

The Cooperative Capital Markets Regulatory System: An Evaluation of Canada's new
Financial Markets Regulatory Framework

by

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1 Glossary

Authority: The Capital Markets Regulatory Authority, also abbreviated as the CMRA. The Authority is the regulatory division of the CCMRS.

CCMRS: The Cooperative Capital Markets Regulatory System.

CMA: The Capital Markets Act.

CMSA: The Capital Markets Stability Act.

Council of Ministers: A council consisting of the Canadian Minister of Finance, as well as the ministers from each participating jurisdiction who are responsible for capital markets. The Council of Ministers oversees the CCMRS.

Executive Committee: the executive of the CMRA, consisting of the Chief Regulator and the Deputy Regulators.

Market Participants: Used as a broad term for participants in the financial system, including, but not limited to trading facilities, clearing houses, credit rating organizations, and capital market intermediaries.

Macroprudential policy: policies that deal with issues of systemic risk.

Memorandum of Agreement: *Memorandum of Agreement Regarding the Cooperative Capital Markets Regulatory System*. Generally referring to the most recent version, last amended in April of 2015.

Microprudential policy: policies that deal with issues of risk relating to individual institutions.

Systemic Risk: A threat to the stability or integrity of Canada's financial system that originates in, is transmitted through, or impairs capital markets and that has the potential to have an adverse effect on the Canadian economy.¹

¹ Definition taken from Cooperative Capital Markets Regulatory System, "Capital Markets Stability Act – Draft for Consultation," 11.

2 Introduction

Discussions relating to an optimal framework for regulating Canadian capital markets have taken place since at least the late 1970s.² Currently, Canadian securities regulation is fragmented; thirteen distinct provincial and territorial securities regulators attempt to collaborate under the umbrella of the Canadian Securities Administrators. The current Passport System, which allows provincial securities regulators to recognize each other's rulings, is a first attempt at collaboration, but the regulatory burden on national-level market participants remains high.

Recently, multiple reports by both international and domestic bodies have suggested the need for a federal capital markets regulator.³ In particular, the Expert Panel on Securities Regulation, established by the federal government and consisting of numerous industry experts, strongly recommends establishing a federal authority for capital markets. They cite reduced transaction costs, increased coordination with international bodies, and quicker reactions to systemic risks as reasons for establishing a central authority.

In response to these concerns there has been a concerted effort to establish a central regulatory body. In 2011, the Supreme Court of Canada found that a

² Phillip Anisman, *Proposals for a Securities Market Law for Canada* (Ottawa: Consumer and Corporate Affairs, 1970).

³ International Monetary Fund, "Canada: Financial Sector Assessment Program - Detailed Assessment of the Level of Implementation of the IOSCO Principles and Objectives of Securities Regulation." Washington D.C.: IMF Publication Services, 2008; Financial Stability Board, "Peer Review of Canada - Review Report." Washington, D.C.: IMF Publication Services, 2012; Hockin, et al., "Final Report and Recommendations." Ottawa, ON: Department of Finance Canada, 2009; David Longworth, "Strengths and Weaknesses of Canadian Financial Regulation Before and After the Global Financial Crisis," *Journal of Banking Regulation*, 2014.

proposed framework, the *Canadian Securities Act*, was unconstitutional.⁴ The Court recognized that while some aspects of capital markets are best dealt with at the federal level, the federal government was attempting to regulate matters that fell under provincial jurisdiction.⁵

To overcome the constitutional issues raised by the Court, the Canadian government has attempted to collaborate with its provincial counterparts. In September of 2013, the governments of Canada, Ontario, and British Columbia announced an agreement to create the Cooperative Capital Markets Regulatory System (CCMRS).⁶ Subsequently, the provinces of Saskatchewan, New Brunswick, and Prince Edward Island, and the Yukon Territory, also signed the agreement.⁷ Under the proposed legislation, each province voluntarily cedes some of its control over capital markets to a federal authority in order to overcome the issues raised by the Court. Consultation drafts of the legislation were released for comment in the fall of 2014, with a goal of implementing the legislation by the fall of 2016.⁸

The CCMRS is a framework for centralized regulation of Canadian capital markets, designed following extensive consultation between the participating

⁴ Nigel Campbell and Doug McLeod, "Supreme Court Finds Against National Securities Regulator," *Blake, Cassels & Graydon LLP*, last modified December 22, 2011,

<http://blakes.com/English/Resources/Bulletins/Pages/Details.aspx?BulletinID=1427>

⁵ Ryan Trimble, "An Examination of the Debate Surrounding the Implementation of A Canadian National Securities Regulator," (Masters Essay, Queen's University, 2013), 14.

⁶ Cooperative Capital Markets Regulatory System, "Agreement in Principle," last modified September 19, 2013, <http://ccmr-ocrmc.ca/wp-content/uploads/2014/04/CCMRWebSept19AIPPDF.pdf>

⁷ Cooperative Capital Markets Regulatory System, "Amended Agreement in Principle," last modified July 19, 2014, http://ccmr-ocrmc.ca/wp-content/uploads/AmendedAiP_July-9-2014.pdf;

Cooperative Capital Markets Regulatory System, "October 9 Press Release," last modified October 9, 2014, <http://ccmr-ocrmc.ca/wp-content/uploads/Oct-9-Press-Release-PEI-english.pdf>; Cooperative Capital Markets Regulatory System, "Memorandum of Agreement Regarding the Cooperative Capital Markets Regulatory System," last modified April 16, 2015, <http://ccmr-ocrmc.ca/wp-content/uploads/moa-04162015-en.pdf>

⁸ Cooperative Capital Markets Regulatory System, "Provincial Capital Markets Act: A Draft Legislation"; Cooperative Capital Markets Regulatory System, "Capital Markets Stability Act: Draft for Consultation"; CCMRS, "Memorandum of Agreement."

jurisdictions. It consists of: the Capital Markets Act (CMA), a uniform provincial and territorial legislation that will be passed in the legislature of each participating province; the Capital Markets Stability Act (CMSA), federal legislation that applies in all participating jurisdictions; and the Capital Markets Regulatory Authority (CMRA), which is responsible for administering both pieces of legislation.

