

# CAN Securities Regulation in CANADA BE FIXED?

New study outlines a research agenda as starting point for change.

**CANADA'S** fragmented securities regulatory structure has domestic and international implications for the country's capital markets strategy. Before Canada can implement a winning capital markets strategy, it must ensure that it has economic, regulatory and governmental institutions and structures in place that will support, rather than hinder, its strategic initiatives. Increasing international competition for capital has made an effective and efficient securities regulatory structure a critical component of Canada's global competitiveness. Participants on all sides of the current debate appear to agree on one thing: the status quo will not allow Canada to meet the domestic and international challenges posed by globalizing capital markets.

In October 2002, the Capital Markets Institute at the University of Toronto (CMI) released a comprehensive study of the issues relating to securities regulatory structure. The study reviews prior reform efforts to determine where we have been and what we have learned since the mid-1960s. It distills that learning into eight factors that we can apply to determine the relative strengths and weaknesses of current reform proposals. The factors for assessing the proposed regulatory structure are:

**1. Constitutional validity:** the regulatory structure proposed should be constitutionally valid without the need for a constitutional amendment or concessions or waivers from the affected provinces.

**2. Stability:** it should have structural permanence, and should not permit strategic behaviour by participating provinces, which might credibly threaten to withdraw if their demands on administrative or poli-

BY DOUG HARRIS

cy issues are not met.

**3. Local and regional flexibility:** it should provide some ability for local and regional variation in securities legislation and/or administration, at least to the extent consistent with satisfying the other criteria.

**4. Universality:** it should be designed to apply as widely as possible across the country.

**5. Accountability:** it should ensure that elected representatives are accountable to their constituents for the quality of regulation of Canada's capital markets.

**6. Determinacy:** a reform proposal should propose a scheme for securities regulation that does not rely on significant further negotiations for the determination of its scope or implementation, and that defines clearly areas of exclusive regulatory authority.

**7. Responsiveness:** the regulatory structure proposed should ensure that the regulator with jurisdiction will have the authority and appropriate incentives to respond efficiently and effectively to changing economic circumstances that affect Canadian capital markets.

**8. Cost effectiveness:** it should provide a clear opportunity to reduce the costs of regulatory compliance for issuers and intermediaries, relative to the status quo.

Each of these criteria has been applied to current reform proposals, and among them federal securities regulation appears to satisfy the greatest number of

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Doug Harris is the director of the Capital Markets Institute at the University of Toronto and is an assistant professor at the Faculty of Law.

CRITERION	STATUS QUO – CSA*	RECIPROCAL DELEGATION	UNIFORM LEGISLATION	FEDERAL SECURITIES REGULATION	REGULATORY COMPETITION
Constitutional Validity	Yes	Yes, subject to extraterritorial limitations	Yes	Questionable	Yes
Stability	No	No	No	Yes	No
Local and Regional Flexibility	Yes	Yes	Yes	No	Yes
Universality	No	No	No	Yes	No
Accountability	No	No	No	Yes	Yes
Determinacy	No	No	Yes	Yes	Yes
Responsiveness	No	Yes for legislation; no for administration	No	Yes	Yes
Cost Effectiveness	No	No	Yes	Yes	Yes

\*Canadian Securities Administrators.

criteria. The results of that analysis are set out in the above chart.

But the results do not advocate a federal securities regulator, or any other current reform proposal. Instead, the study sets out a list of things we have yet to learn, together with a process for doing so. Indeed, we must learn these things in order to escape from the unproductive cycles of debate that have frustrated our best intentions.

The debate in Canada has not typically been informed by robust empirical analysis and suffers from a lack of current data on the central issues. The CMI has developed a research agenda that will help develop the factual record needed to prove or disprove key preconditions underlying various reform proposals. Such an agenda can give legislators and other policy makers the information they need to ensure that any decision on the future structure of Canadian securities regulation is based on a thorough, inclusive and rigorous empirical analysis.

Four critical elements of the current debate must be addressed:

#### Local versus regional interests

We need a comprehensive study of the role of local and regional interests in the structure of securities regulation in Canada. It must look at the extent to which there are geographically segmented capital markets in Canada, the costs and benefits of such segmentation for

the Canadian capital market as a whole, and the role that decentralized securities regulation plays in shaping those costs and benefits. It is only on the basis of this kind of data that the debate can move beyond the unhelpful geographical generalizations that have characterized it to date.

