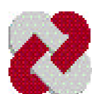
Proposals for an Efficient and Effective Securities Regulatory System in Canada

Submission to the Wise Persons' Committee

June 2003



Canadian Bankers Association
Building a Better Understanding

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Executive Summary

A strong, well functioning Canadian capital market is critical for all Canadians, whether entrepreneurs and businesses seeking capital to grow and create jobs, savers and investors seeking opportunities to build their financial future, or policy makers seeking to foster an innovative and competitive economy. Many factors affect the strength of the Canadian capital market, but a particularly important element is the nature and structure of the securities regulatory system. In a rapidly-evolving business environment, where Canada (with a relatively small capital market) must compete with much larger, more liquid capital markets (particularly that of the U.S.), it is essential that our securities regulatory system be as efficient, cost-effective, flexible, and responsive to market developments as possible.

Regulators have taken a number of welcome steps over the last several years to make the securities system in Canada more efficient. These include National Instruments which have helped to reduce the differences among regulatory systems and the current effort to create a Uniform Securities Law. Other developments include the mutual reliance system (where provinces and territories can rely on a lead jurisdiction to process prospectuses and related material) and the creation of electronic filing systems (e.g., SEDAR, SEDI).

As is widely recognized by regulators, issuers, registrants and other observers, however, much more needs to be done to improve the efficiency and effectiveness of the regulatory system. Despite the efforts noted above, issuers, registrants, and intermediaries must still deal with 13 provincial and territorial regulators (in addition to a number of securities self-regulatory bodies, such as the Investment Dealers Association, Market Regulatory Services, the Mutual Fund Dealers Association, and the Canadian Investor Protection Fund) when carrying on business across the country and bear the costs of supporting the infrastructure of multiple regulatory bodies. While there has been a trend towards harmonization of rules, differences remain among jurisdictions, and individual provinces and territories retain the ability to make changes that differ (sometimes markedly, as is the case with current proposals by the BC Securities Commission) from the rules in other jurisdictions. Further, because of the need to seek the agreement of multiple jurisdictions on changes to joint rules, the regulatory system across Canada is very slow to respond to market developments – in fact, it takes on average at

least 18 months to develop and implement a national rule and often (for example, the efforts to create a national financial planning rule) the process is considerably longer.

While efforts by regulators to improve the system have been important, the CBA has stressed the need for governments and ministers to commit to improving the securities regulatory system. We are very pleased, therefore, that governments are now directly involved in addressing the need for reform – the federal government's creation of the Wise Persons' Committee and the provincial ministers' establishment of the Steering Committee of Ministers are evidence of the importance that governments are placing on this issue.

Improving the regulatory system will of necessity be a multi-stage process involving reforms over time both to the content as well as the structure of regulation. While content reforms are clearly important, the focus of this submission is on the need for structural change to address the problems of multiple, overlapping and duplicative securities regulation in Canada. In this regard, two basic models of structural reform have been put forward (although each model has variations): a passport model and a national regulator model. In our view, the passport model (i.e., as proposed by the provincial Steering Committee of Ministers) would result in important and welcome improvements to the current system. At the same time, however, we feel that even greater efficiencies would result if a national regulator model could be achieved. Accordingly, our submission sets out in detail our proposal for a national regulator to serve as a model for governments and regulators to consider. In brief, our model has the following features:

For every 1 per cent increase in the cost of acquiring capital, the amount of capital that firms and individuals seek to acquire decreases by 0.25 per cent. Productivity growth is strongly and highly correlated with investment in machinery and equipment measured as a share of GDP.

- The regulator would be a single, self-financing, national securities regulator with provincial and federal participation;
- The regulator would be overseen by a Council of Governors to which each participating jurisdiction would name one member. Accordingly, the majority of Governors would be nominated by the provinces and territories. The Council would act as a board of directors and would appoint the CEO of the body, but would not act as a regulatory tribunal;
- Although there would be provincial participation in the new entity, the regulator would be created by federal legislation;
- Provinces would participate on an opt-in basis, and would do so

by incorporating federal legislation by reference and delegating regulatory functions to this new body;

- The regulator would administer a single set of legislative requirements and would have rule-making authority;

- The regulator would have the ability to tailor rules to meet the needs of the market (e.g., specific rules for small firms or certain sectors, or purely local rules with intra-provincial application). Further, there would be regional offices, as appropriate, to ensure that regional expertise (e.g., oil and gas) is maintained.

The CBA supports the efforts now underway by governments and regulators to improve the efficiency of the securities regulatory system. We believe that, if they can be implemented in a timely way, initiatives such as the Uniform Securities Law project and the greater use of mutual reliance and recognition systems through passport approaches can be of incremental benefit to issuers, registrants, investors, and the economy as a whole. We clearly feel, however, that reform should not stop with such initiatives but should build upon them to create an even more efficient and effective regulatory system. In this regard, the Uniform Securities Legislation project is valuable because it could form the basis of the single legislation that would be administered by the national regulator. It is important, therefore, that public policy makers in Canada also actively consider ways of achieving a national securities regulatory system in Canada.

Proposals for an Efficient and Effective Securities Regulatory System in Canada

A Submission to the Wise Persons' Committee by the Canadian Bankers Association

I. Introduction

As a strong advocate for strengthening the efficiency and effectiveness of the financial services regulatory system, the Canadian Bankers Association welcomes the opportunity to present to the Wise Persons' Committee the banking industry's views on improving the securities regulatory system in Canada. We recognize that important progress has been made in recent years by regulators to address overlap and duplication in the system and to reduce the inconsistencies in rules, requirements, and standards among jurisdictions. Nevertheless, we believe that there is still need for significant improvement in the structure of the regulatory system and that action by governments is required to address the issue. We are very pleased, therefore, that governments are now directly involved in addressing the need for reform. The federal government's creation of the Wise Persons' Committee and the provincial ministers' establishment of the Steering Committee of Ministers are evidence of the importance that governments are placing on this issue.

In our view, the circumstances have never been better for a thorough examination of the current system and the development of an action plan to implement the results of the review. There is, for instance, a virtual consensus among governments, regulators, issuers, investors, registrants and other expert observers that the status quo presents concerns that need to be addressed. Further, the environment for reform has changed considerably since the last round of discussions in 1996 to create a national securities regulator, with movement in the direction of creating a national infrastructure to deal with capital markets issues. A decade ago, for instance, Canada had several equity stock exchanges (Toronto, Montreal, Vancouver, Calgary, Winnipeg); today, the only equity exchange in Canada is the TSX and its subsidiary TSX Venture, with the Montreal Exchange taking on responsibility for derivatives trading. The market recognized the need for economies of scale in the face of international competition and regulators allowed the needed changes to take place.

Further, regulators across the country have recognized the important role that national self-regulatory organizations play in securities regulation. In addition to well established organizations such as the Investment Dealers Association and the Canadian Investor Protection Fund, new bodies covering other parts of the sector have been created. Market Regulation Services Inc. has been recognized as an SRO in all of the major jurisdictions, including Quebec. The Mutual Fund Dealers Association (MFDA) is recognized as an SRO by the securities commissions of Ontario, British Columbia, Alberta, Saskatchewan and Nova Scotia.

Also, a factor which was a concern in the 1996 discussions for a Canadian Securities Commission (i.e., the issue of compensation for participating provinces to make up for the loss of surplus revenue from their securities commissions) seems to be less of a concern today. This is due, in large measure, to the fact that most governments in Canada are now in a better fiscal situation (i.e., losing securities-related revenue is less of a concern) and that most securities commissions are taking steps to reduce or eliminate their revenue surpluses.

The CBA recognizes that it will take time to put in place a new, more efficient regulatory structure that eliminates overlap and duplication in the system. We believe that, if they can be implemented in a timely way, initiatives such as the Uniform Securities Law project and the greater use of mutual reliance and recognition systems through passport approaches can be of incremental benefit to issuers, registrants, investors, and the economy as a whole. We clearly feel, however, that reform should not stop with such initiatives but should build upon them to create an even more efficient and effective regulatory system. In this regard, the Uniform Securities Legislation project is valuable because it could form the basis of the single legislation that would be administered by the national regulator. In this submission, we set out for the consideration of the Wise Persons' Committee our proposals for such a national system.

The submission first discusses the importance of having efficient, well-functioning capital markets, and then sets out issues of concern regarding the structure and operation of the current regulatory system. Since the Canadian capital markets operate in a competitive global market, we also discuss some examples of other jurisdictions that have significantly reformed their securities system to determine what lessons they hold for Canada. Finally, we discuss

various options for reforming the securities system and set out a proposal for a national securities regulator for Canada.

