addition, the authors suggest a single agency would lead to greater transparency and accountability, as the regulatory structure is more clear and easier to understand. They also suggest that a single agency would improve monitoring, decrease inconsistency and duplication, and would reduce inequality.[103] While the Bank of Canada states that it is not directly involved in the debate,[104] they are clearly interested in the efficiency of the

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[101] Statistics Canada (2013).
[102] Fay (2004) p. 55, 56.
[103] *Ibid*., p. 56.
[104] *Ibid*., p. 53.

securities market.

The BOC also understands that there is another side to the debate; the article outlines that a single agency may come with negative side effects. In terms of efficiency, the BOC cites arguments that a single agency may not have a clear focus on objectives. As well, the regime adopted under a single regulator may be less efficient for some areas of Canada compared to others and thus the costs of compliance and the structural costs of regulation could actually increase.[105]

Overall, the arguments for either side do not appear to be certain. However, if one combines the concerns of the BOC with other opinions, an interesting perspective can be found. Mr. Tucker's speech to the International Council of Securities Associations focused on the need to pursue macroprudential regimes and financial stability. Financial stability was defined as when the "…financial system is sufficiently resilient that worries about the bad states of the world do not undermine confidence in the ability of the system to deliver its core services to the rest of the economy."[106] One of his points is that central banks play an important role in the interest of financial stability.[107] Along these lines, I would argue that cooperation between a central bank and securities regulators is best done through a single national regulator. As has been stated, Canada has a very centralized banking sector. I believe that a centralized banking sector would communicate best with a central regulator rather than a fragmented system of regulation. While this point is

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[105] *Ibid.*, p. 56.
[106] Tucker (2011) p. 1.
[107] *Ibid.*, p. 2.

not certain, I believe this argument becomes even more prevalent due to the concern over the effects of shadow banking.

Mr. Tucker defines shadow banking as "…non-bank firms or structures that replicate the monetary and/or credit services of banks in some way, involving maturity transformation and/or leverage."[108] A large theme of his speech is that the financial regulators in Canada need to do a better job at monitoring and understanding the shadow banking industry. In particular, he believes that securities regulators, bank supervisors, and other macroprudential authorities should be working closely together in order to accomplish this. While it is true that Mr. Tucker's speech is based on his experience in England, I believe the lessons can be applied to Canada. We have a very centralized banking sector combined with a fragmented securities regulation sector. If Canada wishes to protect against instability caused by shadow banking, it would make sense that these two parties work closely together.

I believe it would be more difficult for the necessary parties to coordinate monitoring shadow banking under the current structure, as shadow banking firms may be interprovincial or international in nature. As a result, it would be difficult for securities regulators in British Columbia to understand the extent of the shadow banking industry beyond their province. Therefore, having a single regulator cooperating with a centralized banking industry would theoretically provide the best opportunity for pursuing financial stability and particularly for monitoring the

[108] *Ibid.*, p. 9.

shadow banking industry. In contrast, if Canada was not willing to move to a single regulator, there are still actions that can be taken to improve stability in terms of the shadow banking industry. As explained by Mr. Tucker, securities regulators should either pass the responsibility of supervising the shadow banks to the banking supervisors or should be vigilant in maintaining a regime to minimize systemic risk.[109] My translation of this idea for Canada is that Canada's decision to keep the current structure should result in passing some responsibility of seeking financial stability on to the central banks and bank supervisors. The fragmented structure of securities regulation does not appear to be ideal for supervising the shadow banking industry as the industry simply goes beyond the jurisdiction of any individual provincial regulator. If the regulators are willing to work with the central banks, this may result in a shift towards increased stability and an attitude of minimizing systemic risk.