This paper will explore macroprudential issues as they relate to the CCMRS. The bulk of the discussion will focus on the CMSA, as it is the component of the framework that is tasked with systemic issues. However, some components of the CMA will also be relevant.⁹

I will list eight principles for effective macroprudential regulation, an approach to financial regulation that focuses on mitigating systemic risk. One of the more compelling reasons for establishing a federal capital markets authority is the need for a regulatory body that can respond effectively to systemic risks. Following an explanation of these eight objectives, I will explore how well the CCMRS accomplishes each.

I find that the CCMRS satisfies, to varying degrees, each of the eight principles necessary for an optimal macroprudential policy framework. However, there are a number of areas that will require continued efforts by the Executive Committee of the CMRA.

This paper will also identify concerns relating to the implementation of the CCMRS. Given an approach to regulation that emphasizes supervision over rules,

⁹ For a more extensive treatment of the CMA, refer to Ray Power, "The Cooperative Capital Markets Regulatory System: An Analysis of its Potential Effects on Ontario," last modified April 15, 2015, <https://ca.linkedin.com/pub/ray-power/bb/844/a08>.

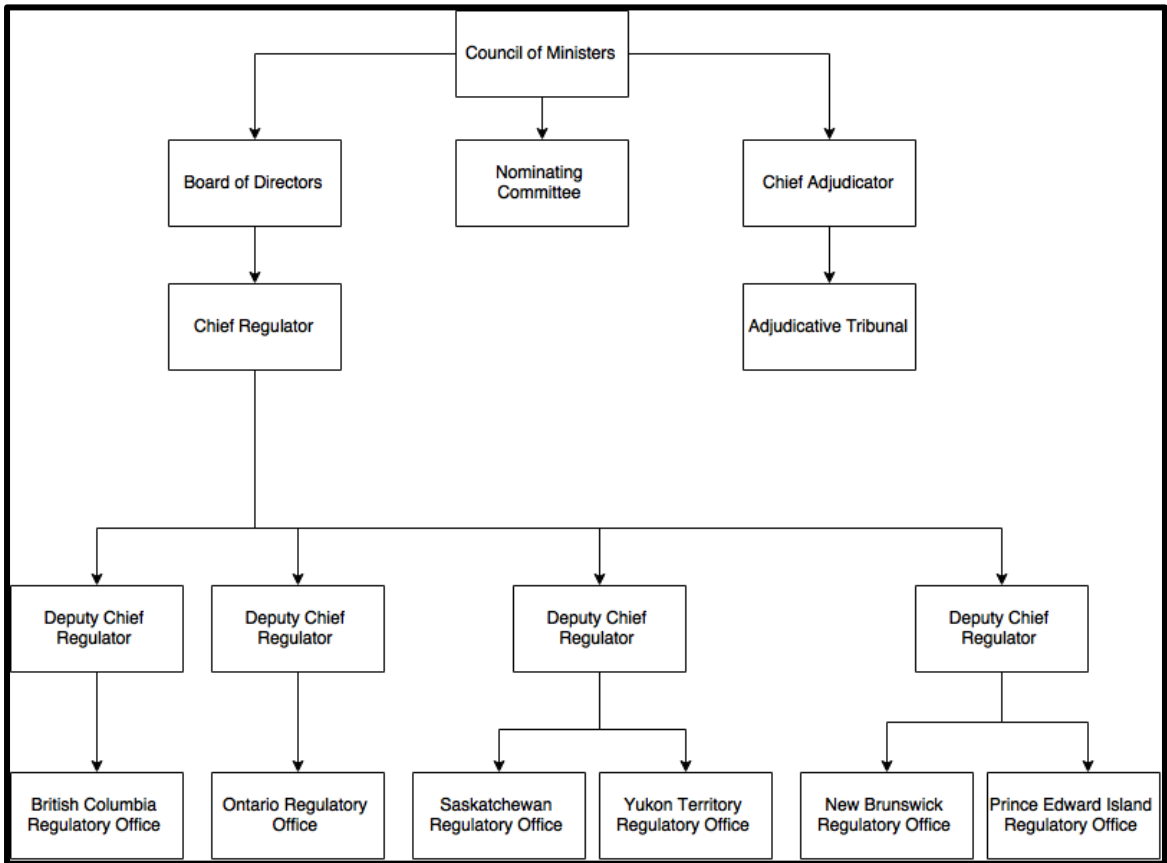
there are several objectives that those tasked with the difficult job of administering the CCMRS must keep in mind. Recommendations for both the Executive Committee of the CMRA and the Council of Ministers will be listed. In particular, establishing an effective dispute resolution mechanism, working towards a common financial language, and focused information-gathering efforts are areas that require the continued attention of the Executive Committee. Hiring the right personnel and increasing the number of participating jurisdictions are areas that require the continued efforts of the Council of Ministers.

In Section 3, I lay out the organizational structure of the CCMRS. A general understanding of this structure will be useful when discussing the implementation and administration of the CCMRS. Section 4 outlines the key components of the CMSA. In Section 5, eight principles for optimal macroprudential regulation are explained. In Section 6 I examine how well the CMSA, as well as the broader CCMRS, accomplishes these objectives. Section 7 offers recommendations for the CMRA's Executive Committee and the Council of Ministers; Section 8 concludes.

3 Structure of the Capital Markets Regulatory Authority

The structure of the Capital Markets Regulatory Authority is outlined below.¹⁰ The CMRA is an independent capital markets regulator with a regulatory division, overseen by the Board of Directors, and the Adjudicative Tribunal. Figure 1 illustrates the components of the CMRA.