II. The Need for Reform

i) The Importance of Efficient Capital Markets

The Toronto Stock Exchange had a market capitalization at the end of 2001 that constituted 2.6% of the market cap of the top ten stock exchanges in the world and 5.5% of the NYSE's market cap.

It is important that Canada have an efficient capital market and an efficient system of regulation will help to make that happen. An efficient capital market means that the cost of intermediation, i.e. the difference between what businesses must pay for capital and what investors receive, is as small as possible. A more efficient capital market means that entrepreneurs have access to low cost capital to help them grow, invest in technology to improve productivity, and better serve their customers. Similarly, a more efficient market means that individual and institutional investors have access to the best rates of return on their investments. This is important as Canadians are increasingly taking responsibility for their retirement income and are turning to capital markets to acquire the financial assets that they count on to provide that income. Pension funds, including the Canada Pension Plan, are also relying on capital market investments to enhance their returns. Efficient intermediation increases their returns and increases retirement income.

The Canadian capital market has certain features that make efficiency all the more important. The market is small – the Toronto Stock Exchange had a market capitalization at the end of 2001 that constituted 2.6% of the market cap of the top ten stock exchanges in the world and 5.5% of the NYSE's market cap.[1] Overall, Canada represents 2% to 2.5% of the world's capital markets. In addition, Canada's business sector has a relatively larger proportion of small businesses and closely-held firms than does the United States, which means the depth, breadth and liquidity in many segments of the Canadian capital market is not as extensive as in the United States.

This is a concern because firms that are not served adequately by the Canadian capital market will go elsewhere to raise their capital. Indeed, this is happening already – according to the Department of Finance, about one-half of the $52 billion in equity and debt raised in 2001 was raised outside of Canada, mostly in the United States.

[1] Canada, Department of Finance, *Canada's Securities Industry*, July 2002.

About one-half of the $52 billion in equity and debt raised in 2001 was raised outside of Canada.

Regulatory inefficiency, which the Bank of Canada[2] sees as a tax on capital market activity, could compound the effects of other factors that cause Canadian firms to borrow in other markets. To the extent that the lack of size and liquidity in Canada's capital markets is compounded by inefficiency arising from the regulatory system, this trend could increase. Since larger issuers are more likely to have access to foreign markets than smaller issuers, the continued migration of such firms could transform the Canadian capital market. One result would be a further reduction in the amount of liquidity and a weakening of access to capital for smaller firms.

An inefficient capital market would also cause investors to seek opportunities outside of Canada. Again, larger investors would have the greatest access to foreign markets. In the end, smaller firms and smaller investors that do not have the option of accessing foreign capital markets, would bear most of the burden of an inefficient domestic capital market.

As a small economy beside the largest and most liquid capital market in the world, Canada cannot afford any unnecessary inefficiency in its capital market. Indeed, to offset the disadvantages of smaller size, Canada should be aiming to achieve a significantly more efficient market than exists south of the border. This cannot be achieved without an improved regulatory system across the country.

A small mining company trying to raise $600,000 in capital in two or more jurisdictions would need to spend $300,000 in regulatory induced costs.

ii) Fragmentation and Overlap in the Current System

The current system of securities regulation with 13 separate provincial regulators administering 13 separate Acts, rules, regulations, staff interpretations, notices, guidelines, etc. (in addition to four self-regulatory bodies) is characterized by fragmented and duplicative regulation. National issuers and firms offering financial services nation-wide must ensure compliance with all 13 Acts simultaneously. The authors of the *Report of the Five Year Review Committee Reviewing the Securities Act (Ontario)* described the problem as follows:

> *Because securities regulation in Canada is a matter of provincial jurisdiction, there are 13 different sets of securities laws administered by 13 provincial and territorial regulatory authori-*

[2] Bank of Canada, *Financial System Review*, June 2003, p.77.

> *ties. Many of the statutes are similar to one another. Some have provisions that are entirely distinctive. None of them is identical. Even where the statutory provisions are identical, they may be interpreted and applied differently from one jurisdiction to the next.*[3]

In particular, the Five Year Review Committee identified differences with respect to prospectus offerings, exemptions from prospectus and registration requirements, take-over bids and continuous disclosure as being particular problematic. One of the more pronounced differences involves registration requirements. Ontario and Newfoundland currently employ the concept of universal registration which captures a broader range of participants than do the other jurisdictions. In a similar vein, all jurisdictions except Quebec require registration once a trade in securities takes place whereas in Quebec, registration is required when a business or person carries on the business of a dealer or adviser.[4] The report went on to say that the price of this structure is "...a balkanized approach to securities regulation that makes it more time consuming and expensive for issuers to raise capital across the country."[5]

iii) The Cost of Regulation

A practical impact of having 13 separate securities regulatory bodies across the country is that the cost of maintaining the existing securities regulatory bodies is out of step with that of competing jurisdictions, because of duplication and the lack of economies of scale. Preliminary research conducted by Professor Howell Jackson of Harvard Law School indicates that the cost of maintaining securities regulatory bodies in Canada (relative to domestic equity market capitalization) is more than 1.5 times that of the U.K. and more than 2.5 times that of the U.S.[6] (Figure 1). These costs are borne directly by market participants, including the investing public, as fees

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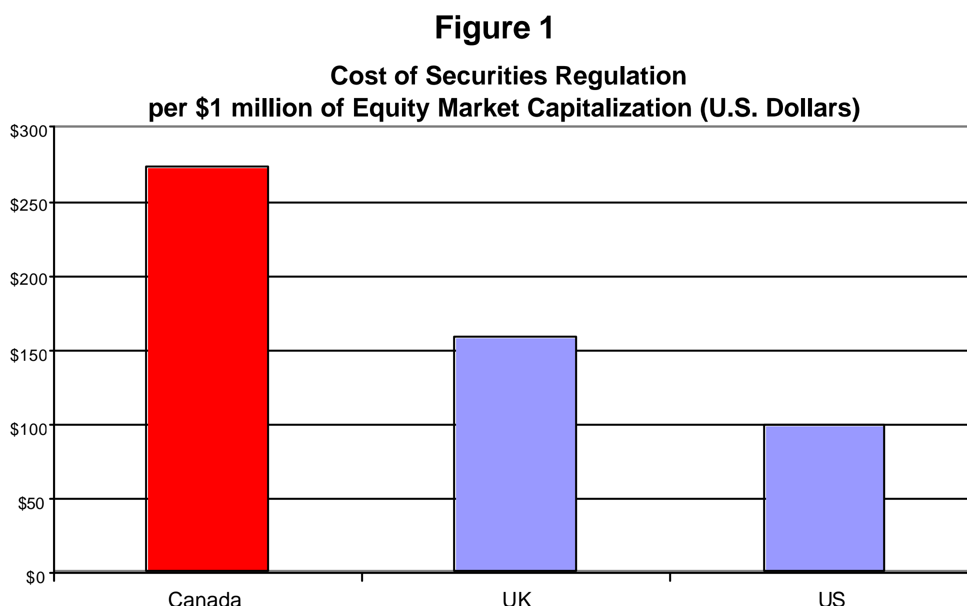
[3] *Report of the Five Year Review Committee Reviewing the Securities Act (Ontario)*. March 21, 2003. p. 30.
[4] Canadian Securities Administrators, *Blueprint for Uniform Securities Law for Canada*, January 30, 2003, pp. 15-16.
[5] *Report of the Five Year Review Committee Reviewing the Securities Act (Ontario)*. March 21, 2003. p. 31.
[6] Professor Howell E. Jackson, Harvard Law School, "An American Perspective on the FSA: Politics, Goals & Regulatory Intensity", Presentation to "Do Financial Supermarkets Need Super Regulators?: Conference of Centre for the Study of International Business Law and the Brooklyn Journal of International Law", September 20, 2002.

The cost of maintaining securities regulatory bodies in Canada is more than 1.5 times that of the U.K. and more than 2.5 times that of the U.S. In contrast, the cost of the regulatory apparatus for banking is lower in Canada than it is in the U.S.

and levies, thereby increasing the cost of participating in the Canadian capital market and working against the interests of making our markets as attractive and competitive as possible.

Figure 1



Source: Professor Howell E. Jackson, Harvard Law School, "An American Perspective on the FSA: Policitcs, Goals & Regulatory Intensity", Presentation to "Do Financial Supermarkets Need Superregulators?: Conference of Centre for the Study of International Business Law and the Brooklyn Journal of International Law", September 20, 2002.