Taking a different perspective on minimizing systemic risk, the recent implementation of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* provided some recommendations that can be applied to Canada's financial industry. The Dodd-Frank suggests two main ways to reduce risks posed by securities. The first is to create a situation of "skin in the game," where companies that sell products must retain a certain portion of the credit risk unless the underlying loans meet certain standards. This would ensure that companies that package and sell investments would lose when the buyers lose out as well,[110] thus creating an

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[109] *Ibid.*, p. 10.
[110] Dodd-Frank Summary (2010) p. 14.

incentive for higher product standards. In addition, the Dodd-Frank suggests that increasing requirements for disclosure would reduce risk. This would entail requiring issuers to "…disclose more information about the underlying assets and to analyze the quality of underlying assets."[111] I believe that, in principle, these two suggestions would decrease systemic risk in Canada's securities market. In light of the recent financial crisis, which is essentially the reason for the creation of the Dodd-Frank, better disclosure would help to reduce the possibility of crises of illiquidity.

Overall, I would suggest that these recommendations would help to promote stability across capital markets. My initial belief is that a national regulator would be more able to create an environment of "skin in the game" and enforce requirements of better disclosure than provincial regulators. The reason for this belief is that a national regulator would be able to set uniform rules and standards much more proficiently than a provincial regulator. I believe that the only way disclosure requirements could properly be enforced is if they are uniform in every province, such that interprovincial companies are always abiding by the same rules. The same theory is true for any rules used to create a "skin in the game" scenario. While it is possible that the provinces could coordinate in order to set uniform requirements, I believe this only goes to show the weakness of a fragmented structure. It is possible under a provincial system to achieve uniform cooperation, however my argument is that this is best accomplished through a national regulator.

[111] *Ibid*., p. 14.

One of the major authorities on securities regulation is the International Organization of Securities Commissions (IOSCO). IOSCO has produced a set of principles of securities regulation that they believe are essential for a regulator to pursue the proper objectives. An interesting development has occurred where IOSCO's principles have been revised to include reducing systemic risk as one of the three main objectives of security regulation.[112] This change has been described as a big innovation, "…but it needs to be incorporated into national regimes and practices."[113] The above arguments lead me to believe that a national regulator would be more effective at instituting regimes and practices aimed at reducing systemic risk. While it is true that provinces can try to reduce systemic risk within their jurisdictions, I would argue that the scope of systemic risk has moved beyond the provincial level and needs to be addressed at the national level.

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[112] IOSCO (2011) p. 11.
[113] Tucker (2011) p. 4.

Section 7: Foreign Investors and Canada's Foreign Influence

One of the most important factors for the growth of Canada's economy is its role in global markets and fostering interest from foreign investors. To provide an example of the importance of foreign investors, Statistics Canada reported that non-resident investors divested $7.8 billion of Canadian securities in June of 2012.[114] As mentioned previously, the Canadian Bankers Association has been strongly in favour of the change to a national regulator. The CBA has argued that the current system does not provide Canada with a clear national voice and is out of step with other countries on the international stage. The CBA stated the following on their website:

> "The global financial crisis has shown more than ever that Canada needs to have an effective national voice when international bodies are developing securities regulation. Having 13 different securities regulators limits our effectiveness in influencing global standards governing capital markets. Further, foreign regulators have expressed concern about which group to contact when dealing with Canadian issues. While provincial securities regulators can perhaps be Canada's ear on the international stage, there is nobody that is Canada's voice."[115]

Not only does this mean that Canada is less influential in policy decisions and initiatives on a global scale, but the fact that foreign regulators are unsure which regulator to approach means that foreign investors must be confused as well. An argument can be made to suggest that a national regulator would entice foreign investors more than under the current system because the system appears less complicated. As well, any potential issues would go through a single regulator rather than many and this would help to reduce concerns over insufficient investor

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[114] Statistics Canada (2013).
[115] Canadian Bankers Association (2011).

protection. It is possible that foreign investors have less confidence in the current Canadian system due to the fact that interprovincial regulation appears confusing, time-consuming, costly, and potentially risky if problems arise.