Figure 1: Capital Markets Regulatory Authority – Organizational Structure



The CMRA will be overseen by the Council of Ministers, consisting of the Minister of Finance of Canada and the ministers responsible for capital markets

¹⁰ For a more detailed description, consult CCMRS, “Memorandum of Agreement.”

regulation from each participating provincial government.¹¹ The Nominating Committee, selected by members of the Council of Ministers to ensure broad geographical representation, is responsible for nominating candidates for both the Board of Directors and the Adjudicative Tribunal. The Council of Ministers vets these nominations, and also has final say on regulations proposed by the Board of Directors.¹²

The Board of Directors oversees the regulatory division of the CMRA, and will be responsible for “the policy, regulatory operatives, advisory services, and enforcement functions of the CMRA.”¹³ The Board also appoints a Chief Regulator, and gives final approval for the Chief Regulator’s choice of Deputy Regulators.¹⁴

Each participating province or territory will have a regulatory office led by a director and located in the provincial or territorial capital. The directors in turn answer to a Deputy Chief Regulator.¹⁵ The intent is that each office will continue to provide all of the services currently provided by the various provincial securities regulators. The Executive Committee, consisting of the Chief Regulator and the Deputy Chief Regulators, will help to ensure information sharing and integration between the various jurisdictions.

The Council of Ministers is also responsible for approving nominations to the Adjudicative Tribunal, which will conduct hearings across Canada in both official

¹¹ CCMRS, “Memorandum of Agreement,” 4.

¹² A politically independent nominating committee, consisting of a geographically representative group of qualified individuals, recommends appointees to the Board of Directors

¹³ CCMRS, “Memorandum of Agreement,” 9.

¹⁴ CCMRS, “Memorandum of Agreement,” 7.

¹⁵ For details surrounding the jurisdictions of the Deputy Chief Regulators, refer to CCMRS, “Memorandum of Agreement,” 10-11.

languages.¹⁶ Members of the Adjudicative Tribunal also serve on the Regulatory Policy Forum, along with the Chief Regulator and the Deputy Chief Regulators.¹⁷ The Regulatory Policy Forum will facilitate discussions surrounding significant policy issues.

¹⁶ CCMRS, "Memorandum of Agreement," 13.

¹⁷ CCMRS, "Memorandum of Agreement," 10.

4 Outlining the Capital Markets Stability Act

This section will outline the components and structure of the Capital Markets Stability Act. The purpose of the Act is: “to promote and protect the stability and integrity of Canada’s financial system through the management of systemic risk related to capital markets; and, to protect capital markets against the commission of financial crimes.”¹⁸ To that end, there are eight parts to the CMSA that I will summarize below.

Part 1 deals with information collection and disclosure.¹⁹ It gives the Authority the power to request that market participants both record a variety of information, and disclose that information to the Authority. The Authority is also given the right to disclose any information obtained from market participants to any governmental or regulatory authority, provided certain confidentiality conditions are satisfied.

Part 2 covers issues of systemic risk.²⁰ In particular, it gives the Authority the right to designate a market participant as systemically important if “the activities or material distress of the [market participant] or the failure of or disruption to its functioning could pose a systemic risk related to capital markets.”²¹ Once a market participant has been designated as systemically important, the Authority can prescribe any number of requirements, prohibitions, and restrictions. Before any of these prescriptions are enacted, the Council of Ministers must be notified and the

¹⁸ CCMRS, “Capital Markets Stability Act,” 11.

¹⁹ CCMRS, “Capital Markets Stability Act,” 12.

²⁰ CCMRS, “Capital Markets Stability Act,” 14-20

²¹ CCMRS, “Capital Markets Stability Act,” 14.

affected market participant(s) must be given an opportunity to make representations.

Part 2 also outlines the Authority's ability to issue urgent orders, which bypass the need for any consultation or permission from the Council of Ministers.²² Among other things, an urgent order can restrict a systemically important market participant from trading, restrict the trading of a security or derivative, or restrict trading on a trading facility. These urgent orders, which are initially issued for a period of no longer than 15 days, give the Authority the ability to react quickly to emerging risks.

Part 3 of the CMSA outlines administration and enforcement regulations.²³ It gives the Authority the ability to enter any building and examine, use, or seize any information relating to the Authority's mandate. It lays out the procedure for prescribing monetary penalties for non-criminal violations of the Act. It also allows the Authority, after a hearing, to issue an order that a market participant comply with any number of directives. These orders are similar in nature to those outlined in Part 2, but they apply to non-systemically important market participants. The powers of the Adjudicative Tribunal are also listed here.

In Parts 4 and 5, issues relating to general and criminal offences, respectively, are outlined.²⁴ Part 4 addresses liability and maximum monetary penalties for non-criminal offences. Part 5 lays out each possible criminal offence

²² CCMRS, "Capital Markets Stability Act," 20-21.

²³ CCMRS, "Capital Markets Stability Act," 21-29.

²⁴ CCMRS, "Capital Markets Stability Act," 29-38.

under the Act, the associated punishments, and guidelines for the court to consider when sentencing guilty parties.

Part 6 of the CMSA deals with a variety of areas not previously addressed. The duties of a person to avoid obstructing the Authority, as well as the responsibility to comply with any decision made by the Authority, are outlined. The guidelines and procedures for the Authority to draft regulations are also given. Some of the powers of the Adjudicative Tribunal are also listed in this section. Part 7 gives transitional provisions, and Part 8 contains several amendments to the *Criminal Code Act* and the *Office of the Superintendent of Financial Institutions Act* as they relate to the CMSA.

5 Eight propositions for optimal macroprudential policy

What follows are eight guiding principles for macroprudential policy. The concepts outlined are borrowed from a number of sources in the macroprudential regulation literature. It is worth reiterating that these are not principles for federal securities regulation; rather, they focus specifically on macroprudential regulation, the area covered by the CMSA.²⁵ These principles are not specific to Canada, but apply to macroprudential regulation in any developed country. As such, they are written without specific reference to Canadian institutions.