It is also interesting to note that the same research by Professor Jackson indicates that the cost of the regulatory apparatus for banking is lower in Canada than it is in the U.S. and, further, that it is lower still in the U.K. This would reflect the competitive advantage that Canada realizes from having a largely consolidated regulatory system for banking, and would indicate that similar gains could be realized in the securities regulatory apparatus through the creation of a streamlined, national system.

It is not just the cost of regulatory bodies that affects the efficiency of markets – compliance costs are also important and indeed are considered by observers to be significantly larger than the cost of the regulatory infrastructure by several orders of magnitude.[7]

[7] While difficult to get a precise estimate of the compliance costs associated with financial regulation, several studies exist which put broad parameters around the range of costs. A study by the American Bankers Association ("Survey of Regulatory Burden: Summary of Results June 1992) puts compliance costs at 12.6% of non interest expenses. A more recent study of UK investment management firms estimates that direct and compliance costs represent 6% of operating expenses (J. Franks, S. Schaefer and M. Staunton, "The direct and compliance costs of financial regulation" Journal of Banking and Finance 1998). Finally, a 2002

In Canada, where mining companies represent more than one-quarter of issuers listed on the TSX, our fragmented system of regulation increases the cost of raising capital. A small mining company trying to raise $600,000 in capital in two or more jurisdictions would need to spend $300,000 in regulatory induced costs, largely in the form of legal, accounting and other professional fees.[8]

While efforts to harmonize the content of regulation, such as the current Canadian Securities Administrators *Uniform Securities Law Project*, are attempting to reduce some of the regulatory asymmetry that results from 13 separate Acts and thereby reduce compliance costs, harmonization efforts by themselves will not fully address the compliance burden of dealing with multiple regulators. This is due to the fact that legal advisors and compliance staff must nonetheless ensure that all Acts, rules, guidelines, etc. are being complied with. Even *substantially similar* provisions are not *identical* and compliance staff cannot rely on substantial similarity to reduce the actual number of compliance points to which they must adhere. Indeed, in the current Canadian Securities Administrators' *Blueprint for Uniform Securities Laws in Canada*, the authors note that "Securities laws also contain administrative and procedural provisions that reflect the laws of a particular jurisdictions and cannot easily be harmonized."[9]

The U.S. experience (discussed below in Part IV) is instructive in this regard – moving towards a more national system of regulation has reduced the compliance burden, especially for small firms seeking to raise funds through capital markets.

iv) Timeliness, Responsiveness and Flexibility of the Regulatory System

The CSA's multilateral rule-making process is not compatible with the rapidly-changing world of financial services today. It takes at least 18 months to draft and implement a multilateral rule.[10] Moreover, the loose nature of the CSA often means that the fate of a draft multilateral instrument is often far from certain when the rule-making process commences. An example of this is the proposed

survey of chief compliance officers of U.K. financial services firms concluded that compliance costs equalled 5% of total costs. (UK Financial Services Practitioners Panel, survey of the FSA's Regulatory Performance Report, November 2002)

[8] Terrance K. Salman, "Promoting Growth through the Capital Markets," Address to the Vancouver Board of Trade, February 27, 2003.

[9] CSA, *Blueprint for Uniform Securities Laws for Canada* (January 30, 2003). p. 5.

[10] *Report of the Five Year Review Committee Reviewing the Securities Act (Ontario)*. p. 76.

financial planning proficiency rule – MI 33-107. The financial services industry initially engaged in a cooperative process with securities regulators to develop a national proficiency standard for financial planning in order to simplify compliance and to establish a base-level standard of proficiency for financial planners. After years of negotiation, several provinces chose not to implement the rule. Clearly, this is not a desirable outcome for any of the parties involved — it wastes time, resources, and goodwill among all participants.

It takes at least 18 months to draft and implement a multilateral rule.

"...a balkanized approach to securities regulation... makes it more time consuming and expensive for issuers to raise capital across the country."

Another example of the current system's challenges in responding in a timely way is the difficulty Canada's securities regulators have experienced in responding collectively to the pressures for change arising from the U.S. Sarbanes-Oxley Act. In a speech to the Canadian Club of Ottawa, Barbara Stymiest, TSX CEO,[11] cited an example where the SEC wrote to the CSA on October 18, 2002 asking for comments on the Sarbanes-Oxley Act. The CSA was not able to respond in a timely way, and replied after the SEC's deadline for making a decision. More generally, there have been strong differences of view among the provincial commissions regarding whether and how Canadian authorities should bring forward corporate governance rules to address the types of abuses that gave rise to the Sarbanes-Oxley Act in the U.S.

v) The Impact of Regulatory Inefficiency on Competitiveness

The negative impact of the current regulatory structure on Canadian equity markets has a ripple effect on the Canadian economy as a whole. The current Canadian securities regulatory structure reduces the competitiveness of the Canadian economy by increasing the cost that issuers and investors must incur to raise capital or to make investments. The more an entrepreneur must pay to raise additional equity capital, the less he/she will be inclined to do so. One recent U.S. study estimated that for every 1 per cent increase in the cost of acquiring capital, the amount of capital that firms and individuals seek to acquire decreases by 0.25 per cent.[12] Clearly the cost of raising capital matters to firms seeking investment. Choices about the type of capital to acquire, where to source that capital, and how much capital to acquire are based in part on that cost.

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[11] Barbara Stymiest, Speech to the Canadian Club of Ottawa, April 15, 2003, p.11.
[12] Robert Chirinko, Steven Fazzari, and Andrew Meyer, "How Responsive is Business Capital Formation to its User Cost?: An Exploration with Micro Data", *Journal of Public Economics,* Volume 74(1). October 1999.

The importance of capital formation and equity investment to economic development is well-documented. A recent study by Statistics Canada on the relationship between financing structures of small firms indicated that equity shortfalls are often a key impediment to innovative activity.[13] Investment is also a key factor in the growth of productivity. In a recent study for Industry Canada, economist Richard Harris of Simon Fraser University highlighted this, stating that "Productivity growth is strongly and highly correlated with investment in machinery and equipment measured as a share of GDP."[14] He goes on to say that the body of literature surrounding the linkage between investment and productivity "...is strongly supportive of the role of investment as a proximate cause of productivity growth."[15] If Canada is to become more productive and enhance its capacity to innovate, part of that effort must include taking measures to reduce the cost of acquiring and using equity capital, including streamlining the securities regulatory system. Those firms that rely upon the Canadian capital market for their financing are the ones for whom regulatory efficiency is most crucial.

"Retail investors can be denied access to public offerings on the basis of where they live."

vi) The Artificial Fragmentation of the Capital Market

In addition to imposing unnecessary inefficiencies and costs on firms that already operate nationally, the existence of 13 separate regulatory environments appears also to have an inhibiting effect on firms seeking to raise capital in more than one jurisdiction, and thereby creates artificial fragmentation of our capital market.

Analysis of the SEDAR database of reporting issuers in Canada indicates that only 5 percent of reporting issuers in Canada report in all thirteen jurisdictions, and only 16 percent of firms report in at least ten provinces or territories. Smaller firms, which often have the most difficulty raising capital, are the most disadvantaged by the current system (Figure 2). The implications of these findings are two-fold:

- The incremental costs created by the current system of securities regulation in Canada have a negative effect on the ability of firms to participate nationally and to raise capital nationally.

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[13] John Baldwin, Guy Gellatly, and Valerie Gaudreault, "Financing Innovation in New Small Firms: New Evidence from Canada", Statistics Canada, May 2002.
[14] Richard Harris, "Determinants of Canadian Productivity Growth: Issues and Prospects", Industry Canada Discussion Paper No. 8 (December 1999). p. 13.
[15] Ibid. p. 14.

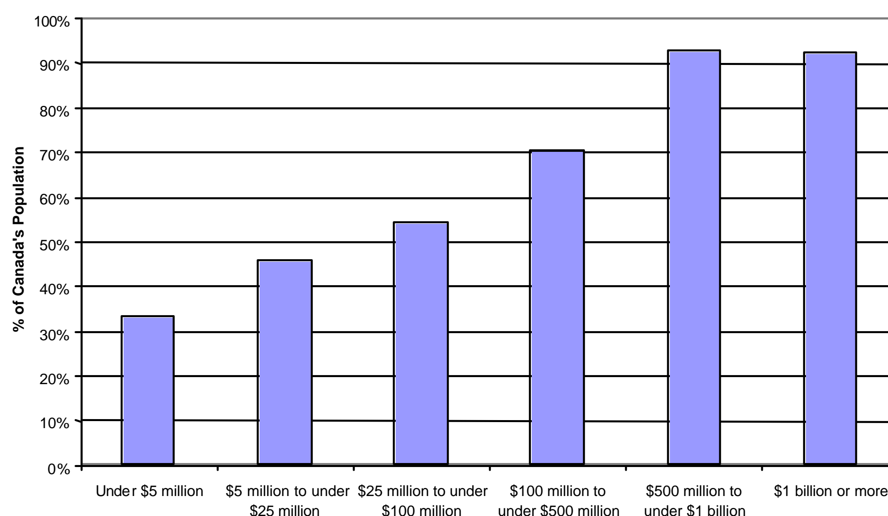
- While some small firms raise capital nationally, large firms have an advantage as they can spread higher regulatory costs over a larger base. Consequently small firms are less likely to make use of the national capital market than are large firms.

