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Securities Regulation in Canada

The Case for Effectiveness

Pierre Lortie

With commentary by
Thomas Hockin

The existing system of securities regulation in Canada is recognized as one of the best worldwide by any measurable criterion, and there is no compelling evidence that a national securities regulator would better serve Canada's needs and interests, a conclusion that is not shared by the commentator.

Selon tous les critères mesurables, le système canadien actuel de réglementation des valeurs mobilières est reconnu comme l'un des meilleurs au monde ; il n'y a aucune donnée indiquant qu'un organisme de réglementation national servirait mieux les besoins et les intérêts du pays — une conclusion à laquelle le commentateur ne souscrit pas.

Compétitivité, productivité et croissance économique

Competitiveness, Productivity and Economic Growth

Contents

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Summary

Since legislation to establish a national securities regulator was tabled in May 2010, there has been a debate around the constitutionality of the legislation, and the Supreme Court is expected to render a decision on the question sometime in 2011. But independent of the constitutional issue, an equally important question is the one Pierre Lortie takes up in this study: Would such a change be sound public policy?

Lortie begins by assessing how Canada's decentralized securities regulation system has performed according to several measures (including adoption of best practices, cost of regulation, investor protection and business cost of equity), and he concludes that it compares favourably with those of other countries.

The author attributes this performance to a high degree of coordination among provincial regulatory authorities. The national reporting systems and harmonized standards cover many aspects of securities markets. Furthermore, dealers can register and companies can clear prospectuses with the regulator in their home province or territory and have it apply in all other jurisdictions, except Ontario. The fact that Ontario is not part of this so-called "passport" system is an inefficiency that the author recognizes, and he urges Ontario to join.

An important asset of the current system in the author's view is that it can cater to regional economic differences, which are considerable in Canada. A national regulator would have neither the ability nor the incentive to cultivate the smaller regional exchanges across the country (such as the TSX venture exchange in Calgary) that cater to clienteles with unique needs. The vibrancy of these exchanges is particularly important in Canada, since other sources of corporate finance (such as venture capital markets and private equity) are scarce compared to those in other countries.

Lortie's conclusion is unequivocal: Notwithstanding legitimate critiques of certain details in the functioning of the current system, Canada has by any measurable criterion a regime that is recognized as one of the best in the world. He finds no evidence whatsoever to support the notion that a national securities regulator would better serve Canada's needs and interests.

In his commentary, Thomas Hockin, who chaired the 2009 expert panel that recommended a national securities regulator, has a decidedly different perspective. He questions the ability of the current system, however coordinated and harmonized, to react quickly enough to developments in global markets that would have national repercussions in Canada. In addition, he argues that a national regulator would improve investor protection by ensuring better enforcement. As well, it would be organized in such a way as to retain flexibility vis-à-vis regional differences.

Résumé

Depuis le dépôt en mai 2010 d'un projet de loi visant à créer un seul organisme national de réglementation des valeurs mobilières, le débat s'est focalisé sur la constitutionnalité d'une telle mesure, et la Cour suprême devrait rendre une décision à ce sujet d'ici à la fin 2011. Mais au-delà de l'enjeu constitutionnel, Pierre Lortie s'interroge dans cette étude sur la question tout aussi importante de la justesse d'un tel changement en termes de politiques publiques.

Pour ce faire, il évalue d'abord en profondeur le rendement de notre système décentralisé de réglementation des valeurs mobilières en examinant plusieurs de ses aspects (notamment l'adoption de pratiques exemplaires, le coût de la réglementation, la protection des investisseurs et le coût du capital). Et il en conclut que le système actuel se compare avantageusement à ceux d'autres pays.

L'auteur attribue la solidité de ce rendement à l'excellente coordination entre les autorités de réglementation provinciales. Outre les systèmes nationaux d'information financière et les normes harmonisées qui couvrent plusieurs aspects du marché des valeurs mobilières, l'on peut faire approuver un prospectus ou s'inscrire à titre de courtier auprès de l'organisme de sa province ou de son territoire de résidence et faire appliquer ces autorisations partout ailleurs au pays, à l'exception de l'Ontario. L'auteur exhorte d'ailleurs l'Ontario à se joindre à ce « système de passeport » pour corriger l'inefficience créée par sa non-participation.

L'un des atouts clés du système actuel réside selon l'auteur dans sa capacité de tenir compte des différences économiques régionales, qui sont considérables au Canada. Or un organisme de réglementation unique n'aurait ni la capacité ni la motivation de cultiver et de renforcer les petites bourses de valeurs au pays (comme la Bourse de croissance TSX à Calgary) qui servent des clientèles aux besoins particuliers. Pourtant, le dynamisme de ces bourses a une importance d'autant plus grande au Canada que les sources de financement des entreprises (comme les marchés de capital-risque et les souscriptions privées) y sont moins nombreuses que dans d'autres pays.

L'auteur conclut sans équivoque qu'en dépit des critiques légitimes touchant certains détails de fonctionnement du système actuel, le Canada possède selon tous les critères mesurables l'un des meilleurs régimes du monde et est reconnu à ce titre. Il ne trouve ainsi aucune donnée indiquant qu'un organisme national de réglementation des valeurs mobilières servirait mieux les besoins et les intérêts du pays.

Dans son commentaire, Thomas Hockin, président du groupe d'experts qui avait recommandé en 2009 la création d'un organisme unique national, soutient un point de vue nettement différent. Il remet ainsi en question la capacité du système actuel, même mieux coordonné et harmonisé, de réagir promptement aux développements au sein des marchés internationaux qui se répercutent sur le Canada. Il avance de surcroît qu'un organisme national renforcerait la protection des investisseurs grâce à une mise à exécution en application améliorée et à une organisation conçue pour préserver la souplesse nécessaire à la prise en compte des différences régionales.

Securities Regulation in Canada: The Case for Effectiveness

Pierre Lortie

On May 26, 2010, the federal government released a proposed *Canadian Securities Act* and, concurrently, asked the Supreme Court of Canada for its opinion regarding the legislative authority of Parliament to adopt such an Act. The federal proposal is all-encompassing: it would give the federal government control over the securities regulation domain through a comprehensive statutory and regulatory regime administered by a single national regulator. The federal initiative thus constitutes a direct challenge to an area that has long been acknowledged to be within the exclusive jurisdiction of the provinces by virtue of article 92.13 of the *Constitution Act, 1867*.[1] Indeed, two provincial courts of appeal — that of Alberta on March 8, 2011, and that of Quebec on March 31, 2011 — have rendered their decision that the federal proposal, as it stands, is unconstitutional. The Supreme Court of Canada heard interested parties in April 2011, and its decision in the matter of the reference is eagerly awaited. Little noted in the public debate, however, is the federal government's contention that both Parliament and the provinces have constitutional authority to adopt comprehensive securities legislation and that, in conceding authority to Parliament to do so, the Supreme Court would not be restricting or reducing the constitutional jurisdiction of the provinces.

Issues of two different orders arise from the federal government's initiative. The first lies in the constitutional realm, which, however, is not the subject of this study. The second pertains to the merits of the federal initiative per se. Is the transition to a single national securities regulator under the jurisdiction of Ottawa sound policy and worth pursuing? Is the transfer of jurisdiction likely to improve materially or, rather, undermine the efficacy of securities regulation in Canada? What are the costs and risks associated with such a fundamental change in the Canadian securities regulatory architecture embodied in the proposed Act? After all, it would be of dubious value to pit the federal government against a majority of provinces in a constitutional battle over this matter unless it could be demonstrated that the performance of the current securities regulatory regime is significantly inferior to what is observed in other countries and that a centralization of the regulatory apparatus is necessary to correct its shortcomings.

The competing economic arguments in this debate can be summarized as follows. Proponents of a single regulatory system posit that centralization is the best approach to securities regulation in Canada since, at the core, uniformity is viewed as necessary to achieve efficiency, and divergence is per se undesirable: "Only a single federal regulator administering a single federal body of law has the power to ensure that market rules are applied consistently across the country" and to "establish a uniformly high standard of investor protection across the country" (Attorney General of Ontario 2010, 21). The current regulatory structure, described in more detail later in this study, is provincially legislated and managed, with each of the 13 provinces and territories having its own securities commission or equivalent authority and accompanying legislation. Thus, preserving the national scope of Canada's securities markets requires cooperation and coordination among many different jurisdictions, a characteristic that is depicted as a fatal shortcoming that would render the system slow to adapt and respond in a timely manner to important market developments. It is also asserted that "[securities] enforcement could be strengthened across Canada under unity of command" (Crawford 2010). In essence, the argument is that the dynamics inherent in a federal system should be suppressed in the securities field because they are inimical to Canada's best economic interests. Proponents of a single regulatory system also argue that a national regulator is essential because securities markets are increasingly global in reach and the interdependencies that result call for securities regulation at the international level. This, they argue, necessitates a single Canadian perspective and unified representation in world forums where securities matters are addressed.

Proponents of the current regime, in contrast, insist that, given the heterogeneity of Canadian securities markets — characterized by diversity among regional industries, types and sizes of issuers and local capital market infrastructures — the current regulatory architecture is, in fact, a strength. In short, they reject the proposition that centralization of the regulatory regime is a desirable goal. They argue that under such a national regulatory regime the concentrated structure of a securities industry dominated by six major chartered banks and closely intertwined with the regulatory and economic policy instruments of the federal government would increase significantly the influence of these banks on the formulation of securities policies and regulation to suit their own interests — a risk compounded by the highly concentrated geographic location of major decision-makers in the Canadian financial industry.[2] Moreover, high concentration levels would put a premium on uniformity, whereas the varying profile of issuers across Canada requires different regulatory priorities, the flexibility to assess the differential impact of regulatory initiatives, and the ability to adapt regulations accordingly.

In essence, the case for the current securities regulatory architecture rests on two major arguments. First, the close collaboration among the Canadian Securities Administrators produces the most effective response to Canada's diverse economic needs; it has delivered a regime of securities regulation that is considered one of the world's best, characterized by a high degree of harmonization in securities legislation and regulations across the country, save where differences fairly reflect local circumstances. Second, the current regime is more efficient from a dynamic perspective because each securities commission is accountable within its region and, therefore, has incentives to pay more attention to the needs and characteristics of its regional economy than to the preferences of the securities industry.

The globalization of capital markets and the urgent need to mitigate the corrosive effects of the phenomenon — as evidenced by the 2008-09 financial crisis — through appropriate regulation are not in dispute. Proponents of the current regulatory architecture are not swayed, however, by the unrestrained use of the recent crisis as a justification for the centralization of securities regulation in Canada. For them, the crisis, which originated in the United States, was mainly the result of inappropriate economic and monetary policies, a failure of prudential regulation and lack of foresight in mitigating and containing systemic risk, a host of issues that lie outside the purview of securities law.