5.1 Efficiency maximization

The goal of macroprudential policy should be to maximize the efficiency of the financial system.²⁶ In recent years, due at least in part to the financial crisis of 2008, the focal point of macroprudential policy has instead been minimizing the likelihood of another crisis. While crises are costly and undesirable, regulations put in place to mitigate them also impose costs on the financial system. As such, the goal of any macroprudential policy framework should be to maximize the efficiency of the financial system. Minimizing systemic risks will be one component of this objective, but there will be other considerations as well.

This principle guides the seven that follow, and is central to this paper's recommendations for macroprudential policy.

²⁵ For principles relating to the broader issue of a federal securities regulator, refer to Hockin, et al. 2009, pg 9-12.

²⁶ David Dodge, "Financial Regulation and Efficiency: Tradeoffs in the Post-Financial Crisis Era," Toronto ON: *CD Howe Institute*, 2014.

5.2 Principle-based regulation

A principle-based approach to financial regulation means focusing the securities regulator's efforts on achieving outcomes rather than process of achieving these outcomes.²⁷ Under such an approach, the regulator establishes broad principles that market participants must abide by. Participants are then left with flexibility regarding how best to achieve the principles, and the regulator is given considerable discretion regarding how best to enforce them.

This approach is beneficial for a number of reasons. Firstly, it reduces the regulatory burden faced by market participants.²⁸ Rather than expending resources to ensure compliance with numerous detailed and specific regulations, a market participant chooses the most efficient way to comply with the regulator's objectives.

Secondly, it fosters an environment of cooperation between market participants and the securities regulator. In a detailed regulatory framework, market participants may expend considerable resources to exploit profit opportunities that are not technically against the rules. In contrast, a principle-based approach allows for discussions between the regulator and market participants about how best to overcome issues.²⁹

Finally, an environment of cooperation will lead to more innovation and reduced compliance costs for market participants. The securities regulator can work with market participants, as well as offer guidance as to how compliance can be achieved most efficiently.

²⁷ Hockin, et al., "Final Report and Recommendations," 17.

²⁸ Dodge, "Financial Regulation and Efficiency," 9.

²⁹ Hockin, et al., "Final Report and Recommendations," 17.

5.3 Ending too big to fail

The regulatory authority must ensure that the failure of any institution is not overly costly to the financial system, and that the cost of a failure is born by stakeholders at that institution. This requires two things: living wills, and proper incentives for stakeholders.

Large market participants should have contingency plans so that their failure is not overly costly.³⁰ Early resolution plans, or living wills, allow the securities regulator to intervene in the event of default, and quickly restructure or sell parts or the entirety of troubled market participants. As a result, the failure of any individual market participant does not endanger the stability of the larger financial system. While these living wills are important, they should not be overly detailed, or creating them will divert resources away from other important tasks. As is the case when imposing any type of rule, the regulatory authority must strike a balance between the costs and the benefits of mandating living wills.

5.4 Countercyclical regulation

While the beginning of an upswing may be driven by economic fundamentals, inevitably risk-taking increases and helps to drive the business cycle. An optimal regulatory framework should include restrictions that are not invariant to economic fluctuations. Instead, requirements such as leverage ratio limits and liquidity requirements should tighten during booms and loosen during downswings. These requirements should apply to shadow banks and conventional banks.

³⁰ Dodge, "Financial Regulation and Efficiency," 8.

Tightening requirements during a boom may be politically difficult, but it is necessary to dampen excessive risk taking.³¹ Determining when an upswing contains too much risky behavior requires innovative diagnostic tests, which relates to the next principle.

5.5 Centralized decision making

Having a central, uniform authority for market participants to interact with reduces the regulatory burden and lowers compliance costs. A common complaint from market participants is that the number of regulatory agencies has ballooned.³²

This central authority should draw on information from as wide a variety of sources as possible.³³ This will involve coordinating with other financial regulatory bodies, both domestically and abroad.³⁴ A coordinated attempt at information gathering will reduce the regulatory authority's information gathering costs, and result in the most informed decisions possible.

Another benefit of a central authority is easier coordination with international financial regulators. Executives from a federal securities regulator could serve on international financial regulation bodies, and represent the interests of Canada as a whole.³⁵

³¹ Dietrich Domanski and Tim Ng, "Getting Effective Macroprudential Policy on the Road: Eight Propositions," *Bank for International Settlements*, 2011, 91.

³² For example, see Anthony Effinger, "The Rise of the Compliance Guru - And Banker Ire," Bloomberg News, last modified June 25, 2015, <http://www.bloomberg.com/news/features/2015-06-25/compliance-is-now-calling-the-shots-and-bankers-are-bristling>

³³ Domanski and Ng, "Eight Propositions," 92.

³⁴ In Canada, these bodies are the Bank of Canada and the Office of the Superintendent of Financial Institutions, respectively. Internationally, agencies such as the Financial Stability Board and the Bank of International Settlements are concerned with macroprudential policy.

³⁵ Hockin, et al., "Final Report and Recommendations," 48.

5.6 Simple and explicit mandate

In any developed country, there will be a multitude of agencies with mandates related to financial markets. As such, a macroprudential policy mandate must clearly distinguish the regulatory authority from other financial agencies. Additionally, an explicit mandate gives the authority the “legal and moral authority to take unpopular actions.”³⁶ Having a simple macroprudential policy narrative will allow for stable public expectations and increased political support.

As part of this narrative, there should be a clear set of performance measures for the securities regulator. These measures should be explicit, measurable, and disclosed to the public on a regular basis.³⁷

5.7 Political independence

Any macroprudential regime will make mistakes, and these mistakes are likely to be politically unpopular. In order to support an efficient, long-term macroprudential strategy the authority must be able to enact politically unpopular policies (such as pro-cyclical tightening).³⁸ Therefore, the Executive Committee should be at least partially immune to political considerations.

5.8 Responding to crises

Given that the goal of macroprudential policy should be to maximize the efficiency of the financial system, rather than to minimize its instability, financial crises will still

³⁶ Domanski and Ng, “Eight Propositions,” 91.

³⁷ Hockin, et al., “Final Report and Recommendations,” 15.