Only 5 percent of reporting issuers in Canada report in all thirteen jurisdictions.

While it is likely that scale factors, and not just the ability to bear regulatory costs, cause the largest firms to seek capital in the larger Canadian market, it is not clear that firms with assets of $25 million or less would generally limit their potential investor base to 10 or 12 million Canadians in a more efficient regulatory environment. This is precisely where the greatest cost of regulatory fragmentation might reside.

This affects the investment options available to investors. According to Neil Mohindra of the Fraser Institute, the current regulatory structure effectively creates a situation where "Retail investors can be denied access to public offerings on the basis of where they live."[16] This conclusion is based on research of rights offerings (a special class of public offering limited to a firm's existing shareholders) conducted by the Institute, which found that in 2000 and 2001, "...investors in each territory and in provinces other than Alberta, BC, and Ontario were excluded from the majority of offerings."[17] He goes on to say that "Territories and smaller provinces such as PEI fared the worst."[18]

Figure 2

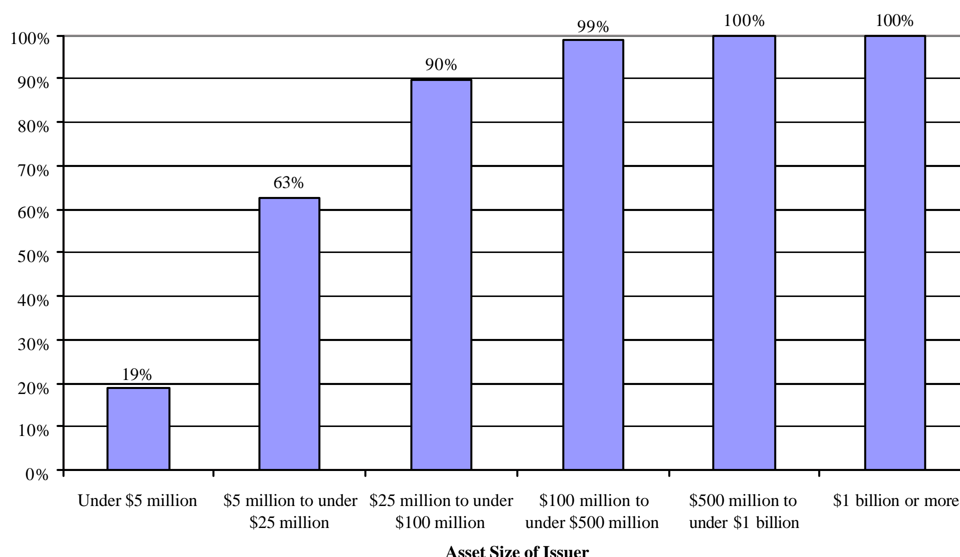


[16] Neil Mohindra, "Investors Sanctioned for Living in PEI", *Fraser Forum* (March 2002). p. 32.
[17] Ibid.
[18] Ibid.

It is sometimes argued that the fragmentation in the capital market is, in part, a reflection of the fact that there are local/regional markets with unique characteristics or needs, which in turn justifies the need for separate regulators across the country. Data from the SEDAR database, however, indicates that while there are some modest variations in the profile of issuers in Canada's four major provinces (Ontario, Quebec, Alberta, and British Columbia), the differences in terms of industrial composition and size composition are surprisingly small. Broadly speaking, the profile of issuers from all four major provinces in Canada is the same – small firms primarily involved in resource, industrial, and finance, insurance and real estate sectors. Such extensive homogeneity among the profiles of reporting issuers headquartered in the major provinces leads one to question the rationale behind the need for regional variations in securities regulations.

Clearly there are still some local capital markets in Canada, especially in the area of exempt distributions; however, in the main, the capital market in Canada is national. Nearly two thirds of issuers report in more than one jurisdiction. Moreover, most issuers concentrate their efforts on the major markets in Canada, which is in part a reflection of cost-benefit calculation that issuers must make given the incremental regulatory costs associated with reporting in additional jurisdictions. As a result the average person in Canada has access to nearly one half (47%) of all public offerings.

Figure 3



Even those industries that are generally associated with a particular region rely primarily on the national capital market. In the oil and gas industry, for example, the majority of producers (in all but the smallest size category) that report in Alberta also report in Ontario (Figure 3). Most of the market capitalization of oil and gas issuers is financed, therefore, in a national rather than local market.

Overall, the evidence presented above shows that, if left to their own devices, issuers in Canada would seek capital on a national basis to access the deepest capital pool and investors would invest across provincial borders to obtain the highest possible returns and enjoy the widest diversification. Fragmentation in the domestic capital market comes about not because of any regionalism inherent to the Canadian capital market but as a result of the incremental costs that the current regulatory structure imposes on issuers seeking to operate in multiple jurisdictions. Cross jurisdictional transactions are at the core of Canada's capital market.

III. Lessons From Other Jurisdictions

Both the United States and Australia provide useful case studies on how decentralized federal systems can accommodate a national form of securities regulation.

i) United States

In the United States, the regulation of securities traditionally resided with the states. Over time, however, the federal government became increasingly involved, creating a dual federal/state structure. In order to address industry concerns about regulatory complexity and the high cost of compliance associated with differing state securities regulations, the federal government's role has become more prominent in recent years. The federal response to regulatory inefficiency was a decision to pre-empt state regulation in some cases, and to require state regulations to conform with federal regulations in other areas. Most of the reforms in securities regulation were contained in the *National Securities Market Improvement Act of 1996 (NSMIA)*. In general terms NSMIA:

- pre-empted state regulation of issuers of securities that list on national securities exchanges;
- pre-empted state registration requirements for federally-registered investment companies (including mutual fund companies);

- exempted from state registration some classes of small securities offerings;
- pre-empted state registration requirements for investment advisors working for large, multi-state firms; and
- required states to harmonize key sections of their requirements for securities broker-dealers with those of the SEC, including capital requirements and reporting requirements.

U.S. streamlining efforts have resulted in lower costs for market participants, particularly for small issuers. A survey of small issuers and professionals involved in developing and marketing small issues, conducted by the SEC after the implementation of NSMIA, concluded that the pre-emption of state regulation in the area of small issues substantially reduced compliance costs.[19] One respondent noted that as a consequence of pre-empting of state regulation in this area, the amount of legal and para-legal time required to comply with state securities regulation decreased from 146 hours to 41.7 hours.[20]

Another lesson from the American experience is that firms prefer to be subject to national, rather than state, regulation when all other considerations are equal. A case in point is the impact that NSMIA had on the relative popularity of two similar classifications of small offerings that small issuers could undertake - Rule 506 offerings (which were exempted from state regulation under NSMIA) and Rule 505 offerings (which were not exempted).

> *The National Securities Market Improvement Act (NSMIA) pre-empted the states from regulating Rule 506 offerings but not Rule 505 offerings. Since the requirements of Rule 505 and Rule 506 are virtually identical except for investor qualification standards, most practitioners advise their clients to do Rule 506 offerings rather than 505 offerings. Given the limited usefulness of Rule 505*

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[19] Securities Exchange Commission, "Report on the Uniformity of State Regulatory Requirements for Offerings of Securities that are not 'Covered Securities'" (October 11, 1997). Section IV(A.): "Benefits of Pre-emption and State Efforts Towards Uniformity".(http://edgar.sec.gov/news/studies/uniformy.htm#seciv)

[20] "Report on the Uniformity of State Regulatory Requirements for Offerings of Securities that are not 'Covered Securities'", Footnote 93. (http://edgar.sec.gov/news/studies/uniformy.htm#FOOTNOTE_93)

> *since the passage of NSMIA, the [Securities Exchange Commission] should consider rescinding Rule 505.*[21]

The shift to rule 506 offerings is evidence of a preference for national regulation. Since the passage of NSMIA there has been a marked decline in the use of Rule 505 – in 1994, there were 2,163 Rule 505 offerings, declining to 1,016 by 1999. By contrast, the number of Rule 506 offerings has expanded dramatically, from 5,414 in 1994 to 13,112 by 1999.[22] Notwithstanding efforts to streamline and harmonize state securities regulation, issuers' preference has been to deal with a single regulator and a single set of regulations.