#### Costs

We also need a comprehensive and methodologically sound study of the incremental costs of a decentralized system of securities regulation. It should focus on costs relating to disparate, substantive rules and administrative practices among the provinces, including multiple regulators, opportunity costs, and lost economies of scale. This would provide good data on the relative cost efficiency of the various reform proposals. Such a study should coordinate and incorporate the work being done by the British Columbia and Ontario securities commissions as well as the Conference Board of Canada to ensure that all relevant information is captured and analyzed.

#### Competition

There should be a study of regulatory competition in the Canadian context, drawing on current theoretical approaches and empirical evidence from other jurisdictions (including the U.S. and the European Union). These would be applied to the Canadian experience with regulatory diversity in the corporate and securities law contexts.

## Look to Australia

There appear to be at least two principal areas in which further study of the Australian experience would advance the Canadian debate. First, like Canada, Australia is characterized by regional segmentation in capital markets activity. Further study of the precise details of state and territory input into the policy formation process, and its impact on the evaluative criteria of accountability and responsiveness, might well provide a model for a Canadian resolution of the local and regional interests issue. Second, the federal, state and territorial governments in Australia found the political will to proceed with bold reform efforts over an extended period, even in the face of successful constitutional challenges. An analysis of how successive Australian federal, state and territorial governments built a consensus while avoiding divisive influences might also provide a model for a Canadian resolution.

The study calls for a joint federal and provincial committee to be established to commission, oversee and report on the research and consultation necessary to recommend securities regulatory structure to the provincial and federal governments. The study argues that this committee must act on the basis of rigorous empirical analysis, with stakeholders involved in the design, conduct and assessment of the research results. Work should begin and be completed on an urgent basis, but must be allowed sufficient time for completion to ensure that the results of the research reflect the best possible basis for the decisions that follow. The immediate and critical role for federal and provincial legislators, as well as issuers, investors and intermediaries is to commit to the development and interpretation of this empirical and theoretical groundwork. That commitment needs to exist to ensure that debate about the system of securities regulation in Canada supports this country's goal to become an effective and efficient competitor in global capital markets.

The CMI study was released just after federal Finance Minister John Manley announced that Harold MacKay had been appointed to recommend a process to determine the best securities regulatory system for Canada's needs and to identify the key issues to be

addressed in that process. Mr. MacKay's report was delivered to the Minister on November 15, 2002 and released publicly on November 19, 2002. By and large, Mr. MacKay's recommendations are consistent with the recommendations in the study. Mr. MacKay advises the federal government to work with the provinces to establish a "wise persons' committee" to determine the best securities regulatory structure for Canada's capital markets, much as the European Union member states did in July 2000 with their creation of the Committee of Wise Men on the Regulation of European Securities Markets. He suggests that the committee's work focus on the respective merits of two models. The first is an enhanced version of the present system that might involve the "passport" model of mutual recognition and reliance. The second is a single commission model in which participating governments would delegate their authority to a single regulator administering one set of rules.

Mr. MacKay's report also echoes most of the issues identified in the CMI study: the importance and role of local and regional interests in Canada's regulatory structure, the costs associated with the current, fragmented structure and the extent to which the various reform proposals would reduce those costs. It also stresses the importance of the Australian experience for the comparative lessons it may offer for Canada. While Mr. MacKay has set an aggressive timetable for the "wise persons' committee", the research agenda described in the CMI study could be completed in time to provide valuable input to their deliberations, given that the debate has been conducted to date in the absence of any independent empirical data on these critical issues.

The key message shared by the CMI study and Mr. MacKay's report is that governments and stakeholders in the Canadian capital markets can no longer afford to defer resolution of the issues surrounding securities regulatory structure. Canada must promote an efficient internal market for capital in order to preserve the benefits of its free flow within the domestic economy. Canada must also respond to the increasing international mobility of capital by actively designing a capital markets strategy, or risk allowing external forces to define for it a diminished and dependant role in the global capital markets. ■