³⁸ Domanski and Ng, “Eight Propositions,” 93.

occur. This means that the securities regulator requires interim powers that allow it to respond quickly so as to control and minimize the effects of a crisis.³⁹

Additionally, given that crises will still occur, strong financial system infrastructure remains important, and thorough accounting and microprudential policy standards should be in place.⁴⁰ This again suggests the need for close cooperation and coordination with the central bank and the microprudential regulator.

³⁹ Hockin, et al., "Final Report and Recommendations," 11.

⁴⁰ Domanski and Ng, "Eight Propositions," 93.

6 Evaluating the Cooperative Capital Markets Regulatory System

In this section I will explore how the CCMRS measures up to the eight principles outlined above.

6.1 Efficiency maximization

While the CCMRS framework should improve the efficiency of the Canadian financial system, for reasons that are outlined below, the objective of financial system efficiency maximization is not stated anywhere in the CMSA. The stated purpose of the CMSA would suggest that legislators view the objectives of the CMSA through the lens of instability minimization, rather than efficiency maximization.⁴¹ As such, it will be important for the Board of Directors and the Executive Committee to keep efficiency at the forefront when making decisions.

One consideration necessary to achieve efficiency will be ensuring that the correct level of regulation is applied to each type of market participant. There is a tendency in Canada for regulators to focus their attention on established market participants, such as traditional banks, and overlook unconventional or emerging participants such as the shadow banks.⁴² In the Bank of Canada's most recent Financial System Review, they identify the need for increased supervision of shadow banks.⁴³ Thus, the Authority must ensure that all types of market participant are subject to an efficient level of supervision.

⁴¹ CCMRS, "Capital Markets Stability Act," 11.

⁴² The term shadow bank refers to non-bank institutions that perform similar roles to banks such as asset-backed commercial paper, money market mutual funds, and investment banks.

⁴³ Bank of Canada Governing Council, "Financial System Review: June 2015," Ottawa: Bank of Canada, 2015.

6.2 Principle-based regulation

Perhaps the most common complaints received during the consultation process related to the idea of principle-based regulation.⁴⁴ Commenters, almost all of who are market participants, desire a more detailed definition of systemic risk.

Commenters also desire a more explicit description of what makes an entity systemically important, as well as the rules that the Authority might impose on them. While these are valid concerns, they also illustrate that those drafting the CMSA legislation have done an excellent job of abiding by a principle-based approach.

Legislation that contains only broad strokes will have a better chance of being enacted into law, and will leave the finer points of the regulatory framework to the Board of Directors and the Executive Committee. Although this approach may cause some initial consternation for market participants due to uncertainty surrounding the specific requirements they must abide by, in the long run it will be beneficial to the broader financial system.

The CMSA offers an excellent example of a principle-based approach to legislation. Those drafting the legislation have written down broad principles that will guide the Authority, while leaving the actual regulations for the Authority to decide. Hopefully, the Authority will take the same principle-based approach when writing their regulations. If they can avoid filling in the blanks with an overly detailed set of regulations, the CCMRS should allow for effective principle-based

⁴⁴ Gordon McKenna and Aaron Palmer, "Comment Letters on Proposed Federal Systemic Risk Legislation Raise Significant Concerns," *Blake, Cassels & Graydon LLP*, last modified May 15, 2015, <http://www.blakes.com/English/Resources/Bulletins/Pages/Details.aspx?BulletinID=2132>

regulation. Given that the draft regulations have yet to be released, it is difficult to evaluate the CCMRS on this front. However, the concept of principle-based regulation is mentioned several times in the Expert Panel's Report, so it would seem likely that the Board of Directors and the Executive Committee will take this approach under consideration.⁴⁵

6.3 Ending too big to fail

When the Authority declares a trading facility, a clearing house, or a capital market intermediary to be systemically important, it can mandate them to implement plans for "business continuity, recovery, or winding up."⁴⁶ This is exactly the type of living will discussed above. The Authority must use discretion when identifying which companies require a living will. The goal is to prevent individual defaults from destabilizing the financial system, while at the same time refrain from needlessly imposing an additional regulatory burden on smaller market participants whose failure would not have a destabilizing effect.

These living wills should contain stipulations that market participants bear the costs of any risks they bear. If taxpayers bear the cost of risks taken by a financial institution, that institution will naturally increase the amount of risk it holds. Recent efforts by the Financial Stability Board and other international entities have focused on this area; the Authority should collaborate with these bodies to ensure that such measures are in place. Incentive structures that do not promote too

⁴⁵ Hockin, et al., "Final Report and Recommendations."

⁴⁶ CCMRS, "Capital Markets Stability Act," 14-21.

much risk taking can be mandated for market participants of all sizes, not just those that are deemed systemically important.⁴⁷

6.4 Countercyclical regulation

There is nothing in the CMSA that relates specifically to leverage or liquidity ratios. These will be outlined more thoroughly in the draft regulations that have yet to be released. Additionally, many of these regulations will be written under the mandate of the CMA. Thus, it is difficult at this point in time to evaluate the CCMRS on this front.

However, a politically unpopular decision such as tightening regulations during an upswing should be easier for the Authority than it is currently for provincial securities regulators. Firstly, given the extensive information gathering available, the Authority will have all necessary information to justify such a decision. Secondly, the Authority can change the requirements uniformly across all jurisdictions. This will be more effective, and easier to accomplish, than having the regulations change haphazardly across jurisdictions. Finally, the Authority will have some degree of separation from the whims of provincial governments, which should make enacting politically unpopular regulations easier.

These countercyclical measures should apply to all relevant market participants. Risks can emerge in the shadow-banking sector just as they can emerge in the conventional banking sector. If the Authority imposes tighter regulations on banks, but allows shadow banks to continue unimpeded, much of the benefit of a

⁴⁷ For details on implementing such measures, consult Financial Stability Board, “Key Attributes of Effective Resolution Regimes for Financial Institutions,” 2014.

countercyclical regulatory framework will be lost. Thus, the Authority must apply countercyclical regulations broadly.