There is a clear lesson here for Canada – issuers prefer the certainty of a single set of national standards. It simplifies compliance and reduces the regulatory burden associated with raising capital. It also demonstrates that issuers perceive a significant difference between *harmonized* regulation and *national* regulation, and they highly value a single set of standards that are guaranteed to apply in all jurisdictions in a uniform fashion.

ii) Australia

Reform in Australia took place over several decades and occurred in a staged fashion.[23] Corporate law and securities regulation were traditionally the domain of the states and business frustration with the costs associated with fragmented regulation led them to seek improvements. In the 1960s, they passed uniform legislation that eventually diverged again as individual jurisdictions reacted individually to events.

In the wake of financial scandals in 1970, a senate committee recommended the creation of a national commission. In 1978, a three-tiered scheme was enacted that had the states enact federal legislation by reference and which saw a federal body (National Companies and Securities Commission) created in addition to existing state Corporate Affairs Commissions. This approach provided uniform

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[21] SEC, *Final Report of the SEC Government-Business Forum on Small Business Capital Formation*. July 1999. (www.sec.gov/info/smallbus/finrep17.htm)
[22] United States General Accounting Office, *Small Business: Efforts to facilitate equity Capital Formation*, (GAO/GGD –00-190, September 2000) pp 29-30.
[23] Five Year Review Committee, pages 293-295.

legislation but fragmented administration and enforcement. Justice R. P. Austin of the Supreme Court of New South Wales described this uniformity of legislative texts as ".. a hollow achievement unless it is accompanied by uniformity of administration of the law."[24] This compromise also proved to be unsatisfactory and was replaced by a national commission, the Australian Securities Commission, established under the auspices of federal legislation, without state involvement. Ultimately this proved to be unconstitutional in certain regards and the resulting system was a single regulator, based on federal legislation which the states apply as their own legislation.

The elements that characterize the evolution of the Australian system are relevant to Canada. The difficulties in maintaining harmonized legislation and dilution in the value of harmonization when administration and enforcement remain fragmented have been identified as issues in the Canadian context. Similarly, commentators here have recognized the need for a regulator's activities to be well grounded in constitutional authority. The Australian experience also provides a working example of how a delegation model can be used to create a single national securities commission without entering the realm of constitutional reform. Professor Ian Ramsey, Harold Ford Professor of Commercial Law at the University of Melbourne sums up the Australian achievement by noting that "Few would doubt that Australia's federal system of corporate law has worked successfully for the past decade. Not everyone may be fully satisfied but we no longer hear the substantial complaints that we did in the 1980s about a lack of uniform administration of companies legislation and ineffective enforcement."[25]

It is also worth noting that in both the U.S. and Australia, a national securities apparatus came about in part due to frustration with the lack of progress made through state-level securities regulation harmonization processes. In both cases, harmonization was seen as moving too slowly, being too selective and fragmented, and harmonization was found to be difficult to maintain in areas where it was achieved.

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[24] R. P. Austin, "The Role of the Courts following Referral of Power – Some Brief Comments," paper presented at the Corporate Law Teachers Association Conference, November 3, 2000.

[25] Ian Ramsey, "Challenges to Australia's Federal Corporate Law," Centre for Corporate Law and Securities Regulation, University of Melbourne (Research Paper).

IV. Options for Reform

i) **Considering the Passport and Single Regulator Models**

The Wise Persons' Committee has asked commentators to consider two broad options for the fundamental reform of securities regulation in Canada, namely a single national regulator and a passport model. The grid below represents our assessment of the strengths of the two models. We consider a variety of features that should characterize a regulatory model and determine the extent to which the two models deliver those features.

In this comparison, the single regulator model is the structure being proposed by the CBA (see below, page 36). The passport model used for comparison is the one set out in the June 11th discussion paper from the Steering Committee of Ministers. It should be noted that both the single regulator and passport models contemplate the possibility that some provinces may not participate in a restructured system, at least in the near term (i.e., in the single regulator model, some provinces may not opt-in and delegate powers, and in the passport model, some provinces may not enter into recognition agreements with other provinces). Since this possibility is common to both models, it is not addressed as such in the assessment below.

Although the model used for the comparison below is that proposed by the Steering Committee of Ministers, it is useful to note that the primary example of where the passport approach is in actual use is the European Union. The European securities regulatory structure looks the way it does because of the context from which it was born. Unlike Canada, which has a relatively homogeneous cultural and legislative base from which to craft a national securities regulatory system, the EU started from a base where "... most of the 12 Member States of the European Community have their own language (or languages), currency, legal system and accounting rules."[26] Complicating matters further, the financial systems of member states had evolved differently from one another resulting in a situation where "...the degree of state ownership of both industry and the banking system, the extent of universal banking, and the relative importance of individual versus institutional participation in the stock market vary country by country within the Community" and, furthermore, "...the

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[26] Brian Scott-Quinn, "European Community Regulation of Securities Markets", *Ministry of Finance (Japan) Financial Review*. Vol 32. p. 4 (of article).

structure of the securities industry and the type of market mechanisms used (in particular the extent of market making in the equity market) vary substantially."[27] The European environment is such that options were limited – the passport model was the most that could be achieved – whereas the Canadian environment does not create similar constraints.

This analysis focuses only on structural change – it does not consider content reforms. The reform of the substance of securities regulation is not a substitute for a single regulator or a passport model – rather it is a complement and could enhance the efficiency and effectiveness of either structural model.

Using the 20 criteria set out below, the analysis indicates that the passport model scores 10.5 out of 20 (52.5%) and the single regulator model 19 out of 20 (95%). Clearly, the single regulator model would produce the best results in terms of efficiency, effectiveness and flexibility and competitive system of securities regulation.

[27] Ibid.

Feature	Single Regulator	Passport
ISSUERS		
1. Single legislative framework for each individual issuer	✓ A single regulator would be responsible for enforcing and administering a single national Securities Act, and so, issuers would face only one regulatory framework.	1/2✓ Partly true. The passport model would maintain separate legislative frameworks in each province, but provides that there would only be one relevant legislative framework that applies to any particular issuer, i.e. that of the issuer's home province. However, since investors would have the right to complain in, and have complaints addressed by, the investor's jurisdiction (not the issuer's jurisdiction), it would be necessary for issuers to be familiar with, and have the capacity to deal with, the rules in all jurisdictions. Also, the passport model indicates that the host regulator reserves the right to pursue enforcement actions if it is not satisfied with the enforcement by the primary regulator, i.e. issuers still face the possibility of having to deal with more than one jurisdiction.

2. The same legislative framework for all issuers belonging to the same category	✓ While the framework might differ for different classes of issuers – e.g., SMEs or oil and gas companies – all issuers within a category are treated equally. There would be no variation across the country.	The passport model would not ensure uniformity for all issuers within the same category. Although harmonization of rules is important to making the model work, the passport model indicates that harmonization may not mean identical rules. The legislative framework may differ from one jurisdiction to another so firms may be treated differently if they have different home jurisdictions. Even if the legislative frameworks are largely similar, differences in the exercise of regulatory discretion might lead to different requirements.
3. Simplifies compliance for issuers	✓ A single regulator administering a single rulebook.	1/2✓ Partly true. Multi-jurisdictional issuers would generally only need to comply with a single piece of securities legislation. The passport model indicates, however, that the host regulator reserves the right to pursue enforcement actions if it is not satisfied with the enforcement by the primary regulator, i.e. issuers still face the possibility of having to deal with more than one jurisdiction.

4. Respon-siveness to local and regional interests	✓ While some provinces feel the single regulator model would be the least respon-sive to local interests, the governance structure of the model proposed by the CBA is designed so that this criteria can be achieved (i.e., the capacity to make local rules with intra-provincial application is provided for).	✓ Provinces and territories may write local rules as they deem appropriate. Local rules would face certain constraints, however: they would need to conform to principles (to be developed) intended to preserve the integrity of the passport system and minimize the impact on other jurisdictions.
REGISTRANTS		
5. Single legislative framework for regis-trants	✓ Single regulator model would create a uniform national legislative structure for all aspects of securities regulation, including registrants.	1/2✓ Partly true. The passport model would maintain separate legislative frameworks in each province, but provides that there would only be one relevant legisla-tive framework that applies to any particular registrant, i.e. that of the registrant's home province. However, since investors would have the right to com-plain in, and have complaints addressed by, the investor's jurisdiction (not the registrant's jurisdiction), it would be necessary for registrants to be familiar with, and have the capacity to deal with, the rules in all jurisdic-tions. Also, the passport model indicates that the host regula-tor reserves the right to pursue enforcement actions if it is not satisfied with the enforcement by the primary regulator, i.e. registrants still face the possibility of having to deal with more than one jurisdiction.