Supporters of a single regulator like to point to a series of royal commissions and high-level task forces that, since 1935, have recommended the establishment of a federal securities commission with comprehensive regulatory powers. They conveniently fail to mention, however, that the Macdonald Commission, which had the explicit mandate to study and propose measures to improve the performance of Canada's economic union, did not embrace such an enlargement of federal jurisdiction in its 1985 report. Provincial regulation of the stock markets constitutes a particularly interesting example. In principle, there seems to be a strong argument for federal regulation. In practice, we have achieved much the same result with provincial jurisdiction (*Report of the Royal Commission on the Economic Union and Development Prospects for Canada* 1985, vol. 3, 167). They also fail to explain why no federal government has implemented any such recommendation.

All federal commissions or task forces that have recommended a single federal securities regulator have done so in the context of the conditions that prevailed at the time, contending that the existing regulatory apparatus was not capable of fostering the development of a market infrastructure that ranks with the best worldwide. But subsequent developments typically have proved them wrong. For example, in supporting a draft securities act in 1979, the Department of Consumer and Corporate Affairs stated that federal government involvement in securities matters was necessary because it would be impractical for the provinces to establish a book-entry national clearing system.[3] Today, the Canadian Depository for Securities Limited is just that.

There is no denying that the globalization of capital markets — particularly non-regulated over-the-counter derivatives and interbank markets — requires coordinated regulatory measures. To a very large extent, however, the key instruments of policy necessary for this task are already under the control of the federal government. Hence, the focus should be on resolving these issues, which, when all is said and done, the proposed *Securities Act* does not address. The public debate on the Canadian securities regulatory regime is, at its core, between competing views about the "best" structure. In a nutshell, the central questions are whether a single regulator is optimal in the Canadian context, and whether such a federal agency would be functionally superior to the current decentralized architecture.

This study is structured as follows. In the first part, I review the empirical evidence concerning the functional performance of the Canadian securities regulatory regime on the continuum from regulatory inputs to market outcomes. In the second part, I address one of the major reasons many provinces are opposed to the federal initiative by examining the respective merits of a centralized securities regulator and the current multijurisdictional architecture with respect to regional economic growth. In the third part, I address concerns pertaining to the capacity of the current regulatory regime to cope with issues related to the globalization of capital markets and the systemic risk this phenomenon entails. In concluding remarks, I draw together the key findings.

The Functional Performance of the Canadian Securities Regulatory Regime

Securities regulation is primarily concerned with issues of business conduct. The main purpose of securities regulations is nicely captured by the following provision of the *Ontario*

Securities Act: to "provide protection to investors from unfair, improper or fraudulent practices; and to foster fair and efficient capital markets and confidence in capital markets." A similar provision is found in modern securities legislation around the world. The International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulations provide a comprehensive framework for capital markets regulation and the characteristics of a sound regulatory regime. The IOSCO Principles delineate the essential qualities and powers of a capital markets regulator; the elements of proper oversight of issuers; collective investments, intermediaries and markets; and the components of an effective enforcement regime. A large consensus prevails in this regard, which explains the regulatory convergence, harmonization and mutual recognition observed internationally among jurisdictions. The reduction of systemic risk was added as a core objective in 1999, reflecting the fact that securities commissions generally exercise prudential oversight aimed at ensuring the financial integrity of securities firms and market infrastructure organizations. To a very large extent, however, this is no longer the case for provincial securities regulators in Canada since this task is already performed by federal government regulators with respect to the parts of the Canadian securities industry that may present a systemic risk for the country.

Regulation is not an end in itself. The purpose of securities regulation is to improve market outcomes — the measures of economic activity that relate to the efficient and effective functioning of securities markets. It is on this basis that the performance of a regulatory regime should be assessed, not solely on regulatory inputs and the pursuit of similarity in regulatory requirements and supervisory structures and approaches. To be sure, the causal relationship between regulatory inputs and market outcomes is often blurred, calling attention to intermediate indicators such as compliance activities, issuer and securities industry behaviour, transaction costs and investor confidence. In several instances, the structure and performance of the industry are the dominant determinants of market outcomes. It is noteworthy that considerations pertaining to the highly concentrated structure and behaviour of the Canadian financial industry are generally absent from the public debate, whereas these features are major determinants of the dynamics of primary and secondary capital markets. In a nutshell, the efficiency and competitiveness of capital markets and financial centres depend on a complex mix of private and public factors that need to be analytically untangled if public policy is to be based on a sound footing.

Direct regulatory inputs

A recent assessment by the International Monetary Fund (IMF) confirms that securities regulation in Canada conforms to the IOSCO Principles and Objectives (IMF 2008a,b). Table 1, which compares the aggregate ratings from the IMF assessments of Canada (2008), the United States (2010) and Australia (2006), shows that the major Canadian securities commissions have been diligent in implementing best practices.[4] Thus, the suggestion of the Wise Persons' Committee (2003, 34) that "if Canada were to [centralize] its securities regulatory structure, it could have the same level of regulation at materially less cost, or much better regulation at the same cost," has no basis in fact. Rather, the comparative data shown in table 2 do not support the contention that the total direct cost of Canada's securities regulatory apparatus is larger than that of common law jurisdictions with a centralized regulator. As a percentage of total capitalization, the total direct cost of Canada's securities regulatory apparatus is significantly lower than that of Australia or the United Kingdom. Indeed, when compared on the basis of the number of listed issuers, the cost of the Canadian securities regulatory apparatus is by far the lowest among common law jurisdictions.

Table 1: Implementation of International Organization of Securities Commissions (IOSCO) Objectives and Principles (number of IOSCO principles), Canada, the US and Australia

	Canada	United States	Australia
Implemented/fully implemented	24	16	21
Broadly implemented	4	8	5
Partly implemented	1	5	2
Not implemented	0	0	1
Not applicable	1	1	1
Total	30	30	30

Source: IMF (2006, 2008a, 2010).

Table 2: Direct costs of securities regulation, Australia, Canada, the UK and the US, 2008

	Australia	Canada	United Kingdom	United States
Total direct costs of securities regulation ($ millions)	266.9	215.9	492.8	1,748.9
Number of listed companies	1,924.0	3,755.0	2,415.0	5,603.0
Domestic market capitalization ($ billions)	722.6	1,106.9	2,031.8	12,402.4
Cost/million of market cap ($)	369.4	195.0	242.6	141.0
Cost/listed company ($ thousands)	138.7	57.5	204.1	312.2

Source: Suret and Carpentier (2010).

Lower direct costs should not be interpreted, however, to mean that Canadians are being short-changed. In a study commissioned by the Task Force to Modernize Securities Legislation in Canada, Jackson (2006) concludes, "In terms of budgets and staffing levels, the Canadian regulatory system is comparable to the overall regulatory system in the United States." At least from the point of view of direct regulatory inputs, proponents of a single securities regulator have yet to make their case. For the Canadian Securities Administrators, a constant concern is to reduce compliance costs for participants while preserving the quality and effectiveness of the regulatory regime. The Wise Persons' Committee singled out three examples of inefficient regulatory divergence as evidence of unnecessary compliance costs, pertaining to substantive registration requirements, the procedure and conditions for private placement exemptions and the rules restricting the resale of securities initially sold under a prospectus exemption; all three matters have since been substantially harmonized across Canada.[5]

In practice, it is the de facto functioning of the regulatory regime that matters to participants, not the de jure aspects. The Canadian regulatory regime is highly harmonized and characterized by

- reporting systems for issuers, insiders and registrants and cease trading orders that are national in scope and equivalent to similar US systems established by the Securities and Exchange Commission (SEC);[6]

- 44 National Policies and 44 National Instruments covering key areas such as prospectus requirements, mutual funds regulation, rights offerings, takeover bids, prospectus and registration exemptions, continuous disclosure contents and marketplace operations; and
- an extensive passport system that gives participants the ability to clear a prospectus, register as a dealer, adviser or investment fund manager or obtain a discretionary exemption from the regulator in their home province or territory and have it be applicable in all other jurisdictions, except for non-Ontario issuers or registrants accessing that market.

The passport system ensures that public companies are subject to only one set of harmonized continuous disclosure requirements. Despite its preference for a centralized regulator, the Crawford Panel on a Single Canadian Securities Regulator (2006) confirmed that the benefits accruing from implementation of the principal regulator system, which preceded the full implementation of the passport system, were significant and recognized by industry participants.

Evidence from intermediate indicators

On the critical dimension of market fairness, comparisons by the Organisation for Economic Co-operation and Development (OECD), the IMF and the Milken Institute consistently rank Canada among the best with respect to the quality of its securities regulations and investor protection. Additionally, a substantial body of independent, peer-reviewed empirical studies (summarized in Lortie 2010) confirms that the fairness and efficiency of Canadian capital markets rank with the best worldwide. The uniform regulatory framework that governs takeover bids and going private transactions firmly establishes as its cornerstone that all shareholders must be treated fairly. The mandatory coattail provision, which requires that, in such events, all shareholders be treated equally, is a significant contributor to these favourable results.

Moreover, the Canadian securities regulatory regime and capital markets enjoy considerable recognition and respect worldwide. At the institutional level, Canada has always exerted a great deal of influence within IOSCO. The Quebec Autorité des marchés financiers (AMF) and the Ontario Securities Commission (OSC) have voting status and, since IOSCO's founding, have been members of both its executive committee and its technical committee.[7] The Alberta and British Columbia securities commissions are associate members. Even though Canada's capital markets represent only about 3 percent of the global capital markets, only Canada, China and the United States have two IOSCO memberships. Moreover, several Canadian securities commissions participate actively in the North American Securities Administrators Association and the Council of Securities Regulators of the Americas. In addition, Canada is the only country to have a mutual recognition and harmonization agreement — the Canada/US Multijurisdictional Disclosure System (MJDS) — with the SEC. The MJDS is "a unique system only available between Canada and the US. The SEC in the US and each of the provincial securities commissions have agreed to recognize the other's prospectus review system and automatically accept prospectuses cleared by the other without further review" (IIAC 2010, 46). The MJDS has stood the test of time and remained in force for close to 20 years — surely a measure of the SEC's high regard for the consistent quality of securities regulation in Canada.

With respect to investor confidence, it stretches credibility to lament that the Canadian securities regulatory regime is, in the words of federal Finance Minister Jim Flaherty, "a national embarrassment" at the international level (Singleton 2011) and, at the same time, to boast that foreign investors and issuers are increasingly active participants in Canada's capital markets. In testimony before the Select Committee of the Legislative Assembly of Ontario on the proposed merger of the Toronto Stock Exchange (TSX) and the London Stock Exchange (LSE), it was reported that, over the past five years, issuers listed on the TSX and TSX Venture Exchange (TSX [V]) accounted for 80 percent of the mining equity financing across the globe. In addition, in their attempts to merge with or acquire the TMX Group, both the LSE and the Maple Group referred to the TMX Group's global leadership in the resources sector and its expertise with respect to small and medium enterprises (SMEs) and public venture capital financing for early-stage growth companies. These votes of confidence belie any suggestion that Canadian equity markets are not well regulated or are uncompetitive on a global basis.