6.5 Centralized decision making

The creation of one authority to replace the numerous provincial and territorial securities regulators should result in more collaboration with other financial markets regulators, such as the Bank of Canada and Office of the Superintendent of Financial Institutions. This should improve the efficiency of information gathering and in theory lower the regulatory burden on market participants. In practice it is difficult to evaluate the CCMRS on this front, as the details of the fee structure have not yet been released.

The amount of information available to the securities regulator will also increase.⁴⁸ As noted by industry commentators, the CCMRS gives the Authority access to more information than available to the Ontario Securities Commission or most other provincial securities regulators.⁴⁹ Thus, the CCMRS should allow for more effective information collection and gathering than the current framework.

Therefore, both through further collaboration with other agencies and increased information gathering capabilities, the CCMRS should allow for the Authority to make well-informed decisions.

⁴⁸ CCMRS, "Capital Markets Stability Act," 12-14.

⁴⁹ Ross McKee and Jennifer Woo, "New Proposed Provincial Capital Markets Legislation: What it Means for Registrants and Other Market Participants," *Blake, Cassels & Graydon LLP*, last modified December 3, 2014, <http://blakes.com/English/Resources/Bulletins/Pages/Details.aspx?BulletinID=2020>

6.6 Simple and explicit mandate

The stated objective of the CMSA is “to promote and protect the stability and integrity of Canada’s financial system through the management of systemic risk related to capital markets; and, to protect capital markets against the commission of financial crimes.”⁵⁰ While I have argued above that this mandate fails to mention efficiency considerations, it is certainly explicit in its intent. The mandate is brief, focused, and comprehensible by the general public. Given the broad powers outlined in the CMSA as well as this mandate, the Authority should be well equipped to initiate politically unpopular decisions.

6.7 Political independence

As seen in Figure 1, the top of the organizational chart for the CMRA is occupied by the Council of Ministers. Thus, the executives of the Authority are not granted complete autonomy from political considerations. While the Nominating Committee submits nominees for the Board of Directors, the Council of Ministers has final say on appointments. This suggests the potential for political considerations to influence the Authority’s actions.

However, in order to reject a new regulation proposed by the Board of Directors, the Council of Ministers requires both a majority of all ministers, and a majority of all ministers from major capital markets jurisdictions, to vote against the regulation.⁵¹ Both this, and the large number of ministers on the Council of

⁵⁰ CCMRS, “Capital Markets Stability Act,” 11.

⁵¹ CCMRS, “Memorandum of Agreement,” 5.

Ministers, may make the Authority at least partially immune to the political whims of any one jurisdiction.

Finally, members of the Nominating Committee “must be independent of the governments represented by the Council of Ministers and possess appropriate qualifications and capital markets-related experience.”⁵² Hopefully, this notion of independence will prevent the Nominating Committee from catering to political considerations.

Given that the Board of Directors holds enormous sway over the policy standpoint of the CMRA, the length of term that directors are appointed for will be important. Currently, the term length is unspecified; the April 2015 Memorandum of Agreement says only that “each director will be appointed by the Council of Ministers, on the recommendation of a nominating committee to hold office for a fixed term, which can be renewed.”⁵³ If the end goal of such appointments is to foster political independence, a longer-term appointment is recommended. Additionally, the criteria that the Council of Ministers considers when renewing the appointment of a director should be explicit, and tied to objective criteria that cannot be swayed by political considerations.

Thus, the degree to which the Authority is independent from government remains to be seen. Efforts have certainly been made to make it somewhat autonomous, but further work will be required to ensure that decisions are not swayed by political considerations.

⁵² CCMRS, “Memorandum of Agreement,” 7.

⁵³ CCMRS, “Memorandum of Agreement,” 8.

6.8 Responding to crises

The ability of the Authority to issue urgent orders will allow it to respond quickly and effectively to emerging risks.⁵⁴ This type of quick regulatory action is among the most-cited reasons for implementing a national securities regulator, and offers the potential for the Authority to quickly smooth risks as they become apparent. As mentioned above, having a federal securities regulator should allow for easier collaboration with other financial markets regulators, which will be particularly important when faced with these rapidly emerging issues.

Given that instability will nonetheless occur, strong financial system infrastructure and policy standards remain important. Canada is strong in this respect, which helped the Canadian economy weather the financial crisis of 2008 relatively well.⁵⁵ The increased cooperation resulting from the introduction of a federal securities regulator may further strengthen these areas.

Thus, the other components of the Canadian financial system remain important, and their effective functioning should continue. The CMSA offers the Authority the ability to react very quickly to systemic risks when they begin to emerge.

6.9 Summary

The CCMRS offers an empowered central authority that should have the regulatory powers and the political independence to make rapid and difficult decisions necessary to address systemic risks. Fully embracing an objective of financial system

⁵⁴ CCMRS, "Capital Markets Stability Act," 20-21.

⁵⁵ Longworth, "Canadian Financial Regulation."

efficiency maximization, as well as pursuing a principle-based approach to capital markets regulation, remain objectives that must be kept at the forefront of the Authority's actions going forward.

7 Implementing the Cooperative Capital Markets Regulatory System

There are a number of issues that the Executive Committee of the CMRA must keep in mind in the years ahead. While the draft legislation is a good first step in establishing an optimal macroprudential regulatory framework, significant work remains. A number of recommendations for those tasked with administering the CMRA are outlined below.

7.1 Transitional issues

The glaring issue with the CCMRS at present is that only seven out of thirteen jurisdictions are participating. Ultimately, advocates of a unified federal authority would like to see all thirteen jurisdictions participate, but achieving this consensus remains an issue. Without uniform participation, interactions between participating and non-participating jurisdictions remain an important consideration. The details surrounding how participating and non-participating jurisdictions will interact have not been released.⁵⁶ These details will be of vital importance to market participants and regulators alike in the years ahead.