Canada's capital markets rely on foreign relations more than other countries due to the nature of Canada's securities landscape. Canada's capital markets have a significant portion of reliance on their closest partner, the United States. This is because Canada has been proclaimed as the country with the largest number of companies listed in a foreign market.[116] This piece of information can be used in support of and against the choice to move to a national regulator. One could argue that having such a high portion of listings in foreign markets means that a national regulator is the best choice. This is because a national regulator would have the authority and resources to properly supervise the cross-listed companies and their well being. In contrast, some researchers have argued that these cross-listed companies are subject to regulatory authorities outside of Canada, such as the SEC. As a result, there is no need for a change in the regulation scheme since regulation of these companies does not fall under Canada's responsibilities.[117] In general, these cross-listed companies are very large, making up a small percentage of the total number of companies but a large percentage of total market capitalization in Canada.[118] Therefore, while one could argue that the motivation to change the current system is to help regulate larger companies, 26 of the 34 largest companies

[116] Carpentier (2010) p. 43.
[117] *Ibid*., p. 43.
[118] *Ibid*.

in Canada are cross-listed and subject to the SEC.[119] Policy makers must determine whether the responsibility of regulators to oversee these large companies warrant a system overhaul.

The members of the aforementioned Expert Panel believe that the establishment of a single regulator, titled the Canadian Securities Commission (CSC), would create an environment that improves Canada's standing from a foreign perspective. The Panel argues that the CSC would "…foster the development of a strong international division, which would represent Canada in multilateral forums and in bilateral relations with other national securities regulators."[120] In addition, the CSC would have the ability and resources to compensate investors in cases of violations of securities law, something that may be of concern to foreign investors.

Another issue the Panel wants remedied is that the fragmented structure of the current securities regulation scheme weakens Canada's otherwise strong federal leadership over the financial sector. In their opinion, a new structure under the CSC would strengthen the reputation of Canadian capital markets at an international level. In addition, "a single, streamlined regulatory approach would make Canada's capital markets more attractive to foreign issuers and investors."[121] I believe that it is hard to refute the fact that a single national regulator would improve the strength and attractiveness of Canada's capital markets from a foreign perspective. I also believe that Canada's national voice on securities regulation would gain more respect if it were coming from a single regulator. However, this paper has shown

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[119] *Ibid*., p. 44.
[120] Expert Panel (2009) p. 42.
[121] *Ibid*., p. 48.

that Canada’s situation is unique from many other foreign nations.

Section 8: The Solution to a National Problem – Joint Cooperation

After extensive insight into the debate over a national regulator, it is important to review some possible solutions. One of the major issues revolves around the fact that individual provinces do not want to lose power or control such that securities regulation could not be customized to that specific province. This was evident in the geographical diversity section and in order for a solution to be found, I believe the only possible outcome is a scheme involving joint cooperation between the provinces and the national regulator. It seems that Parliament is aware that joint cooperation is necessary as the original proposal of the Act included an opt-in system that would allow provinces the choice of participation.

One of the most informative sources of information comes from the judgment of the Supreme Court after ruling the Act was unconstitutional. The Court holds the position that a change is seemingly incoming, as the recent efforts to streamline regulation demonstrate the movement in this direction. The Court refers to examples of streamlining which include the recent implementation of the Passport System. As the Court describes, the system is "…based on harmonized rules that allow issuers and market intermediaries to engage in activities in multiple jurisdictions while dealing with a single principal regulator."[122]

In the concluding sections of the judgment, the Court stated the belief that a cooperative approach that recognizes the provincial nature of securities regulation and allows Parliament to address national concerns is possible.[123] Arguments have been made against a system of regulation that gives significant power to both

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[122] Securities Act (2011) para. 42.
[123] *Ibid*., para. 130.

provinces and a national regulator. One such view is that it would be inappropriate to leave regulation of matters within a province to a provincial body and regulation of interprovincial or international matters to a national body.[124] This is because Canada's capital markets are naturally integrated and thus separating the regulatory bodies based on where the matters are deemed to be located may become extremely complicated. In addition, I would suggest that separating the regulatory bodies in this way would mean a failure to properly address issues of systemic risk. Just because matters of regulation seem to be within a province does not mean issues of risk or instability could not quickly spread to other provinces or to the international level. A crisis in a smaller market will likely spread to larger markets and this can occur extremely quickly. Therefore, I do not think a system that divides jurisdiction of a regulatory body based on the type of matters being regulated is the best choice as a solution. I think a different system of cooperation between provinces and Parliament could be created that would decrease systemic risk more effectively.