The cost of securities regulation governing the issuance of stock in public markets is embedded in the direct costs borne by the issuer.[8] A comparison of the cost of initial public offerings (IPOs) in Canada and the United States shows conclusively that the Canadian securities regulatory regime does not impose on Canadian issuers, including junior issuers, a burden that is higher than that in the United States. The results presented in table 3 for the 2004-08 period are in line with those of previous studies of IPO costs in Canada and the United States over the 1997-99 period (see, for example, Kooli and Suret 2003). If anything, the cost of IPOs in Canada as a proportion of the size of the issue decreased over the 1997-2008 period. In short, contrary to prevailing views, the Canadian multijurisdictional regime places a lighter cost burden on issuers than that imposed in the US market.

Table 3: Costs of initial public offerings in Canada and the United States, 2004-08

Size of issue (US$M)	Brokerage fees (%)	Other expenses (%)	Total direct costs (%)
Canada			
1.0-9.9	8.07	8.21	16.27
10.0-49.9	6.18	3.79	9.97
50.0-99.9	5.92	2.41	8.33
100+	5.68	1.57	7.25
United States			
1.0-9.9	8.45	14.48	22.93
10.0-49.9	7.05	5.43	12.48
50.0-99.9	7.05	3.38	10.43
100+	6.42	1.88	9.31

Source: Suret and Carpentier (2010).

With respect to enforcement, it is essential to note that Canadian securities commissions are not criminal enforcement agencies; rather, their main recourses are administrative, civil and penal sanctions, and it is on these dimensions that the performance of the current regime must be assessed. Responsibility for the investigation and prosecution of criminal activity in capital markets rests with the police and attorneys general. Parliament has exclusive jurisdiction to bring securities crimes under the ambit of the Criminal Code. The federal government already has responsibility for the enforcement of the Criminal Code provisions concerning securities fraud and the prosecution of serious offences, since the Attorney General of Canada has concurrent jurisdiction to prosecute fraud-related cases, including insider trading offences.

Critics of the Canadian regime often use raw comparisons of the number of enforcement actions in Canada and the United States in the public debate. Indeed, the US/Canadian ratio of public enforcement actions is about double the ratio for domestic market capitalization. The validity of the conclusion drawn from these top-line comparisons, however, rests on two implicit assumptions. The first is that the incidence of securities violations and criminal offences must be the same in both countries, yet wide differences in crime trends across other segments of the two countries' societies cast serious doubts that this assumption is reasonable. Moreover, the high level of concentration of the securities industry in Canada enhances the level of compliance across the country and accordingly reduces the incidence of violations compared to what occurs in a fragmented and highly dispersed structure.

The second assumption is that regulators in the two countries have the same propensity to rely on *ex post* sanctioning and litigation rather than on *ex ante* supervision, but an analysis of the lessons drawn from many developed markets other than the United States suggests otherwise. For instance, a comprehensive study of the regulation of related-party transactions in 72 countries (Djankov et al. 2006) demonstrates that common law countries typically emphasize *ex ante* measures such as extensive disclosure and the approval of related-party transactions by disinterested shareholders. The United States, however, is unique in placing greater emphasis on *ex post* litigation and enforcement mechanisms. These findings, which reinforce those of earlier studies of securities law, show that regulatory requirements concerning private contracting, transparency and full public disclosure of information coupled with private enforcement mechanisms are significantly more effective than public enforcement in promoting efficient capital markets (La Porta, Lopez-de-Silanes and Shleifer 2006). It does not follow that public enforcement does not have a role to play, but it is ill-advised to overstate its importance and beneficial impact on market outcomes.

Interestingly, detailed comparisons of the records of public enforcement actions in Canada and the United States during the 2002-04 period are instructive in that they actually lead in a direction opposite to that advocated by the federal government. In the United States, the superiority of state agencies in taking public enforcement actions (40.8 percent of public enforcement actions versus 17.6 percent for the SEC) is clearly established (Jackson 2006). Indeed, the jurisdiction of state securities commissions to investigate and bring enforcement actions with respect to fraud, deceit or unlawful conduct in connection with securities transactions was explicitly preserved under the *National Securities Markets Improvement Act of 1996*, while the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* confirmed the jurisdiction of the states under the NSMIA and expanded the investor protection and enforcement roles of state securities regulators.

Clearly, proximity and knowledge on the part of individual players render enforcement more effective. The important role given to self-regulatory organizations (SROs) in the supervisory and enforcement machinery in Canada and the United States is based on that premise. The comparative data concerning enforcement by SROs show, first, that the ratio of enforcement actions taken by Canadian SROs and their US counterparts is no different than the proportion of enforcement actions taken by Canadian securities commissions relative to those taken by US federal and state agencies; and, second, that the proportion of monetary sanctions imposed by SROs relative to those imposed by government agencies is 31 percent in the United States and 12 percent in Canada. These results provide ample reasons to refute the contention that the architecture of the Canadian securities regulatory regime explains the difference in the incidence of enforcement actions in the two countries.

Few enforcement issues have more political resonance than illegal corporate insider trading. The number of high-profile criminal indictments for illegal insider trading in the United States compared to the rather subdued record in Canada has prompted many to insinuate that insider trading is a scourge in Canadian capital markets (Insider Trading Task Force 2001). The empirical evidence again tells a different story. A study of 420 takeover announcements of publicly listed Canadian firms from 1985 to 2002 (King and Padalko 2005) demonstrates conclusively that the magnitude and timing of pre-bid run-ups for Canadian and US takeovers are very similar and that the price-volume dynamics in the case of Canadian takeovers are more consistent with the predictions of the market-anticipation hypothesis than with that of illegal insider trading. As the study notes, “While we cannot dismiss the possibility of illegal insider trading in any takeover in our sample, the evidence suggests that this problem is not widespread for this type of corporate event” (3).

When devising measures to eradicate the occurrence of illegal insider trading, account must be taken of the fact that the typical insider transacts only modest amounts of shares — on average, fewer than 10,000. An analysis of detailed trading data in the period preceding important announcements on several exchanges leads Michael Aitken to conclude: “Of some surprise is the generally low level of activity…The numbers ranged on average across markets from 1.7/100ths of 1 percent to 4.4/100ths of 1 percent” (2010, 8; see also Market Regulation Services 2004). It would also appear that illegal trading by corporate insiders takes place early in the process, not immediately before the announcement. The impact of such trading is therefore generally inconsequential to the market and hence very difficult for exchanges or regulators to detect.

It has also been demonstrated that efforts to manipulate a security’s closing price at the end of a trading session induce volatility and raise the cost of executing larger trades through a widening of market spreads. The incidence of such manipulative trading behaviour can be estimated by the mean frequency of daily exchange stock-price-ramping alerts. The results of a rigorous study show that the “mean alert incidence” per thousand listed securities was 0.88 for the TSX compared with 1.01, 1.28 and 1.04 for the Australian Stock Exchange, the LSE and the New York Stock Exchange, respectively (Aitken, Harris and Ji 2010). Here again, market design measures, the prohibition of certain trading practices and real-time surveillance (*ex ante*) are significantly more effective in preventing trade-based manipulation than *ex post* enforcement penalties.

Market outcomes

Relative to gross domestic product (GDP), the market capitalization of Canadian issuers is greater than that of issuers in most developed economies, a measure indicative of a well-developed and efficient capital market (Hendry and King 2004).

Canadian corporations raise about one-quarter of their financing needs abroad, mostly in the United States. In the 2000s, the share of foreign placement of new Canadian equity securities represented around 20 to 25 percent of total issuance value. In the case of corporate bonds, the portion sold offshore, mostly in the United States, was about 40 percent. These US offerings are, on average, twice the size of Canadian offerings, a clear indication that the factors at play are not of a regulatory nature but, rather, a direct consequence of the size and depth of US corporate and high-yield bond markets. Moreover, according to data from the Bank for International Settlements, foreign loans account for 40 percent of total bank loans to the Canadian nonbank sector (Klyuev 2008). Based on the proportion of foreign financing in each source of funding, Canadian public equity markets are very competitive, at least compared to other sources of corporate financing.

Another indication of the relative health of market outcomes in Canada is the finding that, unlike Canada, the United States is experiencing a secular decline in its population of listed companies. Between 1996 and 2008, the total number of companies listed on a US exchange declined by 38.8 percent, while domestic company listings declined by 43 percent. In Canada, during the same period on the TSX, the total number of listed companies *increased* by 10.6 percent. These results are a direct consequence of IPO activity in the two countries, which, between 1990 and 2006, increased by 396 percent in Canada and 129 percent in the United States. As a result, the aggregate value of equity raised in Canada through IPOs relative to that raised in the United States grew from 6 percent in the 1990-95 period to 20 percent in the 2001-06 period (Cetorelli and Peristiani 2009).

Other international comparisons indicate that, relative to other jurisdictions, the Canadian securities regulation regime facilitates access to public capital markets by Canadian issuers. According to the IMF, “The current system has responded to the specific characteristics of its capital market, such as allowing for a large presence of small issuers, and the concentration of certain industries in specific provinces” (2008a, 37). On the basis of their listing requirements and international criteria, the TSX is considered a junior market whereas the TSX (V) is a public venture capital market. Overall, about 3,600, or 94 percent, of the companies listed in Canada fall within the SEC’s small or micro capitalization categories (Carpentier and Suret 2009). Notwithstanding their much smaller average and median size, the survival rate of listed SMEs five and ten years following their IPO is superior in Canada to that observed in the United States, a result assisted in part by unique features of Canada’s securities regulatory regime — notably, the ability of nonprofitable listed companies to make follow-on seasoned-equity offerings in the private or public markets (Suret and Carpentier 2010).

Ultimately, the net effect of the functional performance of a securities regulatory regime will materialize in one critical economic factor: the cost of equity. As is to be expected, the cost of capital is higher in markets with less effective regulations since shareholders investing in such markets demand a higher risk premium — hence the assertion of proponents of a national securities regulator that the allegedly lower quality of securities regulation penalizes Canadian firms in their financing costs relative to US firms. In fact, however, comparative studies indicate that the cost of equity in Canada is one of the lowest in the world and that Canadian firms are not burdened by a "made-in-Canada" risk premium that increases their cost of equity relative to that in other developed economies and discounts the trading price of their shares. For instance, estimates of the cost of equity in the main common law countries for the 1992-2001 period are as follows: the United States, 10.24 percent; Canada, 10.52 percent; the United Kingdom, 10.64 percent; Australia, 10.72 percent; and New Zealand, 11.14 percent (Hail and Leuz 2006).[9] A study published by the Bank of Canada concludes that, when longer-term sovereign bond yields are taken into account, "our tests are unable to conclude definitely that there is a difference between the Canadian and U.S. cost of equity" (Zorn 2007, 33). Other studies find that there is no material difference between the cost of equity in the United States and in Canada except in the finance and resources sectors, where Canada enjoys a net advantage of approximately 100 basis points (Claus and Thomas 2001; He and Kryzanowski 2007). The results of these comparative studies of the cost of equity are consistent with the higher propensity of Canadian firms to access public equity markets.