The Expert Panel on Securities Regulation proposes one possible solution to the issue of participation.⁵⁷ In their report, the Panel suggests letting individual market participants opt in to the federal legislation. If a market participant opts in, they will be regulated under federal legislation rather than under their home province's legislation. Based on their consultation with a broad sample of market participants, the Panel suggests that this option may appeal to a large number of

⁵⁶ For the little that exists, see CCMRS, "Capital Markets Stability Act," 44.

⁵⁷ Hockin, et al., "Final Report and Recommendations," 60.

market participants. As an additional benefit, Anand and Green suggest that if a large number of market participants from non-participating jurisdictions opt in, the holdout jurisdictions may be induced to join a federal system.⁵⁸

Another possible mechanism to achieve uniform participation across all jurisdictions is to employ side-payments to dissenting provinces.⁵⁹ While this is not among the Expert Panel's recommendations, the Authority should recognize it as an option.

7.2 Personnel considerations

The Expert Panel recognizes that the abilities and experiences of those tasked with running the CMRA will have an enormous bearing on its success.⁶⁰ The Chief Regulator should be respected within the securities law and regulation fields, have exceptional leadership abilities, and be capable of overseeing large organizational changes. As such, compensation for the Chief Regulator, as well as for other employees of the CMRA, should be at least equivalent to what is available to individuals of similar talent levels in the private sector.

Members of the Executive Committee, and the Chief Regulator in particular, should be able to consider, but not be swayed by, the concerns of both market participants and politicians. As shown by the comments on the CCMRS received during the public consultation period, the concerns of market participants

⁵⁸ Anita Anand and Andrew Green, "Why is This Taking So Long? The Move Towards a National Securities Regulator," *University of Toronto Law Journal*, 2010, 684.

⁵⁹ Anand and Green, "Why is This Taking so Long?" 683.

⁶⁰ Hockin, et al., "Final Report and Recommendations," 43.

often fail to consider the broader objective of financial system efficiency.⁶¹ Similarly, politicians, in particular those sitting on the Council of Ministers, will also have concerns that may not be consistent with the Authority's mandate. The Executive Committee should consist of individuals able to interact effectively with both market participants and politicians, and review their concerns, without being carried along by their arguments. Fostering an environment of cooperation and collaboration, while remaining autonomous and pursuing an objective of efficiency maximization, should be an important aspect of the Committee's job.

The impact that those charged with running the CMSA will have on its effectiveness cannot be overstated. As outlined in Section 6, given that the draft legislation follows a principle-based approach, the decisions of the Board of Directors and the Executive Committee will have an enormous bearing on the success of the CCMRS. In order for the CCMRS framework to be effective, these regulators must keep efficiency concerns at the forefront, ensure regulations are flexible to cyclical variations in the economy, and focus on issuing a clear and concise policy narrative that the public can engage with.

7.3 A global financial language

One example of the positive influence of a federal securities regulator on the efficiency of a financial system can be found in the continued efforts to establish a global financial language. As outlined by Ali et al., the Financial Stability Board and the G20 Finance Ministers and Central Bank Governors are the international bodies

⁶¹ Cooperative Capital Markets Regulatory System, "Cooperative Capital Markets Regulatory System - Comment Letters," last modified December 8, 2014, <http://ccmr-ocrmc.ca/publications/comment-letters/>

leading the push towards a global financial language.⁶² Entities such as the European Union (through the European Markets Infrastructure Regulation) and the United States (through the US Treasury's Office of Financial Research) have created bodies that can interact with the aforementioned international bodies and effectively represent national or continental concerns. The CMRA will be able to play a similar role for Canada, and effectively bring Canadian contributions and concerns to this international push for a common financial language.

The benefits of a global financial language are well understood, and its implementation should be one of the priorities for the Authority in the years to come. A common language across Canadian market participants will make the Authority's task of assessing and evaluating risks easier and more efficient. If Authority staffers do not have to expend time and resources navigating the nuances of each market participant's reporting system, they will have more time and resources for other tasks. From improved risk management both within and across market participants, to greater knowledge of the complex web that connects financial institutions domestically and abroad, to lowered barriers to entry and increased competitiveness within the financial industry, such an infrastructure would contribute in many ways to maximizing the efficiency of the financial system.

7.4 Dispute resolution

Assuming that the principle-based approach to regulation advocated above is adopted, the CMSA's dispute resolution mechanisms will be integral to ensuring its continued success. As with any principle-based regulatory system, disputes between

⁶² Ali, et al., "Towards a Common Financial Language."

market participants and the Authority are inevitable, and market participants will question the Authority's interpretation of a principle when it affects them unfavorably. As a result, the dispute resolution mechanism contained in the CMSA will be tested repeatedly, and its effective functioning is necessary to ensure constructive interactions between the Authority and market participants.

The primary dispute resolution mechanism in the CMSA is the opportunity for market participants to "make representations" before the Authority carries out an action such as disclosing confidential information or declaring a market participant to be systemically important.⁶³ However, when issuing an urgent order the Authority may avoid giving affected market participants the opportunity to make representations if it believes that doing so would undermine the effectiveness of the order.⁶⁴

What is not made clear in the CMSA is what making representations entails. Does the market participant present its argument to the Executive Committee, to the Board of Directors, or to the Adjudicative Tribunal? How is a decision rendered? These are the sorts of details that must be made clear to market participants before the CCMRS is enacted.

A similar ambiguity exists for orders made by the Adjudicative Tribunal.⁶⁵ With an exception for urgent orders, all other orders by the Tribunal must allow those affected a hearing before they are carried out. However, the details surrounding the hearing procedure remain unclear.

⁶³ CCMRS, "Capital Markets Stability Act," 14.

⁶⁴ CCMRS, "Capital Markets Stability Act," 20.

⁶⁵ CCMRS, "Capital Markets Stability Act," 25.

Criminal offences of the CMSA will be prosecuted through the Canadian justice system; as such, the dispute resolution mechanism for criminal offences is not relevant to this paper. However, there is very little explanation as to the dispute resolution mechanism for general (non-criminal) offences. All that is contained in the CMSA is a brief outline of potential financial penalties for a variety of offences. However, there is no mention of any details regarding any appeal process. Presumably, those charged with a general offence will have an opportunity to make representations, but the finer points of this process are yet to be released.