When looking for a joint cooperation solution, one idea is to look to a similar framework of regulation that currently exists and use this model as a foundation. One comparative framework that has been suggested as an example is the Canadian Pension Plan Investment Board (CPPIB).[125] The CPPIB was formed as a combined effort between federal and provincial Finance Ministers and was formulated to invest the funds of the CPP to help ensure long-term sustainability and even

[124] *Ibid.*, para. 23.
[125] Hockin (2012).

growth.[126] The reason that the CPPIB is a great comparative example is because it is a Board that operates within subject matter that is both provincial and federal by nature. As a result, the CPPIB was designed to represent and coordinate the provinces, territories, and federal government. This situation is very similar to the issue of implementing a national securities regulator.

The head of the CCPIB as a whole is the Board of Directors. As explained on the CPPIB website, "Directors are appointed by the federal Finance Minister in consultation with the participating provinces, and with the assistance of a nominating committee."[127] This aspect of the Board would likely prove practical if Parliament mirrored this policy in its national regulator scheme. Looking further into this structure:

> "The chair of the nominating committee is federally appointed, and each participating provincial government appoints one representative. The nominating committee recommends candidates for appointment and re-appointment to the federal Finance Minister. In turn, the federal Finance Minister makes the appointments in consultation with the provincial Finance Ministers."[128]

This policy clearly demonstrates a willingness to cooperate between the federal and provincial parties. My view is that governance is important to a legislative initiative as it will dictate the effectiveness of the initiative's purpose, the direction of the initiative, and thus will oversee changes to the initiative. If a similar structure of governance were applied to the national securities regulation scheme, this would encourage provinces to participate in the opt-in structure. If provinces and

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[126] CPPIB (2013).
[127] *Ibid*.
[128] *Ibid*.

territories are assured of their influence through consultation then it may help to eradicate concerns and fears.

In addition to the factors listed above, another interesting aspect of the CPPIB is that the federal and provincial Finance Ministers review the CPP and CPPIB every three years.[129] I believe this policy would be beneficial to a national securities regulation scheme, as it would provide provinces and territories the opportunity to vocalize their concerns and propose changes accordingly. If the argument is being made by Parliament that the securities industry has grown beyond the scope of provincial regulation, I can infer that Parliament believes the securities industry changes over time. This means that the new system should include a policy that dictates when to review the scheme and allow for any necessary changes to be made. I would suggest that, similar to the CPPIB, this review should occur every three to five years. This recommendation is based on the fact that three to five years should be sufficient time to see changes occur within the industry without being wasteful or redundant by reviewing too often.

Along similar lines, the CPPIB holds biennial public meetings "…in each participating province during which Canadians and stakeholder groups can ask questions of [the CPPIB's] Chair and CEO."[130] I believe that some of the hesitation of provinces that fought against the Act was the result of the desire to protect larger companies and firms within their jurisdiction. As discussed in the earlier sections, firms in different markets face different challenges and are thus concerned for their well being as a result of possible changes under a national regulator. Firms in

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[129] *Ibid*.
[130] *Ibid*.