Critics of the Canadian securities regulatory regime assert that the requirements of multiple regulators have led some issuers of securities to limit their public offerings in some provinces. Indeed, several Canadian and foreign issuers have avoided the Quebec market because of the actual or perceived burden of having to publish their prospectuses and other disclosure material in French — an examination of the number of public financings by prospectus in Canada reveals that in 2009-10 only about 48 percent of issuers filed their prospectus with the AMF during that period. The June 2011 announcement by IAMGOLD Corporation is a case in point.[10] Notwithstanding serious concerns about this unhealthy state of affairs, the fact remains that requirements concerning the language of disclosure documents, which relate, in part, to concerns about investor protection, would not change under a single federal regulatory regime, as federal government authorities have stated unambiguously. The solution to that problem accordingly lies elsewhere.

Regional Economic Growth under a Centralized Securities Regulator

The strongly held view prevailing in several provinces that the takeover of the securities regulation domain by the federal government would have, over time, a deleterious effect on regional economies is not a hollow concern. Periodic consultations with the Council of Ministers likely would not be enough to ensure that regional concerns are addressed; the proposed *Securities Act* specifies only that a meeting "must be held at least once per year." The proposal to establish regional offices might be comforting for the employees concerned but, from a decision-making point of view, it is not reasonable to expect regional offices to carry the same clout as headquarters. The main impetus for the federal initiative is to assume control of securities regulation and to establish uniformity across the country; this cannot be achieved through regional offices that have management and policy-making autonomy. An abundant literature on the behaviour of organizations, supported by experience, teaches that it is an imprudent wager to overlook the logic of institutions and industry structures. This is an area where the federal proposal really falls short since, by its very nature, a national regulator cannot entertain a regime of exceptions to accommodate local and regional differences and promote the economic development initiatives that are inherent to Canada's multijurisdictional architecture. Rather, such a regime is likely to prejudice and stymie growth and job creation in many regions and sectors without any commensurate benefits at the national level.

Promoting a strong and diversified financial infrastructure

In 2009, the Canadian economy ranked 13th in the world, as measured by its GDP. In that same year, Toronto was 12th in the City of London Global Financial Centres report (City of London 2010). No doubt this rating reflects the fact that Toronto is home to 5 of Canada's largest domestic banks, 55 foreign bank subsidiaries and branches and 6 of Canada's top insurers. All these great financial institutions are under federal regulatory authority. The TSX, under provincial regulation, is the eighth-largest stock exchange in the world by market capitalization. Thirteenth, 12th and 8th — these three rankings show clearly that Canada has not paid a price for its decentralized network of securities regulators, despite the important national and global dimensions of capital markets.

Stock, commodity and derivative exchanges and their clearing organizations are key market infrastructure institutions around which high-value service industries coalesce. Their vitality and dynamism have a direct effect on the real sector of the economy. The recent debate engendered in Toronto in the wake of the proposed merger of the LSE Group and the TMX Group provided a vivid illustration of its importance, real or perceived. It is indisputable that measures that undermine the competitiveness of an exchange or clearing organization have broad regional economic implications; this phenomenon can be observed in Quebec since the withdrawal of stock trading activities at the Montreal Exchange in 2000. The converse is also true, and Toronto is a case in point.

It is no coincidence that the first provinces to oppose the federal government's initiative were Alberta (home to the TSX [V] and the Natural Gas Exchange), Manitoba (home to ICE Futures Canada) and Quebec (home to the Montreal Exchange). The survival of these exchanges occured not simply because of their specialization but because each of these provinces had the regulatory authority to ensure that each exchange had a governance regime that promoted its development and shielded it from myopic corporate behaviour. Battle-scarred by the negotiations to protect the economic interests of their provinces, notably Alberta and Quebec, they have no reason to believe that, in similar circumstances, a national regulator would have gone to the mat to secure equivalent results.

To avoid duplication and streamline the regulatory supervision of exchanges and clearing houses, the Canadian Securities Administrators have developed a coordinated approach that takes the form of a "lead regulator." Thus, the regulator for the TSX is the Ontario Securities Commission (OSC); for the Montreal Exchange and the Canadian Derivatives Clearing Corporation (CDCC), it is the AMF; for ICE Futures Canada, it is the Manitoba Securities Commission (MSC); and for the Natural Gas Exchange, it is the Alberta Securities Commission

(ASC). The ASC and the British Columbia Securities Commission (BCSC) assume these responsibilities for the TSX (V).

This arrangement has powerful implications for regional economic growth since each "lead regulator" has a vested interest in the long-term success of the exchange and clearing organizations under its umbrella. This provides the impetus for developing the special expertise particular to the markets under the lead regulator's supervision, gaining intimate familiarity with all the processes and rules, becoming knowledgeable about the participants in its segment of the industry, both in Canada and abroad, and nurturing the competency to recognize and anticipate competitive threats. And make no mistake, those threats differ greatly between markets. For instance, the intricacies of regulating alternative trading systems to ensure the fair and orderly execution of all trades and high-frequency algorithmic trading are, in their technical aspects, issues that are mainly confined to the TSX, albeit with implications for specific Montreal Exchange derivatives and TSX (V) markets. For the ASC and the BCSC, issues pertaining to the regulation of venture issuers have more salience, whereas the MSC focuses mainly on the exigencies of agricultural commodities markets.

In the face of this demonstrated diversity of expertise and strong incentives to foster the development of local market infrastructures and capital markets, proponents of a centralized system have not shown how a national regulator would deliver the same focused attention, expertise and responsiveness to competitive threats with the direct accountability for results as is the case with the current regime. The inherent inability of a centralized regulator to promote diversified financial infrastructures is well understood in the United States, where the SEC is considered the "protector" of New York and the Commodity Futures Trading Commission (CFTC) the "protector" of Chicago. Despite many reports recommending the merger of the SEC and the CFTC, *Dodd-Frank* not only did not follow this course of action but, on the contrary, it enlarged the CFTC's mandate.

As another case in point, the European experience should serve as a lesson for Canadian decision-makers. The European Commission observed that second-tier markets for SMEs did not succeed as expected, in large part because the senior management of the senior exchanges that owned the junior exchanges and their regulators focused their efforts on the main market, which accounts for most of their revenues and prestige, and did not commit the attention needed to promote their development (Bannock 1994). To date, the TSX has not smothered the TSX (V). This is in large part because the activities and market behaviour of the latter remain under the watchful eye of the Alberta and British Columbia securities commissions. In this regard, it is noteworthy that, while the economies of these two western provinces account for 29 percent of Canada's GDP, in the first five months of 2011 they generated 78 percent of Canadian corporate listings on the TSX (V) and 64 percent of Canadian corporate listings on the TSX and the TSX (V) combined.

The structure of the Canadian securities regulatory system also promotes the global reach of Canadian exchanges. This is the case not only for the TSX but for all other Canadian exchanges. For instance, ICE Futures Canada, the country's only agricultural commodities exchange, benefits from a broad international participation. It has received regulatory approvals to offer its services in jurisdictions throughout the world, including in the all-important US, UK and French markets. Each of these regulatory approvals has been based on the foreign regulator's being satisfied that the MSC is providing competent oversight and regulation of ICE Futures and its designated clearing house ICE Clear. The same can be said of the Montreal Exchange, where, depending on market conditions for Canadian debt and currency, between 40 and 60 percent of the volume of its financial futures markets is generated from abroad; it also must be noted that the Montreal Exchange is the only Canadian exchange to operate a US exchange — the Boston Options Exchange.

Entrepreneurship equity financing

Another major economic cost associated with the centralization of the securities regulatory apparatus is most likely to be the gradual elimination of the conditions conducive to the functioning of a Canadian public venture market with its concomitant effect on the ability of fast-growing Canadian SMEs and junior national resources companies to obtain financing. The promise that a national regulatory agency would adopt proportionate regulation is not easily reconciled with the strong drive underlying the federal government's initiative to ensure uniformity of regulations and enforcement across the country. This issue cannot be casually dismissed because it goes to the heart of the policy conundrum of establishing the balance between the conditions of access to public (and exempt) markets by small issuers and the goal of protecting public investors.[11]

Following the seminal work of David Birch (1981) we have gained a much better understanding of the dynamics of economic growth. We know that high-growth companies create a disproportionate number of net new jobs even though they account for only a small percentage — around 5 to 7 percent — of firms. In Canada, the high-growth firms that had a continued existence between 1985 and 1999 accounted for 56 percent of the net jobs created during that period but were only 6 percent of the total number of firms. In the United States during the 2002-06 period, high-growth companies represented 6.5 percent of total firms but accounted for 84 percent of net job creation. Only 2.5 percent of these firms were less than four years old (Acs, Parsons and Tracy 2008), which belies the conventional idea that start-ups and technology firms are the engine of economic growth. These results are congruent with the fact that, during that period in the United States, the median age of firms at the time they went public was about four years and the fact that they mirror the distribution of firms across all industrial classifications. Similar results are observed in Canada, except that junior natural resources firms are overrepresented, a consequence of the fact that other sources of external capital are virtually nonexistent for such firms.

High-growth firms generally do not generate sufficient capital internally to fund current operations, let alone fuel rapid growth. There is substantial evidence that financing obstacles are more growth constraining for SMEs and prevent firms from reaching their optimal size. The traditional sources of external equity required by high-growth firms are venture capital, private equity and public markets. In Canada, however, venture capital and private equity firms do not constitute a buoyant industry; thus, the mix of funding sources for SMEs in Canada is singularly different than in other developed economies. During the 1989-2006 period, 802 companies graduated to the TSX from the TSX (V) whereas venture-capital-backed IPOs accounted for only 122 new TSX listings. During the 1991-2008 period, Canadian venture capital firms exited through an IPO in about 5 percent of the cases compared with more than 39 percent in the United States.

One reason given to explain the difference is that the valuation of companies that issue IPOs is higher in the United States than in Canada. The president of the Business Development Bank of Canada (BDC), one of Canada's largest venture capital institutions, suggested at a recent event of the Institute of Corporate Directors that the proportion of failures in a Canadian portfolio of private equity and venture investments is the same as in the United States, and the difference lies in the fact that we do not have many "home runs." Indeed, the valuation of venture-capital-backed IPOs appears to be 48 to 66 percent lower in Canada than in the United States (Carpentier, Cumming and Suret 2010a).[12] Another explanation put forward is that the lower pricing of IPOs in Canada reflects the price exacted by the market for Canada's more lenient regulatory requirements. Recent empirical studies have demonstrated that the spread between IPO pricing in Canada and in the United States is due to differences in liquidity prevailing in the markets in the two countries, but when comparisons are made between IPOs where the expectations of liquidity are similar, the difference in IPO valuations is not significant. The argument that the current regulations penalize Canadian companies that issue an IPO thus does not stand up to scrutiny (Carpentier, Cumming and Suret 2011).