One of the goals for any principle-based regulatory system is to foster an environment of coordination and cooperation between the regulator and the regulated. If the Executive Committee does a good job of creating such an environment, they will limit the number of disputes that occur. However, because of the Authority's ability to interpret the CMSA broadly, disputes will still occur, and the minutiae of the dispute resolution framework will become increasingly important.

An optimal dispute resolution framework contains a clear set of principles for market participants to abide by. Market participants must be able to discern when they have grounds to appeal, and when the Authority's decision must be accepted, without either party becoming encumbered by overly specific rules. This will allow the dispute resolution mechanism to be consistent with the broader goal of financial system efficiency.

When making representations to the Authority, a market participant should appear before the Executive Committee to argue their case. Market participants

should not appeal the Authority's decisions to the Adjudicative Tribunal or the Board of Directors for a number of reasons. Firstly, the Chief Regulator and the rest of the Executive are appointed for their experience and their ability to effectively regulate Canadian capital markets. Therefore, they will be the best suited to render rulings that are fully consistent with the objectives of the CCMRS. Secondly, given their full time employment by the Authority and their intimate familiarity with Canadian capital markets, members of the Executive Committee will be able to make an informed decision quicker than the Tribunal or the Board of Directors. Finally, knowing that they are appealing a decision with the same entity that rendered it should cause market participants to limit appeals to cases where new information has become available. This will help limit the number of appeals, and lower the costs of these disputes. Any appeal process should only serve to give the Executive more information with which to make their decisions.

Thus, as is the case with any regulatory framework that emphasizes supervision over rules, effective dispute resolution mechanisms will be an important component of ensuring the CCMRS's success. The Executive Committee must think carefully when crafting these mechanisms.

7.5 Informational issues

With the extensive information gathering powers given to the Authority under the CMSA, the Authority will have an unprecedented level of discretion to decide what information to collect. In order to achieve efficient and effective information gathering, the Authority should focus its efforts on two separate areas.

Firstly, the Authority must maintain a detailed understanding of the existing Canadian capital markets landscape. This will involve working closely with market participants to collect and monitor information on existing business practices.

Secondly, the Authority must use its discretion to quickly gather information about new and rapidly growing areas. Rapid growth may be observed in innovative new financial instruments issued by existing market participants, or it may occur via new market participants. Ensuring that these growth areas do not pose a systemic risk to the financial system will be an important part of the Authority's work.

Past examples of these rapid growth areas include the subprime mortgage crisis in the US; subprime mortgages ballooned from 8% of mortgage originations in 2003 to 20% in 2005, and regulators weren't able to predict or prepare for the resulting crash.⁶⁶ Another example is the collapse of the Canadian asset-backed commercial paper (ABCP) market in 2007, which was largely caused by the emergence of third party ABCP.⁶⁷ Both of these issues could have been largely avoided had an empowered capital markets regulator acted proactively. The Authority should use its information gathering abilities to identify and prevent similar crises before they occur.

One example of a current growth industry that should be closely monitored by the Authority is the peer-to-peer lending industry, which has only recently emerged in Canada.⁶⁸ While peer-to-peer lending is currently only a fraction of the Canadian loan industry, if its rapid growth continues it may pose a systemic risk to

⁶⁶ Joint Center for Housing Studies of Harvard University, "The State of the Nation's Housing: 2008."

⁶⁷ John Chant, "The ABCP Crisis in Canada: The Implications for the Regulation of Financial Markets."

⁶⁸ Clare O'Hara, "Canadians Turning to Peer-to-Peer Web Loan Providers."

the financial system in the years ahead. Another recent development that the Authority would do well to examine is the increasing risks borne by pension funds.⁶⁹ Long thought of as stable vehicles for long term investments, and subject to less regulatory oversight than traditional banks, pension funds are bearing more and more risk in search of higher yields. This behavior should be closely monitored, as it has potential for negative consequences on the Canadian financial system.

Thus, while the information gathering powers outlined in the CMSA are a positive first step, the Authority must be sure to focus these powers not only on managing existing concerns, but also on proactively identifying and mitigating new ones.

⁶⁹ OECD, *OECD Business and Finance Outlook 2015*, 78.

8 Conclusion

The CCMRS offers a significant improvement over the current capital markets regulatory framework in Canada, and satisfies to some degree most of the eight principles for optimal macroprudential policy outlined in Section 5. In particular, it does an excellent job of centralizing decision-making, increasing the availability of information, and taking a principle-based approach to legislation. However, efficiency considerations, as well as ensuring a principle-based approach to regulation, remain ongoing concerns that must be addressed by the Executive Committee and the Board of Directors of the CMRA.

In the years ahead, there are several areas that the Executive Committee, the Board of Directors, and the Council of Ministers should focus on. Efforts by the Council of Ministers to achieve participation from all provinces and territories in Canada would greatly improve the effectiveness of the CMSA. In particular, inducing participation from the major capital markets of Alberta and Quebec should be a top priority. It will also be important for the Council of Ministers to ensure that the personnel hired to administer the Authority are as capable as possible, and that their compensation reflects this.

The Executive Committee should seek to contribute to and collaborate with international efforts to establish a common financial language. The potential benefits from a standardized language could be sizable for the Canadian financial system. The Executive Committee will also need to ensure that an effective dispute resolution mechanism, that both minimizes the costs of disputes and fosters a cooperative environment, is established. Finally, the Executive Committee should

ensure that the Authority's information gathering efforts are focused on both ensuring the stability of existing market participants and products, and on monitoring the emergence of new market participants and products.

It will be interesting to reevaluate the CCMRS in 18 to 24 months, when regulations have been released and the CMRA is fully operational, to gain a more complete picture of the effectiveness of this novel macroprudential framework. Hopefully, the number of participating jurisdictions will continue to grow, and the elusive uniform framework for Canadian capital markets will become a reality.

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