Alberta that focus on oil and gas industries do not necessarily face the same challenges as firms in Toronto which focus on banking and other markets. I believe that Canada should utilize a policy similar to the CPPIB that allows major firms within provinces to approach the national regulator with concerns and suggestions for improvement. This could encourage the provinces that are against a national regulator to choose to opt-in and help to alleviate their concerns. Furthermore, the CPPIB ensures that a Special Examination report of their records, systems, and practices is conducted every six years.[131] Most recently, this report was conducted by an outside auditing and accounting company to guarantee an expert assessment occurs.[132] One possibility that I believe could be beneficial for encouraging the change to a national regulator is allowing the provinces to coordinate and conduct a Special Examination of the national regulator's policies, systems, and practices. I do not believe this should occur too often, as it would be inefficient, but having a similar policy to the CPPIB in place would once again help to encourage provincial and territorial participation in the national regulation scheme.

If Parliament wishes to create and implement a new scheme of national regulation, there is a possibility that it would include an opt-in system in its initial state. There is also the possibility that not all provinces and territories would participate. The Supreme Court discussed this possibility and relayed the views of the Crawford Panel,[133] a body established by Ontario to discuss and endorse the adoption of a single Canadian securities regulator. The Crawford Panel is of the

[131] *Ibid*.
[132] *Ibid*.
[133] Crawford Panel (2006).

belief that it would not be necessary that all provinces and territories participate in order for the new system to be successful. Instead, the Crawford Panel suggested that it is more important that "…there be an initial core group of Participating Jurisdictions that agrees to enact…common legislation that establishes the [single regulator] and delegates to it authority over capital markets regulation."[134]

I agree with the Crawford Panel that uniform participation is not necessary. The Court has made it clear that the power to regulate cannot be stripped or taken from the provinces or territories. As a result, the opt-in feature appears to be the best strategy to remain consistent with this ruling. Once the system is established, I believe that the provinces and territories that do not wish to participate will see that their decision has lead to a disadvantage. If there is a core group of participators then regulation will be streamlined throughout these jurisdictions. A successful implementation of a new system will hopefully result in increased investor protection, increased efficiency, and reduced systemic risk. These features will likely encourage and increase investment due to higher investor confidence and one would think that an investor would be more willing to participate in a market that includes these features. This means that the non-participants could be missing out on a growing market and as a result this will create incentive to opt-in to the new scheme. It is obvious that the goal should be unanimous participation. However, in a situation where there is resistance to change and the transition is difficult, I would suggest that the best solution is to create an opt-in system that would create incentive for non-participants to join over time.

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[134] Securities Act (2011) para. 25.

One of the dangers I foresee with implementing the solution described above is the possibility of non-participants attempting to bargain or make demands in order to obtain their participation. For example, provinces that have argued against a national regulator, such as Quebec or Alberta, may demand that certain features be included in the new system before agreeing to their participation. If Parliament agrees to any of the non-participants' demands, this could result in disadvantages to those provinces that immediately agreed to join. In addition, if Parliament acknowledges any of these demands, it would only encourage other provinces to attempt their own negotiations. As a result of these concerns, I would recommend that the opt-in system should be designed in order to avoid opportunities for negotiation. I believe there are a few possible ways of accomplishing this. Parliament could create a system such that there are certain responsibilities left to the Provinces in terms of regulation. This is a very fine line as it is essential to avoid a national system that actually functions like the provincial system that is currently in place. Possible responsibilities could include issues like regulation enforcement or provincial representatives acting on behalf of the national office, as described through the idea of implementing local offices. If certain responsibilities were left to the provinces, this would allow Parliament to try to satisfy those provinces that are not willing or are hesitant to join the national system, as they would retain some sense of independence. Another possibility is that Parliament could design a scheme that leaves zero room for negotiation.

Regardless of the provinces' challenge against the change to a national regulator, it appears this change will be forthcoming in the near future. One of the

highlights of the 2013 Canadian Budget is incoming legislation to solve this problem. This legislation will be in accordance with the decision of the Supreme Court in reference to the proposed *Securities Act* and the goal is to carry out the government's responsibilities for capital markets. This legislation will move forward "…if a timely agreement cannot be reached with provinces and territories on a common securities regulator."[135]

[135] Budget in Brief (2013) p. 21.