Since the 1980s, the Labour-Sponsored Venture Capital Corporation (LSVCC) program and the BDC's venture activities have been the federal government's main tools to support venture capital activity. The tax-subsidized LSVCC program has been costly, accounting for more than half of all venture capital under management but delivering dismal rates of return. There are strong indications that the program has crowded out private venture capital (Cumming 2007). Consequently, and contrary to the situation in the United States (see table 4), the venture capital industry in Canada has not delivered returns sufficiently attractive to entice institutional investors to allocate significant capital to this segment. No doubt reflecting this performance, the total amount of capital raised by venture capital firms has been in steady decline since 2006. Moreover, banks, venture capital and private equity firms generally shun natural resources exploration and junior mining, oil and gas companies.

Table 4: Rate of return of venture capital (VC) firms in the United States, Europe and Canada (1995-2005)

	All VC firms	1st quartile
United States	27.6	76.6
Europe	6.5	38.1
Canada	-3.0	19.2
Labour-sponsored firms	-1.4	n.a.
Nongovernment-sponsored firms	-3.9	23.3
Other firms	-3.6	14.5

Source: Duruflé (2007).
Note: n.a. = not applicable.

Canada is unique in having developed a vibrant public venture market. International comparisons indicate that, relative to other jurisdictions, the Canadian securities regulation regime facilitates access to public capital markets by Canadian issuers. A very large proportion of the TSX and TSX (V) issuers are SMEs; 82 percent of the listed companies have a market capitalization of less than $250 million. Overall, about 3,600, or 94 percent, of the companies listed in Canada fall within the SEC's small or micro capitalization categories (Carpentier and Suret 2009).[13] The TSX (V) has become the most effective avenue for the financing of small firms, particularly high-growth firms, in all sectors of activity. Interestingly, the evidence shows that listing on the TSX (V) greatly facilitates subsequent financing in the private (exempt) market, including junior firms in the natural resources sector. Eighty-two percent of new equity raised by TSX (V)-listed companies was generated through private placements.

The proclivity of a national regulator to tilt the current balance between ease of access and investor protection through the adoption of more stringent regulations would be encouraged by four powerful forces. First, at the policy level, it would need to counter a widely held view in the academic and regulatory communities that non-onerous listing requirements and regulation with respect to the conditions of access to public markets are detrimental to investors. Many studies conclude that lenient listing requirements inexorably lead to the emergence of a "lemon market," in which only companies of poor quality list, increasing the incidence of market manipulation and hurting investors by yielding poor returns on a systematic basis (see, for example, Black 2001; Klausner and Litvak 2001).[14] These results raise insistent questions about the appropriateness of current listing regulations. In a public debate, the TSX (V) is at a disadvantage since all failures of listed issuers are public whereas those of the venture and private equity industry remain confidential. From an economic growth perspective, the appropriate approach is not to deny the empirical data but to ensure that the TSX (V) results are compared fairly with those stemming from other modes of SME financing, including firms unable to raise sufficient equity capital.

Second, comparisons with other developed countries provide a facile excuse for a national regulator to tighten the regulatory requirements governing access to public and exempt markets. Listing requirements on the TSX (V) and the rules that govern IPOs, seasoned equity offerings and private placements are currently significantly more permissive in Canada than is the case abroad. During the 1986-2006 period, 3,857 companies listed on the TSX (V); average gross proceeds at listing were $2.05 million (median = $0.65 million), 49.3 percent had no revenues and 80.1 percent had negative earnings. True to form, a recent confidential report on the Canadian venture industry by an international consulting firm commissioned by a federal agency states, without nuance, that "relatively low listing requirements in the TSX (V) are counterproductive."

In the United States, the SEC Penny Stock Rule requires newly listed firms to have a positive net income, a market value of US$50 million and a minimum bid price of US$4 per share. Thus, the average market capitalization of TSX (V) companies is about 10 percent of the minimum size set by the SEC.[15] In Europe, listing requirements on junior markets generally call for minimum IPO gross proceeds of about $8 million. On the London Alternative Investment Market, average IPO gross proceeds amount to $15 million. On the First North market (Scandinavia), the mean market capitalization is $15 million, and on the New Zealand Alternative Exchange it is $12.5 million. In Canada securities regulations preclude investors who acquire securities distributed under prospectus exemptions from selling these securities for a period of four months, while in the United States the mandated holding period is two years for nonregistered securities. Clearly, the duration of the mandatory holding period will influence the size of the discount investors will require at issuance to compensate for the additional risks created by the resale restriction.

Third, the Canadian government attitude vis-à-vis public venture capital can be characterized as one of benign neglect. For instance, the federal Scientific Research and Experimental Development (SR&ED) program provides Canadian-controlled private corporations a refundable investment tax credit at an enhanced rate of 35 percent on the first $3 million of annual qualified research and development expenditures, refundable at 100 percent; the credit rate is 20 percent for such expenditures exceeding $3 million and it is refundable at 40 percent. Public technology companies that otherwise would meet the eligibility criteria for SR&ED cash refunds are thus disqualified; the applicable credit rate is reduced to 20 percent and is nonrefundable. This policy discriminates against some 745 technology companies, many of them high-growth companies, that have been listed on the TSX (V) since 1986.

Fourth, the structure of the financial industry has potent effects on entrepreneurial equity financing. Following the enactment of the *Gramm-Leach-Bliley Act* in 1999, which ended the separation between commercial and investment banking in the United States, commercial banks acquired most of the investment banks specialized in the financing of small companies. Concurrently with that structural change in the investment industry, the number of IPOs and listings on the AMEX and NASDAQ exchanges began its steep decline. In Canada, although the number of listings on the TSX continued to increase, the average annual rate of new listings slowed considerably from 47 per annum in the 1991-97 period to 13.6 per annum between 1997 and 2008; about 31 percent of 1997-2008 new listings are graduates from the TSX (V). In Quebec, a recent study aimed at identifying the main reasons behind the dearth of going public transactions and the fact that, in 2010, only 5 percent of new Canadian corporate listings on the TSX and TSX (V) were Quebec-based companies concludes that the structure of the financial ecosystem, particularly the dominance of bank-owned securities firms, is one of the main culprits (FMC-Avocats/PWC 2011).

The conclusion is unmistakable: large national investment bankers and institutional investors are averse to small IPOs and investment in small public companies, in part, because SMEs are not capitalized enough to allow them to justify investments of meaningful size. Their segmentation of the market responds to economic considerations that are rational from their corporate point of view. It does not follow, however, that their corporate interests are necessarily aligned with Canada's and the provinces' economic growth needs and objectives. Hence, the concern is well grounded that the influence that large Canadian banks and institutional investors would exert on a national regulator would erode, consciously or inadvertently, the conditions of success of a public venture market. Moreover, it does not follow that, under these circumstances, investors would be better off. In the United States, the odds of failure of a firm taken public by a top-tier investment bank are about twice those of a firm underwritten by a smaller specialized investment banker (Peristriani 2003).

Proponents of public venture financing give significantly more weight to economic growth, which shows strong regional variation in Canada. For instance, 48.1 percent of the new listed issuers on Canadian exchanges between 1986 and 2006 belonged to the natural resources sector, a segment of the economy where bank or debt financing for and institutional investments in junior companies are virtually nonexistent. Proponents can point to the fact that the value-weighted average rate of return of new listings on the TSX (V) amounted to 15.7 percent over the 1995-2005 period, outperforming the TSX's 10.7 percent.[16] For the 2001-06 period, the annual return of the TSX (V) S&P Index was 23.5 percent, compared with 13.1 percent for the TSX S&P Index. The graduation rate of TSX (V) issuers to the TSX for the 1986-2006 period was 7.67 percent, a proportion that corresponds to that of high-growth firms. Indeed, their value-weighted cumulative abnormal returns over the three years before graduation were 75.56 percent, and rates of return thereafter were in line with the market (except for issuers with no revenues) (Carpentier and Suret 2010). It must also be noted that 31.5 percent of the new TSX listings of Canadian companies during the 2007-10 period graduated from the TSX (V), that 20 percent of companies in the TSX/S&P Index started as TSX (V)-listed companies and that the TSX (V) is for all practical purposes the only avenue for the junior natural resources sector. In September 2010, mining and oil and gas companies listed on the TSX (V) represented 4 percent of the average market capitalization value of TSX-listed companies in the same sector. Yet between January 2008 and September 2010, these TSX (V) firms accounted for 29 percent of the total equity capital raised by natural resources companies.

It is true that the average stock market performance of TSX (V) issuers conceals a high skewness: many investors incur losses and approximately one-third of issuers fail, wiping out the total equity investment. It has been shown that the average long-term returns of investments in the stock of companies that have listed on the TSX (V) through the reverse merger option are negative and are worse than for IPO-listed firms and that the multiple obtained through a reverse merger is half that achieved by IPO issuers (Carpentier, Cumming and Suret 2010b). Securities regulatory policy involves a trade-off between the stringency of regulation and investor protection. For instance, many issuers accept the lower multiple associated with a reverse merger as a trade-off for the rapidity and certainty of the financing. Considering the volatility of markets, this is not an irrational choice. In the Canadian system, it is one provincial government's prerogative to choose a balance that differs from that in another province in order to achieve broader objectives. In light of the manifest success of the Canadian public venture market in allowing a large number of SMEs to reach their high-growth potential, it is a legitimate and rational choice for a province to favour high skewness exposure over lower mean-variance portfolio yields.

The current Canadian securities regulatory regime allows the venture market to be segmented from the major market — and the TSX (V) unambiguously is. Consequently, the spillover effects in terms of reputation and other qualitative considerations are minimal. Tasked with a national mandate, this segmentation of markets would be inherently difficult to sustain or justify for a national regulator since, under its narrow mandate, investor protection considerations would always trump regional economic growth considerations. This is precisely why a national securities commission, in the long term, would not likely support the development of both a seasoned and a venture stock market.

What about the Changing Nature of Capital Markets?

Ostensibly, one of the main arguments consistently put forward in support of the federal initiative is the growing international interdependencies of capital markets and the regulatory implications that ensue, particularly with respect to systemic risk.

Globalization of markets

The globalization and interdependencies of capital markets are indisputable developments with serious consequences for all economies. With respect to securities regulation, which is primarily concerned with business conduct and investor protection, as opposed to prudential and systemic risk issues, it is not realistic to expect countries to shed their legal traditions, which evolved naturally from the norms, traditions and institutions that have shaped their individual societies, in favour of internationally uniform rules and regulations. The differences observed between civil and common law jurisdictions are a case in point. These legal and institutional frameworks and regulatory, supervisory and enforcement mechanisms and practices, therefore, are unlikely to converge — IOSCO, after all, issues guidelines, not binding rules. This implies that the focus of the global approach toward securities regulation must be centred on the ends to be achieved — the performance of the regulatory regime — rather than on the approaches and means used to attain them. Mutual recognition of regulatory regimes — recognition that a given regulatory regime delivers the results that are sought under the IOSCO Objectives and Principles — thus becomes the most efficient approach to enhance and promote high-quality securities regulation internationally.