6. Simplifies compliance for registrants	✓ A single regulator would provide uniform registration requirements, administration, and enforcement nationwide.	1/2✓ Partly true. Registrants would generally only need to comply with a single piece of securities legislation. The passport model, however, indicates that the host regulator reserves the right to pursue enforcement actions if it is not satisfied with the enforcement by the primary regulator. Further, investors have the right to pursue actions in their own jurisdictions (and under that jurisdiction's rules), i.e. registrants still face the possibility of having to deal with multiple jurisdictions.
INVESTORS		
7. Provides uniform investor protection	✓ A single regulator would provide one, uniform enforcement mechanism across the country with no jurisdictional uncertainties.	Under the passport model, responsibility would rest with the investor's jurisdiction (for investor complaints) and the primary regulator (for enforcement actions). Also, the investor's jurisdiction could launch enforcement action if it was not satisfied with the primary regulator's actions. In practice, therefore, investor protection could vary from province-to-province. Also, although the model indicates that provinces would seek to enter into enforcement agreements with each other, cross-jurisdictional enforcement and compliance issues would face the same difficulties as today.

ALL CAPITAL MARKET PARTICIPANTS		
8. Single administrative system and consistent application of securities rules	✓ One regulator administering one rulebook, with corresponding efficiencies and consistency of administrative application.	Given that the passport model involves multiple regulators, there may be variations in the administration and interpretation of separate Securities Acts.
9. Reduces the cost of the regulatory structure	✓ Single regulator would replace the existing provincial securities regulatory authorities. Economies of scale could be achieved and regulatory resources allocated more efficiently.	In the passport model, existing regulatory bodies would remain in place, with continued duplication of function and structure (with corresponding costs) across the country. Also, despite the primary regulator approach, each jurisdiction would continue to levy fees to maintain its individual administrative structure. Consequently, no economies of scale would be achieved.
10. Reduces the volume of regulation	✓ A single Securities Act would replace existing Securities Acts.	1/2✓ The same number of acts and rules would continue to exist. Although efforts would be made to harmonize legislation, the model indicates that this may not mean identical legislation, i.e. differences are likely to remain. Although market participants would generally only have to deal with their primary jurisdiction, the model's investor protection approach (i.e., action by the investor's jurisdiction) means that participants would have to be familiar with all jurisdictions' regimes.

11. Promotes rapid, coordinated response to changes in the marketplace	✓ A single regulator system would streamline the rulemaking process significantly.	1/2✓ Partly true. Each jurisdiction can respond rapidly but must do so within the parameters of the passport agreement. Any co-ordinated response would be much more time consuming, as the current CSA process demonstrates. Also, the maintenance of the passport system depends on the ability of all jurisdictions to maintain harmonized rules and legislation. So, material changes to rules/legislation in response to developments would need to be made in all jurisdictions in order for the passport system to function as intended.
12. Accessibility to the system for all market participants	✓ As proposed by the CBA, a national regulator would have regional offices, drawing in large measure upon human resources from existing commissions.	✓ Existing commissions would continue to be in place, and there would be processes in place to ensure access for issuers, registrants, and investors through the passport model.
13. Supportive of innovative regulatory changes	✓ The single regulator may write rules as it deems appropriate.	1/2✓ Provinces and territories may write innovative rules as they deem appropriate. Such rules would face certain constraints, however: they would need to conform to principles (to be developed) intended to preserve the integrity of the passport system and minimize the impact on other jurisdictions.

		Also, the maintenance of the passport system depends on the ability of all jurisdictions to maintain harmonized rules and legislation. So, material innovative changes in one jurisdiction would need to be made in all jurisdictions in order for the passport system to function as intended.
OTHER PUBLIC POLICY CONSIDERATIONS		
14. Clear lines of accountability	✓ The single regulator, as proposed by the CBA, would be governed by a Council of Governors made up of individuals named by all participating governments. Provinces would delegate their powers to the new body, which would be anchored by federal legislation. Under this federal legislation, the Minister of Finance would formally appoint Council members on the advice of the provinces (as above), and would be accountable for the regulator.	✓ The accountability framework under the passport model would be broadly the same as currently exists – each provincial regulator is accountable to the provincial government.
15. Enhances international profile	✓ Single national regulator would be seen as a national voice for the Canadian securities regulatory system.	1/2✓ The status quo would remain with a variety of provincial bodies sitting on international bodies. If all jurisdictions participate, however, the system could evolve to the point where the CSA could take on the role of the single national voice in international settings.

16. Provides an International voice for <u>all</u> Canadians	✓ Single national regulator would be seen as a national voice for the <u>entire</u> Canadian securities regulatory system and serve the interests of the entire capital market.	1/2✓ The status quo would remain with a variety of provincial bodies sitting on international bodies. If all jurisdictions participate, however, the system could evolve to the point where the CSA could take on the role of the single national voice in international settings.
17. Builds on existing securities regulatory expertise	✓ The single regulator would draw knowledge and human resources primarily from current provincial regulatory authorities.	✓ The passport model essentially maintains the existing regulatory expertise.
18. Works within the existing constitutional division of powers	✓ The regulator would be based on existing powers to delegate authority or to legislate by reference, as well as by federal powers over inter-provincial trade.	✓ Authority remains with the provincial governments.
19. Ease of transition to a more efficient securities system and structure across the country.	The move to a single regulator requires a more complex transition process in which a new body is created, staff are transferred among organizations and regulatory authority is transported to new jurisdictions.	✓ The passport model would require harmonized legislation and agreements among participating provinces. However, since it maintains the existing infrastructure, it is likely easier to implement than a single regulator.

20. Provides a platform to move to a single national market conduct regulator	✓ This model creates an infrastructure that could accommodate all aspects of financial services market conduct regulation. Regulation of banks could migrate from a federal regime to a cooperative federal/provincial regime.	Under the passport model, responsibility would rest with the consumer's jurisdiction (for consumer complaints) and the primary regulator (for enforcement actions). Also, the consumer's jurisdiction could launch enforcement action if it was not satisfied with the primary regulator's actions. In practice, therefore, consumer protection could vary from province-to-province. Also, although the model indicates that provinces would seek to enter into enforcement agreements with each other, cross-jurisdictional enforcement and compliance issues would face the same difficulties as today. Also, since the passport model retains individual provincial commissions, any attempt to create a national market conduct regulatory system based on the passport model would result in more regulatory fragmentation and duplication for banks which are now subject to a single federal market conduct regulator (the FCAC).

Based on the above analysis, it is clear that implementing the passport model would result in significant improvements over the status quo, particularly in the areas of simplifying compliance requirements for issuers and registrants. At the same time, however, it is also our view that a national securities regulator would provide more substantive benefits and efficiencies for the capital market and for market participants and, as such, deserves serious attention from

While there are some modest variations in the profile of issuers in Canada's four major provinces (Ontario, Quebec, Alberta, and British Columbia), the differences in terms of industrial composition and size composition are surprisingly small.

policy-makers and governments across the country. In considering the options, the following factors should be considered:

- The regulatory structure should be consistent with, and appropriate for, the size and scope of the market and its participants. Canada has a national capital market that is well integrated into global markets. Accordingly, in our view it would be more efficient to have a single national regulator that reflects the financial reality and that is open to modifications to accommodate specific local concerns, rather than the existing system of multiple regulators that continually needs to modify and realign their local rules to reflect financial reality. Put simply, it is better to have a single national regulator to serve a national market, than to have a multiplicity of local bodies that go to great pains, often unsuccessfully, trying to achieve the results of a national regulator.

- A single regulator administering a single set of rules would reduce the complexity of the regulatory framework and reduce both direct and indirect regulatory costs. At the simplest level, it would reduce the number of filings that need to be made, the number of fees that need to be paid and the number of regulatory staff that need to be employed. More importantly, it would reduce the degree of regulatory uncertainty that market participants face and improve the timeliness of regulatory responses. Every participant would know what rules apply and would know that they will be administered uniformly.