Section 9: Conclusion

While there does not seem to be much guaranteed knowledge regarding the transition to a national regulator at this point, Ottawa has made it clear that some sort of solution is forthcoming. The Supreme Court ruling on the *Securities Act* outlined what areas of jurisdiction belonged to Parliament. These areas include "…matters of national importance and scope, including preventing systemic risks in the financial system."[136] As a result of this, Ottawa seems to have decided that making some sort of change is necessary and does not feel that waiting for uniform agreement from the provinces and territories is necessary. If an agreement is not made in the near future, Ottawa will move forward with legislation that covers areas of its jurisdiction as approved by the Supreme Court. As stated in the 2013 Budget:

> "This will include the capacity to monitor, prevent, and respond to systemic risks emerging from capital markets. A federal capital markets regulatory framework would be applied consistently on a national basis and would not displace provincial securities commissions, which would still manage the day-to-day regulation of securities activities."[137]

In consideration of the geographical diversity issue and the desire of the provinces to maintain some autonomy, I have concluded that it would be most beneficial to implement local offices in the major capital markets in Canada. I believe that the best outcome would be to have them work under the supervision and direction of the national regulator. Local offices would be essential if a national regulation system were to maintain adequate levels of local market service. As determined in this essay, the diversity of markets in Canada may create detrimental effects when moving to a national regulator. If Parliament were to meet this

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[136] Canadian Press (2013).
[137] Budget 2013 p. 143.

challenge with a policy initiative then I believe the implementation of local offices is the best option. This would also help to improve the issue of protection of investors and enforcement of regulations. Local offices would foster investor protection and fraud prevention as "…proximity to individual investors puts [a source of authority] in the best position, among all law enforcement officials, to deal aggressively with securities law violations."[138]

In addition to local offices, I believe that the recommendation for uniform performance measures would aid in minimizing the effects of geographical diversity. This would allow a national regulator to aim to provide adequate service to all markets and would set clear objectives. While the different markets are unique in their content, uniform performance measures would help to ensure that no particular market is suffering as a result of the change in regulation systems.

In terms of improving investor protection and enforcement of regulations, I believe that the recommendation for an independent adjudicative tribunal is a strong policy option. As discussed in this essay, this recommendation is similar to the suggestion by IOSCO that outlines the importance of a neutral mechanism in order to solve conflicts. My personal recommendation would be to implement a system similar to that of Canadian courts, such that local authorities handle smaller issues and larger issues are referred to a single, larger authority. The key point would be to separate the adjudicative function from the regulatory body, as neutrality is essential to ensure fairness. I would also suggest that Canada should try to adopt a

[138] Carpentier (2010) p. 93.

whistleblower program similar to that suggested by the Dodd-Frank. This would create incentive for market participants to monitor others and would create apprehension in those considering illegal activity.

Finally, I believe that the main cause for concern currently facing the securities market is the presence of systemic risk and the role of shadow banking. I believe that it is essential for Canada to undertake steps to reduce systemic risk and implement a body with the mandate to pursue financial stability. My ultimate conclusion is that some form of a national regulatory body is the best option for Canada. A national body would promote the most efficient coordination between the Bank of Canada and the Office of the Superintendent of Financial Institutions. In addition, a national body has the ability to coordinate the economy at a national level. I believe this is significantly more advantageous than trying to coordinate individual provinces in a timely manner. As well, I believe that Canada's best method of monitoring the shadow banking industry is through a national securities regulator. My belief is that it is best for the nation if Parliament is successful in their attempt to create a body with enough authority to monitor the shadow banking industry. If they fail to do so, I believe it is imperative that some responsibility to monitor is passed to the Bank of Canada and other financial authorities.

This paper has shown that there is no obvious solution for Canada's securities regulation. Regardless of the system, there are costs and benefits that must be weighed against each other. This paper has allowed me to

conclude that the benefits of a national regulation system outweigh the costs, and the costs of the current system are too high to leave the system untouched.

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Appendix A
Canada's Securities Regulatory System
Expert Panel (2009) p. 73.