The stance various jurisdictions have adopted following the demutualization of exchanges illustrates the point. Traditionally, stock, commodity and derivative exchanges exercised extensive regulatory powers over members and participants. The demutualization of exchanges, which changed their not-for-profit status to that of for-profit corporate organizations, raised serious questions about the conflicts, real or potential, arising between their regulatory role and their new profit mandate. Governments worldwide have sought to ensure greater independence of market and industry regulation from market operation despite the significant advantages and benefits of self-regulation. A review of the approaches taken by governments reveals fundamental differences in approach that can be categorized into three groups:

- the “government-led model,” where central governments (for example, in France, Germany and Japan) maintain control over certain key aspects of securities regulation;
- the “flexibility model,” where governments (for example, the United Kingdom, Hong Kong and Australia) seek to grant leeway to market participants while also performing some regulatory functions, a regulatory approach that, while more market friendly, remains intrusive in certain aspects — for instance, in the United Kingdom, approval for listing on the LSE is given not by that exchange but by the Financial Services Authority; and
- the “cooperation model,” the framework adopted by the United States and Canada, which grants a much wider regulatory role to market infrastructure institutions while also ensuring that securities commissions exercise oversight over the conduct of their self-regulatory role, particularly with respect to their enforcement tasks (Gadinis and Jackson 2007).

The absence of consensus regarding which of these three regulatory approaches better fulfills the objectives of securities regulation is to be expected. The solution, of course, is to anchor mutual recognition on the basis of shared principles and objectives and the comparability of market outcomes, not on the equivalency of regulatory inputs and uniformity in laws, regulation and approaches to implementation and enforcement.

The IOSCO's assessment methodology is unambiguous with respect to the relevance of the structure of the regulator for functional performance: "There is often no single correct approach to a regulatory issue. Legislation and regulatory structures vary between jurisdictions and reflect local market conditions and historical development. The particular manner in which a jurisdiction implements the objectives and principles described in this document must have regard to the entire domestic context, including the relevant legal and commercial framework" (IOSCO 2003a, 3). The results of the evaluation of the functional performance of regulators in implementing IOSCO's Objectives and Principles reveal no clear correlation between the architecture of the regulatory apparatus and the delivery of quality securities regulation. Adoption of a federal *Securities Act* would not alter this reality.[17]

Regulation of systemic risk

The 2008-09 financial crisis gave renewed salience to the regulation of systemic risk. This is an area where the federal government has clear responsibilities and, it needs to be emphasized, already possesses the tools to do its job. These have stood the test of time, particularly in periods of substantial turmoil and stress in financial markets.

The Office of the Superintendent of Financial Institutions (OSFI) has the prudential regulatory responsibility to oversee and regulate the securities-related activities of Canadian banks "in a system where all banks, and all of their subsidiaries (including investment banking), are under the scrutiny of a single regulator" (Price 2010, 1).[18] This, of course, is perfectly in line with the powers and duties assigned to the superintendent under the *OSFI Act*. The federal government's contention that the proposed *Securities Act* is "squarely aimed at dealing with systemic risk," in view of provisions permitting compelling the production of documents from "market participants" (section 109) and the sharing of information in Canada and abroad (section 224[1]), does not break new ground. These powers are already available to OSFI, and, to the extent it was deemed important to extend its ambit to certain unregulated organizations such as hedge funds and "dark pools," the simple extension of the definition of financial institutions in the *OSFI Act* to include such "market participants" would accomplish that objective.

The operating arm of the Canadian Depository for Securities Limited (CDS) — namely, CDS Clearing and Depository Services Inc. (CDS Clearing) — is a systemically important part of the Canadian financial infrastructure. Hence, in 2003, the CDS clearing and settlement system was brought under the regulatory authority of the Bank of Canada in accordance with the *Payment Clearing and Settlement Act*, even though the activities and conduct of CDS and CDS Clearing remain regulated by securities commissions. At the same time, the Canadian Derivatives Clearing Corporation (CDCC) systems have not been brought under the oversight of the Bank of Canada in accordance with the *Payment Clearing and Settlement Act*, suggesting that the CDCC was not considered large enough to present systemic risk for Canada. It is well noted that the exchange-traded derivatives markets were not significantly disrupted during the 2008-09 financial crisis, in large part because of the markets' transparency and the central counterparty mechanism that characterizes their clearing houses.[19] In December 2009, the CDCC was selected by the Investment Industry Association of Canada to become the central counterparty for the Canadian repo market, a critical infrastructure for Canadian-dollar core funding markets. The Bank of Canada has indicated its intent to designate it under the *Payment Clearing and Settlement Act* when the service comes into force.

Looking forward, it is urgent to correct deficiencies in the market infrastructure institutions for over-the-counter derivatives markets that were exposed by the financial crisis and to ensure their resilience to future shocks. The main axes of reform include product, legal and process standardization, increased transparency, including the establishment of trade repositories, and the design, establishment and monitoring of central counterparty clearing organizations.

At the end of 2009, the six largest Canadian banks held almost 97 percent of the approximately $12.4 trillion of over-the-counter derivatives held by all Canadian financial institutions. In terms of prudential regulation, these institutions are already regulated by a federal agency, OSFI. Eighty percent of these derivatives contracts are booked in a foreign jurisdiction on at least one side of the transaction. Given the global nature of the over-the-counter derivatives market, the viability of a stand-alone Canadian central counterparty clearing organization presents challenges. Moreover, since the most important asset classes are derivatives linked to interest rates and currencies, it follows that central banks effectively will become the guardians with respect to the means employed to contain systemic risk and the backstops of last resort in the event the financial integrity of such a central counterparty clearing organization is threatened.

An interagency working group has been established to develop policy options for Canada, to coordinate policy developments with industry and, in due course, to spearhead the adoption of legislation and regulations and the implementation of policies. The group is composed of representatives of the federal Department of Finance, OSFI, the OSC, the AMF and the ASC, and is chaired by the Bank of Canada, as it should be. This composition also ensures that Canada's objectives and concerns will be well represented at IOSCO since both the AMF and the OSC have standing and, even though Canada represents less than 2 percent of global over-the-counter derivative markets, they exert significant leadership in IOSCO's key decision-making bodies. And all this is being accomplished without creating any constitutional heartburn. Canadian federalism will not prevent Canada from meeting its G20 commitments concerning these matters.

Concluding Remarks

A substantial body of empirical evidence supports the proposition that the performance of the current Canadian securities regulatory regime compares favourably in terms of regulatory inputs, intermediate indicators and, most important, market outcomes against the results achieved by other developed countries. The high degree of legislative and regulatory harmonization that prevails across Canada, the establishment of truly national reporting systems and the acceptance of mutual recognition as an organizational principle are remarkable achievements. Notwithstanding critiques of certain details in the functioning of the system, the fact remains that the federal government's absence from the field of securities regulation has not led to a "race to the bottom" with regard to quality and effectiveness. On the contrary, Canada has by any measurable criterion a regime recognized as one of the best worldwide. There exists no evidence whatsoever to support the notion that a national securities regulator would better serve Canada's needs and interests.

While the IOSCO Objectives and Principles are explicit with respect to the functional attributes of a securities regulatory regime and an extensive body of empirical studies exists pertaining to the many dimensions of functional performance, no such formal guidance is professed with regard to structural matters. Indeed, IOSCO states that "there need not be a single regulator. In many jurisdictions, the desirable attributes of the regulator set out in the Principles are in fact the shared responsibility of two or more government or quasi-government agencies with governmental powers" (IOSCO 2003b, 9). It is therefore up to us.

From an economic and business point of view, available data clearly show that the current securities regulatory architecture serves Canada very well. It is respected internationally, costs are low, compliance is high and it is highly responsive to regional economic conditions and needs. Given the magnitude of the changes in the proposed *Securities Act*, the burden is on its proponents to make the case for how moving to a single federal regulator would benefit Canadians. In my opinion, they simply have not done so.

A mature understanding of the principle of subsidiarity — one of the main features of federalism — would have the federal government focus on matters of major and significant importance for the Canadian economy that cannot be performed effectively by the provinces. This is clearly not the case for securities regulation.

Some commentators suggest that the Canadian asset-backed commercial paper (ABCP) crisis provides a rationale for a federal securities regulator. With hindsight, it is easy to lecture on what securities regulators might have done differently to help prevent the debacle, but this would fail to recognize that, in line with applicable securities regulation in other major jurisdictions, issuers of commercial paper are exempted from the obligation to issue a prospectus when their issues are rated investment grade by a credit-rating agency.[20] It needs to be noted that retail investors were made whole early in the unfolding crisis. John Chant concludes that "this case offers no evidence one way or the other with respect to the organization of regulation" (2009, 40). Stephen Choi of the New York University Law School draws a similar conclusion: "Importantly, the ABCP crisis does not provide support for the argument that Canada should move toward a national securities regulator. The regulatory structure for exempt offerings underlying the ABCP market prior to the financial crisis was similar to the regulatory structure within the United States securities regime. Similar with the provinces, the SEC provides for private placement exemptions from public offering registration requirements for securities sold through exempt transactions to primarily sophisticated investors" (2010, 94).

The final word on this matter belongs to Purdy Crawford, the architect of the ABCP restructuring, who stated that, even if a federal agency had been in place, the same exemptions would have governed the issuance of commercial paper.[21]

Valid comparisons about the performance of the Canadian securities regulatory regime cannot be those made against an idealized, error-free system; the appropriate standards are the actual performance, over time, of regimes in jurisdictions with well-developed capital markets. Lofty vision statements do not a high-performance organization make. Nor should claims of the impotence of the current securities regulatory regime to address specific matters of national import be accepted at face value. The history of developments in Canadian securities markets has taught us otherwise.

The central thesis that appears to motivate the federal government is that high formal and public enforcement intensity is essential to ensure the quality of capital markets.[22] The evidence does not give any credence to this approach. It fails to recognize the effectiveness of *ex ante* disclosure measures over *ex post* enforcement actions and the importance of instilling a culture of compliance through the effective use of the whole arsenal of regulatory tools. The experience of many countries provides insightful lessons of what works in securities regulation. It is definitely not what is argued by the federal government. Moreover, the denigration of Canada's capital markets is unwarranted and surprising given their superior performance relative to those of other countries: the OECD's assessment of the quality of securities market regulation assigned Canada the 2nd rank in terms of investor protection; the United States ranked 3rd, the United Kingdom ranked 4th and Australia ranked 12th.