- A single regulator would be more likely to allocate resources efficiently and achieve economies of scale across the system. Instead of having numerous regulators, working for different commissions, examining the same issues, regulatory resources could be applied efficiently within the single regulatory body. All jurisdictions would have access to the services of high quality regulatory staff, spread across the country. In some cases, and where appropriate, staff might specialize in regional offices.

- A single regulator would provide Canada with a single voice internationally and a mechanism by which to respond to events in a timely fashion. It would be responsible for protecting the interests of the Canadian capital market.

Accordingly, while we welcome the incremental benefits that would result from implementing a passport system and recognize that such a system may require fewer steps to achieve in the nearer term, the CBA recommends that governments across Canada pursue a single national regulator as their goal for achieving an efficient regulatory structure.

ii) Jurisdictional Considerations Regarding the Single Regulator Model

Several ways in which a single national regulator can be created have been identified in the public policy discussions on securities reform over the last several years. A key consideration underlying the different models is how to ensure that a single regulator would have clear constitutional powers to exercise regulatory authority over all securities matters. As we make clear in the discussion below, it is our view that (a) the manner in which securities regulation is currently exercised does not necessarily reflect the actual allocation of constitutional power over securities among levels of government, and (b) federal government involvement is needed to ensure that a national regulator has the needed regulatory authority.

At issue are the following two questions:

1. While the provinces and territories have jurisdiction over securities matters that are purely intra-provincial, do they also have clear authority over securities matters that have interprovincial and international aspects?

   There is some uncertainty regarding the legal authority of provinces and territories to regulate cross jurisdictional transactions. In his review of case law and literature in this area, Professor Jeffrey MacIntosh of the University of Toronto Law School has noted that "…*provinces can only delegate to a national commission that authority which they constitutionally possess […] the provinces' ability to regulate in relation to transactions with an interprovincial or international character is increasingly problematic. A national commission operating under the authority of joint provincial delegation will have no more power to deal with cross-border transactions than the authority currently possessed by the provinces.*"[28] Furthermore, as the Crawford Report has noted,

[28] Jeffrey G. MacIntosh, "A National Securities Commission for Canada?" in T.J. Courchene and E.H. Neave eds. Reforming the Canadian Financial Sector: Canada in Global Perspective, John Deutsch Institute for the Study of Economic Policy, 1997,

Nearly two thirds of issuers report in more than one jurisdiction. In the oil and gas industry the majority of producers (in all but the smallest size category) that report in Alberta also report in Ontario.

"*To date, the provinces have asserted jurisdiction over securities regulation under their power over property and civil rights in the province. However, over the past few decades, securities activity has gradually acquired more of an interprovincial or national character. The Federal Government therefore may have overlapping jurisdiction in securities regulatory matters under its "trade and commerce power" or under its general power to create legislation for the 'Peace, Order, and Good Government of Canada'.*" Indeed, as noted above, the Canadian capital market does not have a predominantly local character, as two-thirds of issuers report in more than one province. Even in the oil and gas industry, where there is a clear regional bias in the location of economic activity, the appropriate capital market is national – in all but the smallest size category, issuers report in Ontario as well as Alberta. All of this would suggest that single regulator models that rely solely on delegation by provincial governments are problematic.

2. While it is clear the federal government has jurisdiction over the regulation of securities matters that have interprovincial and international elements to them, notwithstanding the past practice of the federal government not to exercise such authority, can a similar case be made for the regulation of purely intra-provincial matters?

   The existing legal analysis[29] indicates that the federal government has a legitimate claim to jurisdictional authority over interprovincial and international securities transactions. At the same time, however, this authority is less clear for intra-provincial trades which appear to be more clearly under the authority of the provincial governments by virtue of their property and civil rights authority within the province. Consequently, a single regulator model that does not include provincial participation might also be problematic.

iii) Options for a Single National Regulator

The following discussion considers three models for achieving a single national regulator.

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p. 208. Joyce Maykut also makes this point when she argues that "cross-jurisdictional model that includes the federal jurisdiction will inevitably be safer constitutionally than a model that does not." Joyce C. Maykut, "An Alternative Regulatory Model for Canada," 8th Annual Queen's Business Law Symposium, November 16, 2001, p. 13

[29] MacIntosh, "A National Securities Commission for Canada?".

Inter-provincial Delegation Model: The provinces could, without federal participation, establish a pan-Canadian regulatory commission to which they would delegate regulatory authority over securities. Such a model would alleviate political concerns about federal involvement in what provinces see as their jurisdiction. It could also achieve many of the efficiencies associated with a single regulator. On the other hand, it would suffer from some legal uncertainties regarding the body's powers over inter-provincial and international securities matters.

Such a pan-Canadian body would likely be the creation of the securities legislation of all of participating jurisdictions. Consequently, it would not be able to provide a clear public accountability mechanism, as all participating jurisdictions would be responsible for the commission. As well, while the legislation of participating jurisdictions would be harmonized, this could present some administrative challenges with respect to future legislative changes to ensure that every jurisdiction authorizes the commission to administer uniform legislation.

In the United States, the federal government's role has become more prominent in recent years. The federal response to regulatory inefficiency was a decision to pre-empt state regulation in some cases, and to require state regulations to conform with federal regulations in other areas.

Another lesson from the American experience is that firms prefer to be subject to national, rather than state, regulation when all other considerations are equal.

Unilateral Federal Model: The federal government could unilaterally enact securities legislation and create a securities commission. A unilateral federal commission would establish a clear accountability framework with a federal commission under a federal statute, responsible to the Parliament of Canada through an appropriate Minister, and would provide Canada with a single voice internationally. Also, a federal securities presence would allow for better coordination of economic policy matters nationally - monetary policy, banking policy, and national tax and fiscal policy are currently federal responsibilities. To date, capital market regulation has been the exception.

On the other hand, the legislation could be challenged by some provinces and/or territories, which could create uncertainty in the market. The federal government could reduce the degree of uncertainty by passing the appropriate legislation and referring it to the courts prior to creating the commission. The ability of the government to move forward would depend on the outcome, and it is possible to foresee a result that upholds the federal authority over interprovincial and international activities, but does not put the government in a position to assert authority over purely intra-provincial matters. As such, the model might not provide a comprehensive system of regulation encompassing all aspects of securities activity and this might result in an increase in the number of securities

regulatory bodies, i.e. a federal body in addition to existing provincial bodies.

Cooperative Federal/Provincial Model: In this model the federal and provincial governments agree to set up a single regulatory body to oversee the "national capital market." This national market would include all of the jurisdictions that participate in the model.

The commission would be overseen by a Council of Governors with each participating jurisdiction naming an individual to the Council to serve in such a manner as to create a high degree of confidence in Canada's capital market by protecting investor interests and promoting an efficient capital market. By virtue of their majority, provincial appointees could control the Council. Participating jurisdictions would delegate their appropriate regulatory authority to the commission.

On the one hand, this model would provide a system of regulation free of jurisdictional conflict, as it is a cooperative endeavour. It would also provide a comprehensive system of regulation for all aspects of securities matters, within the territory of participating jurisdictions. Because of this comprehensiveness, the single regulator could also be the mechanism by which local rules and exemptions are administered, and could, therefore, do so in a co-ordinated fashion which protects the national nature of the market. Further, there would be a national voice to speak for Canada in international securities forums. While non-participating provinces might wish to continue having an international voice, the presence of the federal government in this model would enhance its stature in the international realm. It would be important in such a model to ensure that there is a clear accountability framework, and this could be achieved by ensuring that the model is anchored in a single statute of a single jurisdiction.

Using 20 criteria, the passport model scores 10.5 out of 20 (52.5%) and the single regulator model 19 out of 20 (95%).

On the other hand, since the model requires provinces to agree to participate, it is possible that it would not cover the entire Canadian capital market.

Based on the above analysis, we believe that a single national securities regulator, based on a federal-provincial cooperative model, would be best for Canada, and are encouraging the federal, provincial and territorial governments to pursue such a model.

iv) Details of the CBA's Proposed National Regulatory Model

In this model, the federal government would play a role but the **control of the CSC would rest with a Council of Governors, comprising a majority of individuals nominated by the provinces and territories.** Federal government participation would facilitate coordination with other domestic regulators and policy makers and would provide some international advantages.

The following is a detailed presentation of the proposed structure of the Canadian Securities Commission.

- The CSC would be a national body, in which provinces and territories would agree to participate. It would commence operations once a critical mass of provinces and territories has been achieved. Those participating jurisdictions would, in aggregate, comprise the "national securities market" over which the CSC would have full and exclusive regulatory authority. Once all jurisdictions have agreed to participate, only one securities regulator would exist in Canada and the "national securities market" would encompass the entire country.