Whatever the Supreme Court of Canada decision in the matter of the proposed *Securities Act*, the financial industry should fear, and would do well to prepare for, the unintended consequences of the federal initiative. In any case, if the Supreme Court were to rule against the federal government, one hopes that Ontario would join the passport system. The reason it gives to justify its position — that the passport system does not eliminate multiple fees — is not material enough to justify the fragmentation and added costs for issuers caused by the province's abstention.

The biggest risk, however, is that the impetus that has driven the Canadian Securities Administrators to pursue further harmonization and coordination will wither away. Although it remains a *non-dit*, there is little doubt that the fear the federal government could step in constitutes an incentive to address with a national perspective the needs of the Canadian capital markets. What will happen once this perceived threat is eliminated? I submit that the actions of the financial industry to encourage Ontario to join the passport system and the decision of the Ontario government in this regard would have considerable influence on the future course of events.

Conversely, should the Supreme Court of Canada rule that Parliament has constitutional authority to adopt comprehensive securities legislation, then the transitional problems and costs and the concurrency issues will become the first order of the day. The proposed *Securities*

Act relies on the provinces to opt in and to agree to jettison their securities legislation on a voluntary basis. Notwithstanding the virtues of "cooperative federalism," the proposed recipe most likely would lead to a long, tumultuous and chaotic transition period. Only Ontario has supported the federal government before the Supreme Court; several provinces are irreducibly opposed. In the longer term, this situation might well lead to a situation quite opposite to what was sought.

This double jurisdiction would create fertile ground for conflicting regulations. In such a legal environment, it is likely that the Canadian securities regulatory framework would become more fragmented, not less. The contention that adoption of the proposed *Securities Act* would lead to a "single federal regulator administering a single federal body of law with the power to ensure that market rules are applied consistently across the country" reflects a static view of the Canadian polity. It fails to recognize that, in a federal state, economic or political pressures create dynamic situations in which the constituent jurisdictions enact measures to achieve their objectives. The choice of instrument depends on those available, not on whether it is a first best solution.

Notes

1 This notion of exclusive competence is not hermetic. Parliament has exclusive jurisdiction to legislate securities crimes under its exclusive legislative jurisdiction over criminal law, a matter that I address later in this study. The Supreme Court of Canada has also ruled that certain provisions of the *Canadian Corporations Act* that pertain to takeovers and insider trading could stand concurrently with similar provisions of provincial securities legislation.

2 The Ontario submission to the Supreme Court of Canada highlights this significant concentration of the financial industry in Toronto (paragraphs 4 to 10).

3 Section 10.1 of the draft Act provided as follows: "The purpose of [Part 10] is to facilitate the development and implementation in Canada of one or more book-entry systems for the transfer and pledge of securities whether or not they are evidenced by security certificates."

4 The IMF has neither consulted with nor assessed the performance of all Canadian securities commissions. The conclusions are drawn from its work with federal, Ontario and Quebec regulators. Similarly, in the United States, the assessment pertains to the SEC and the Commodities Futures Trading Commission; it does not encompass the activities of state securities regulators, which fulfill a major role with respect to investor protection.

5 These National Instruments are, in order, NI 31-103, NI 45-106 and NI 45-102.

6 These are the System for Electronic Document Analysis and Retrieval (SEDAR), the System for Electronic Disclosure by Insiders (SEDI), the National Registration Database (NRD) and the National Cease Trade Order (CTO) Database.

7 Initially, the Quebec Securities Commission was the member until the legislative change that merged it within the AMF.

8 The following amounts overstate the incremental costs induced by securities regulation since, even in their absence, investors will require certified financial statements and binding legal agreements. In fact, the evidence shows that "sound" public laws reduce the costs of transactions.

9 Estimating the cost of equity is not straightforward. For instance, the cost of capital estimates presented by Hail and Leuz (2006) are themselves averages of estimates derived from four different models for calculating the cost of capital. The differences among the estimates from each of these models appear to be greater than differences among the five countries mentioned above. In a seminal paper on this issue, Fama and French (1997) estimate that standard errors of more than 3 percent per year are typical in the estimation of the cost of capital for sectors.

10 "IAMGOLD Corporation today announced it has filed a preliminary short form base shelf prospectus with securities regulators in each province and territory of Canada except for Quebec and a corresponding registration statement with the U.S. Securities and Exchange Commission" (Press release, June 30, 2011).

11 Recent comments by Douglas Hyndman, chief executive officer of the Canadian Securities Transition Office, before the Investment Industry Association of Canada are instructive. Focusing on differences in rules and regulations, he said that "the greatest number of differences lie in the regulations governing exemptions for private placements of new securities" and that "British Columbia and Alberta have many of the different standards." He boasted that the "transition office staff [had] made decisions about how to harmonize those differences into uniform national standards" (Harman 2011).

12 In the United States, venture-capital-backed IPOs underwritten by top-tier investment banks underperform other IPOs, and the post-IPO probability of failure for a venture-funded firm is about 1.5 times higher than that of non-venture-funded firms (Peristriani 2003).

13 The Advisory Committee on Smaller Public Companies of the SEC (United States 2006) defines a small cap company as a public company with equity capitalization of approximately $128 million to $787 million. Companies with a market capitalization lower than $128 million are defined as micro cap companies. The European Union defines SMEs in terms of maximum net assets as follows: approximately $65 million for medium-sized, $20 million for small and $4 million for microenterprises. Statistics Canada defines an SME as any business establishment with up to 499 employees and less than $50 million in revenues.

14 See also the comments by Josh Lerner quoted in Suret (2011, 26-7).

15 On May 6, 2011, the SEC issued an order authorizing NASDAQ OMX to establish a new exchange, the BX Venture Market, in which the quantitative standards of the listing criteria are substantially lower than those that apply to other exchanges. For example, to be eligible for initial listing, a company not previously listed on a US exchange needs to have, among many criteria, an operating history of at least one year and a minimum of either $1 million in stockholders' equity or $5 million in total assets. Of particular interest, securities listed on the BX Venture Market are not exempt from state "blue sky" rules relating to the registration of securities and, therefore, must satisfy state law registration requirements and other state laws that regulate the sale and offering of securities.

16 The average rate of return over the 1995-2005 period of new listings on the TSX (V) that are not natural resources issuers is not significantly different than for the whole market (14.83 percent versus 15.69 percent).

17 For an informed review of the relevance and applicability of the IOSCO Principles and Objectives with respect to functional and structural issues, see Spink (2010).

18 In Ontario, a Memorandum of Understanding between OSFI and the Ontario Securities Commission in March 1988 completed the Ontario-Canada Hockin-Kwinter Agreement of April 1987. Quebec also concluded a policy coordination agreement with the federal government in March 1988.

19 The successes of central counterparty clearing houses of exchange-traded and over-the-counter financial derivatives in withstanding the effects of the financial crisis — notably the disruptions caused by Lehman Brothers Holding's filing for protection under US bankruptcy law on September 15, 2008 — has confirmed the inherent strengths of the model for financial policy-makers. For a detailed account of the travails this event provoked in Europe and the United States, see Norman (2011).

20 National Instrument 45-106, section 2.35.

21 In his interview, Crawford stated: "Je suis en faveur d'une agence unique, pour plusieurs bonnes raisons…Mais la réalité, c'est que si nous avions mis sur pied une agence unique, il y aurait eu les mêmes exemptions. La crise a pris tout le monde par surprise, et une agence unique n'aurait rien changé…L'agence unique aurait adopté les mêmes règles. La probabilité qu'ils auraient décidé d'examiner le créneau exempté est très mince. Je sais qu'à Ottawa, on n'aime pas ça quand je le dis, mais c'est la réalité" (Desjardins 2009). On April 1, 2011, the Canadian Securities Administrators released proposed *Regulation 41-103 respecting Supplementary Prospectus Disclosure Requirements for Securitized Products* and proposed *Regulation 51-106 respecting Continuous Disclosure Requirements for Securitized Products*. The consultation period closed on August 31, 2011.

22 The press release issued to announce the tabling of the proposed *Securities Act* was entitled "Government of Canada Moves to Protect Canadian Investors."

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Commentary by Thomas Hockin

Arguments for a National Securities Regulator

For investor protection and macroprudential policy-making, securities regulation matters profoundly. Since most major securities can be globally traded, regulation of them is of national importance.

The Royal Commission on Price Spreads first identified the benefits of a single Canadian securities regulator in 1935. A variety of panels and commissions that have examined securities regulation in Canada have also found that the current system, which at one time served us well, is now outdated, inefficient and in need of change.[1] The Supreme Court of Canada is currently considering whether Parliament has the authority to adopt the *Securities Act* proposed by the federal government. These deliberations, by definition, will not provide an opinion on whether a national regulator is good policy. The Court is considering only whether the Constitution permits the creation of a national regulator through the form of legislation currently proposed. The policy debate is therefore left to public forums like this one.

To understand why the idea of a national regulator enjoys significant support among panels that have studied this issue (including the Expert Panel on Securities Regulation, which I chaired and which delivered its final report in January 2009) and why it is a priority for the federal government, it is important to look at the realities in securities markets today. It is important, as well, to ensure that Canada has a regulatory structure to meet the needs of the future. Opponents of the project seem to be satisfied with the status quo. Pierre Lortie's lucid and forceful paper is the most comprehensive articulation of past CSA work I have seen.

Yet despite the harmonization and coordination that the Canadian Securities Administrators have accomplished, the existing passport system does not include Ontario. Markets are dynamic, and we must ensure our regulatory structure has the capacity to adapt to keep pace. In this modern era of sudden liquidity seizures, financial institution collapses and sovereign debt challenges, this topic has never been more strategically important for the Canadian economy.

At its heart, this is a debate between those who perceive capital markets in Canada to be national and international and those who perceive them as fitting into 13 separate, inward-looking jurisdictions. A look at the evidence, however, easily leads one to the conclusion that the latter view is artificial, and that a national regulator would better reflect how our markets work and what our markets need. Financial market activity in Canada transcends provincial borders, and the current system serves only to discourage issuers from gaining access to larger pools of capital beyond their backyard. Let us examine the evidence behind this assertion.

First, how do businesses seeking to acquire capital by issuing securities interact with Canadian markets? Overwhelmingly, including the small and medium-sized businesses that are so vital to the Canadian economy, they seek to offer securities beyond their home province — 95 percent of initial public offerings, reverse take-overs and qualifying transactions completed between 2004 and 2008 involved more than one securities commission in Canada (Suret and Carpentier 2010, table 13). Second, despite the need to deal with a multitude of different rules and different interpretations of the same rules and to pay fees in each jurisdiction, only 6.5 percent of these transactions involved all 13 securities regulators. Third, let us not forget that almost every other structural component of securities markets in Canada, from exchanges to self-regulatory organizations such as the Investment Industry Regulatory Organization of Canada to clearing systems, operates across the country. The need to obtain agreement from different commissions in provinces with different election times and policy timetables contributes to inertia in the development of new rules consistent with new realities of the market and in the modification of the existing ones.[2] Delays, gaps and duplication, and the nonnational and noninternational focus of local authorities who tend to concentrate on local concerns, are the main reasons why systemic issues will arise.