- Once operational, the CSC would obtain its financing from industry participants through fees. It would operate on a cost-recovery basis and would not transfer any surpluses to any level of government. Any persistent surpluses would eventually be returned to stakeholders. One possibility would be to use any surplus in one budget cycle to reduce fees in the subsequent cycle, as the Ontario Securities Commission proposes to do. The CSC would start off with a clean financial slate.

- The CSC would be responsible for all aspects of securities regulation now undertaken at the provincial and territorial level, including the recognition and oversight of self-regulatory organizations (SROs) such as the IDA. The CSC would have broad rule-making authority, similar in scope and process with current practice in major provincial jurisdictions, and would have full enforcement powers. Provincial and territorial governments that participate in the CSC would delegate all authority to the commission.

- The CSC would have the authority to tailor its rules to the needs of the marketplace by establishing national rules to meet the needs of specific sectors, such as mining, oil and gas or the

small business sectors.

In addition, provinces have long expressed concerns that a national body would not be responsive to local needs of the small business community for access to capital. Most proposals for structural reform recognize this as a legitimate concern. Consequently, the CSC should have the authority to administer local rules on behalf of provinces and territories. So as not to detract from the national nature of the capital market, such local rules **would not** apply automatically to participants. Rather, participants must choose to have them apply and any transactions based on such local rules would have to be clearly identified, with full disclosure for investors. In general, a local rule would be more permissive rather than more restrictive; for example, it could provide for liberal capital raising prospectus exemptions. Issuers who do not choose to have these local rules apply to them will automatically be subject to national rules.

Wherever local rules are applied, the following three scenarios could arise:

- The CSC approves the local rules but requires that any securities sold pursuant to such provisions could not be promoted to residents outside of that jurisdiction, whether in the primary or secondary market.
- More than one jurisdiction adopts the same local rule. In such a case, cross-border trades could take place among those jurisdictions.
- The merits of the local rule become evident to all participants and it is adopted by the Council of Governors as a national rule.

Whenever the CSC is asked to administer local rules, it should first consider whether the objectives could be achieved through a national rule instead. The ultimate decision would be up to the CSC which could refuse to administer local rules if it considers a proposal to be harmful to investors or harmful to the Canadian capital market.

As noted above, the administration of local rules would be guided by the principles that they not harm investors or detract from the national capital market. In addition, they should not add administrative complexity or confusion which would needlessly add to regulatory

costs, at both the Commission level and at the compliance level.

- The CSC would represent Canada on international bodies (such as IOSCO) and in international relationships / negotiations such as dealing with the SEC. The existence of the CSC would provide a true national alternative that does not currently exist.

- Oversight of the CSC would be the responsibility of a Council of Governors, with the government of each participating jurisdiction being entitled to name one member.

  This Council would be like a board of directors, providing broad oversight (e.g., budget approval, operating policies for the CSC, etc.) but not engaging in the day-to-day running of the CSC. The Council would also be responsible for authorizing rules (developed by the CSC) to be released for public comment. The Council would not act as a regulatory tribunal or hear appeals of CSC regulatory decisions. Members of the Council would be expected to have appropriate capital market experience to help the CSC effectively achieve its objectives and would be expected to undertake their duties in a manner for the benefit of all stakeholders – they would **not** represent the government that nominated them.

  All members of the Council would have the same roles and powers. The Council would elect the Chair. In all circumstances, the control of the Council would rest with Governors nominated by provincial and territorial governments by virtue of their majority representation.

  In ordinary circumstances, Governors would have equal votes and a simple majority would be needed. On particular, and exceptional issues, it might be appropriate to require a greater degree of consensus. In such cases it might be more appropriate to use a voting mechanism that is weighted by capital market activity or population, or to maintain the one-member one-vote rule but to require a super majority (two-thirds) to carry the vote. Specific rules would need to be established to determine when such special voting would take place.

  The Council would appoint the CSC Commissioner and Deputy Commissioners, who would be responsible for the delivery of regulation, the development of rules for Governors' review, and serving as regulatory tribunals.

Given the requirement that Governors have capital market experience, provinces might look to their existing regulatory structures for their initial nominees.

- The CSC would table with the designated Ministers in each participating jurisdiction a Statement of Priorities for the upcoming year. Prior to that tabling, a draft document would be published for comment. In addition, the CSC would provide an annual report to designated Ministers which would be tabled in the respective legislatures.

- The CSC would constitute a repository of expertise on securities regulation and would use that expertise to make rules and develop amendments to the securities legislation.

- The CSC would draw upon the expertise of existing, participating securities commissions and would have a network of regional offices. During the transition, offices would continue to exist in participating provinces, with some rationalization into regional centres. Eventually decisions about staffing and office location would be made by the Council, on the basis of capital market and administrative needs.

- Although provinces would delegate authority to the new body, the CSC would be anchored by federal legislation, with the federal Minister of Finance as the responsible Minister. As such, the Minister of Finance would have the responsibility of approving rules written by the CSC.

In making this proposal, the CBA considered different models of achieving federal involvement, i.e., a model in which each participating jurisdiction enacts a securities act that the commission administers by delegating authority to the commission, and a model in which a federal securities act is the anchor legislation. In the former, all participating jurisdictions (federal and provincial) enact identical securities legislation, as contemplated by the Uniform Securities Legislation Project, and all delegate regulatory authority to the CSC. This variant would treat every participant equally and hence might be more acceptable to provinces and territories. This would come at the price of greater administrative complexity, however. This complexity can be addressed by making securities legislation a kind of "platform legislation" that would leave many of the details to the rules that the CSC would have the power to write. The administra-

tive complexity could also be alleviated somewhat by requiring only the most significant of rules to be approved by Ministers. The real challenge to this approach, though, is the lack of direct and unambiguous political accountability.

The model that the CBA is recommending, i.e. anchoring the CSC in federal legislation and making the federal Minister responsible, has the advantage of a clear and unambiguous chain of Parliamentary accountability. The designated federal Minister would be responsible for the actions of the commission. In addition, this model would provide administrative advantages as well. When legislation needs to be amended or rules need to be approved, only one legislature would be directly involved, ensuring that the commission would be subject to consistent legislation and would be able to administer the same rules across all participating jurisdictions.

"Few would doubt that Australia's federal system of corporate law has worked successfully for the past decade. Not everyone may be fully satisfied but we no longer hear the substantial complaints that we did in the 1980s about a lack of uniform administration of companies legislation and ineffective enforcement."

Professor Ian Ramsey, Harold Ford Professor of Commercial Law at the University of Melbourne

V. Concluding Comments

The banking industry believes that we have a unique opportunity to undertake a fundamental reform of the manner in which we regulate securities in Canada. The call for change is coming from a wide range of market participants who observe first hand the excess costs associated with a regulatory system that does not meet the needs of the Canadian economy and the Canadian capital market.

U.S. streamlining efforts have resulted in lower costs for market participants, particularly for small issuers. As a consequence of pre-empting of state regulation in this area, the amount of legal and para-legal time required to comply with state securities regulation decreased from 146 hours to 41.7 hours.

The Canadian system of securities regulation is the product of our history. Canada is not unique in this regard – Australia and the United States have experienced a similar historical pattern. Yet while the Canadian system of regulation has not kept pace with the evolution of the economy, capital market or financial institutions, the Australian and American systems have been able to undergo substantial reform and establish a regulatory system that reflects international best practices. Reform in those countries was not quick or easy but the ultimate benefits are clear to see.

We believe that Canadians deserve similar high standards in our regulatory system. While we recognize that profound reform takes time and a great deal of effort, we further believe that Canadians should not settle for anything but the best that they can achieve. The national cooperative regulator model proposed here constitutes, in our view, the best that can be achieved.

Ultimately, it is envisaged that this model would encompass all

provinces and territories. In the interim, that is not likely to be the case. Consequently, two important considerations need to be dealt with - the critical mass needed for the CSC to be established and the working relationship that the CSC would have with non-participating provinces and territories.

Our submission has focussed on the ultimate model when fully implemented. Transition issues are a legitimate concern and need to be addressed. For example, would the structure of the Council of Governors be different in the early stages? What kind of relationship would exist between the CSC and non-participating jurisdictions? These issues would need to be addressed by any cooperative model, including a passport model. Transitional issues are not insurmountable and are not a barrier to the creation of a single national regulator based on federal and provincial cooperation. Consequently we believe that it would be best for all Canadians if our governments worked together to achieve that goal.