Like most Canadian markets, securities transactions extend beyond even national borders. In the month of May 2011 alone, foreign investors purchased over $15 billion worth of Canadian securities and Canadians purchased over $3.5 billion in foreign securities (Statistics Canada 2011, table 1). Canadian companies are increasingly looking abroad, including the 347 Canadian companies that are reporting issuers in the United States, of which 133 are listed on the New York Stock Exchange (United States 2010). These companies enjoy a consolidated regulatory structure abroad while having to navigate a multitude of costly rules and fees at home.

Costs to investors in Canada are now augmented by a structure, mandate and history focused almost exclusively on investor protection rather than the broader goal of balancing investor protection with economic competitiveness and cost efficiency. Often forgotten, the latter two are goals that also benefit the investor.

Let us remember the exemplary provision in the Quebec Derivatives Act that requires regulators to consider the costs of the rules they make, as well as unintended consequences that may result from their application. The general absence of such a focus in our current structure, and the lack of a constant review of the rules' effectiveness in meeting new challenges mean that these rules may not be effective in the future. This too leads to systemic risk.

In a multijurisdictional context, implementing a mandatory review process, as is done for the Bank Act and its associated regulations, is unlikely to be successful. Why is this? Some jurisdictions may not be sufficiently knowledgeable in a changing marketplace, responsibility may well remain unclear and elections will cause delays and changes in direction.

In the midst of all this, it is clear that issuers and investors do not look exclusively, or preponderantly, to their home provinces' capital markets. Hence, facilitated access to a national market would offer tangible benefits. After all, every other element of this essential component of the Canadian economy operates nationally. Why, then, is it controversial to call for a national regulator with national rules, national enforcement and a Canada-wide perspective in encouraging efficient markets, protecting investors and reducing systemic risks?

In this commentary, I highlight four key areas where the views of certain proponents of the status quo, including Pierre Lortie, are inconsistent with the needs of capital markets in Canada. These relate to systemic risk, Canada's influence and reputation on the world stage, local market needs and the enforcement of securities laws. The Expert Panel's 2009 report uncovered the importance of each of these.

The systemic risk imperative

The International Organization of Securities Commissions (IOSCO), with 200 government and regulatory members, is the chief international body for establishing standards for securities regulation, and has set out three fundamental objectives for securities regulation, one of which is the reduction of systemic risk (IOSCO 2003, 2). Clearly, the issue of systemic risk in the financial system is not just an ancillary area of concern to securities regulators.

IOSCO has also noted that the "pre-crisis practises of securities regulators…reflected a lack of a financial stability perspective in securities regulation" (IOSCO 2011, 8). The need for new tools and new perspectives in securities regulation has been the subject of renewed focus, with various sources proposing new measures to combat this problem, which is intrinsic to securities regulation in every G7 country (see, for example, Anand 2010; IOSCO 2011, 8). In short, securities regulation has become much more than registering a dealer or approving a prospectus, and we need a regulatory approach that reflects this reality.

The federal government's proposed *Securities Act* takes a novel and important approach to giving a securities regulator the tools to monitor systemic risk. It explicitly mentions systemic integrity and stability in its purposes, and it would mandate the proposed Canadian Securities Regulatory Authority (CSRA) to monitor potential risks as they arise. The Act would also allow the CSRA to make urgent regulations to protect market stability, share information with regulatory authorities and governments outside Canada and temporarily cease the trading of securities when there are unusual fluctuations, and it would require a court to consider threats to systemic integrity as aggravating circumstances when imposing penalties.[3] Also significant would be the enhancement to stability of having a national regulator in place to work with federal agencies, such as the Office of the Superintendent of Financial Institutions and the Bank of Canada, to respond rapidly to emerging issues that require coordination.

A clear example is the asset backed commercial paper (ABCP) market. In 2007-08, a severe problem emerged when more complicated versions of these financial instruments were developed and the market expanded rapidly. All this occurred without a regulatory review of disclosure changes. There would have been a much fuller picture in terms of these market changes at a had regulatory authority been at the national level rather than provincial level.

In a comparative context and speaking from personal experience as Canada's representative to the International Monetary Fund (IMF), it is clear to me that the current system is neither sufficient nor consistent with the approach taken in other countries. Ensuring global financial stability has become one of the most important priorities at international institutions like the

IMF, and so it is no surprise that a tenuous consensus-based securities regulatory forum for Canada-wide responses to emerging issues (which is what the Canadian Securities Administrators system currently offers) is a glaring shortfall that has received significant attention abroad.

International influence and reputation

Canada is often lauded overseas for its reputation for market stability and integrity, but in the same breath, the international community overwhelmingly endorses the federal government's efforts to create a national regulator. The Organisation for Economic Co-operation and Development has called for a Canadian securities regulator to improve the efficiency of regulation "in order to attract foreign capital, encourage competitive impulses and improve macro-prudential regulation" (2010, 6). The IMF has also been unequivocal, stating, "The creation of a national securities regulator will bridge potential gaps in the supervision and regulation of what are essentially national markets, and create a venue for bridging securities regulation into the ambit of national coordinating initiative for promoting financial stability" (2010, 23).

It is also notable that Canada, through the federal government, lacks a representative at IOSCO. Only Ontario and Quebec are full members, while Alberta and British Columbia are associate members. This, in effect, leaves the residents of nine provinces and territories without a voice in this important international body, which is difficult to reconcile with the assertion that the current regime protects local interests. The current provincial members of IOSCO are mandated to advance the interests of their jurisdictions, while a national regulator would advance those of all provinces and territories by representing Canada as a whole.

Responding to local needs

The federal government's efforts to date have also demonstrated a comprehension of the principle that the needs of each region of the country should be taken into account when creating new national institutions. It has taken a voluntary approach, not on the grounds that it increases the likelihood of winning a constitutional argument, but rather to "ensure the new securities regulator meets the needs of Canadians and businesses in all regions" (Canada 2009). An advisory committee with representatives from all willing provinces and territories has been formed to help shape the regulator — a clear mechanism for finding compromises on issues relating to the uniqueness of local markets.

Furthermore, the Canadian Securities Transition Office (CSTO) Transition Plan describes plans for a CSRA that would be distributed across the country, in terms of both expertise and authority (CSTD 2010). Commitments to delegated decision-making, the appointment of deputy chief regulators for the various regions and the retention of existing expertise are clearly at odds with characterizations that the proposed structure of the CSRA is rigid and centralized.

Furthermore, when a province opts in to the Canadian securities regulatory framework, it will have a seat on a council of ministers that will advise on the appointment of senior officials and be empowered to call before it these officials for an explanation of the CSRA's activities and priorities.[4]

Inadequate enforcement

Modern financial systems rely on confidence to function properly — investors need to know that securities regulations are in place to protect them and that the regulations will be enforced when broken. Unfortunately, in Canada, it is clear that enforcement is inadequate. During my interactions with stakeholders as the chair of the Expert Panel on Securities Regulation, I often heard from stakeholders that authorities in the United States have better success taking enforcement action against Canadians who contravene securities regulation than Canadian authorities do. This lack of confidence is troubling, and often worsened by all-too-frequent stories about jurisdiction hopping and uneven enforcement efforts in Canada. This is quietly mentioned in the US as a reason the US Securities and Exchange Commission has hesitated to develop a mutual recognition arrangement with Canada. Effective enforcement is one of SEC's sine qua non expectations for such an arrangement.[5]

Take, for instance, the case of Michael Mitton, who was banned from capital markets in 2005 by the British Columbia Securities Commission. As the Canadian Coalition for Good Governance (CCGG) noted in its submission to the Supreme Court of Canada (2011, 4-6), Mitton defrauded investors in British Columbia, Alberta, Ontario and Quebec and was convicted on 90 counts of criminal charges relating to his conduct. Despite this, Mr. Mitton is still free to engage in capital markets activities in every province other than British Columbia, Alberta and Ontario because each securities commission must issue a reciprocal enforcement order for bans placed in other jurisdictions to take effect. This is inefficient and serves investors poorly.

Recognizing the importance of enforcement for market participant confidence, let us move beyond the anecdotal evidence and look at the statistics. Between 2007 and 2009, an annual average of 131 enforcement orders were made by securities commissions, but only 61 reciprocal orders. The CCGG points out that 1,572 reciprocal orders would have been necessary to ensure that a ban in one province applied across the country (2011, 6). This shortfall, which has been taken advantage of by fraudsters in the past, clearly points to the need for a national securities regulator that has the resources, expertise and national mindset to better protect investors across Canada.

It is clear that only a national regulator can reflect today's capital markets, offer effective responses to systemic risks, effectively enforce securities regulation and represent Canada's interests abroad. I am joined in this assessment by numerous expert reports and the international community. The federal government has made efforts to ensure that a CSRA would accommodate local needs, and provinces and territories would be well advised to work with the CSTO to ensure these needs are addressed.

In closing, I stress that my experience in capital markets and at the IMF has shocked me. The challenges to maintaining healthy, vibrant and stable capital markets in the current economic environment are more significant than I had ever before comprehended. A national securities regulator, created with the input of the provinces, would help Canada meet these challenges and reap the rewards. It is time for the selective, inward-looking arguments to be put to rest and for productive collaboration to continue. This initiative has been proposed with the needs of all Canadians in mind; it is time to give a national securities regulator a chance to serve them.

Notes

1 See, for instance, Canada (1964); Williamson (1979); Wise Persons' Committee (2003); Crawford Panel on a Single Canadian Securities Regulator (2006); Task Force to Modernize Securities Legislation in Canada (2006); and Expert Panel on Securities Regulation (2009).

2 Examples of such inertia include the following:
a) Regulations around multiple marketplaces and alternative trading systems (ATSs): While the CSA may rely on the OSC to lead the initiative, the complex nature of the issue, and the requirement to obtain consensus from other provincial jurisdictions that may not have the requisite expertise, can overtax the OSC and lead to unacceptably long delays and missteps in a fast-moving market environment. This has a clear systemic impact; b) National Instrument 24-101 (the Institutional Trade-Matching and Settlement Rule): Details to implement this rule, reflected in the Frequently Asked Questions (FAQ), were agreed upon among regulators and regulated entities by late July 2007 after a series of meetings that included representatives from Ontario, Quebec, British Columbia and Alberta. The FAQs were not published until five months later on December 14, 2007, close to three months after key measures of the rule went into effect on October 1, 2007. The explanation given was that the process of simply getting the FAQs through the approval process takes many months; c) Credit default swap (CDS) rules: Participants in Canadian Depository for Securities Limited had to wait a minimum of 78 days for the utility to get regulatory nondisapproval for a new file feed identifying dividend eligibility for tax reporting. This was at best a technical change, without any CDS, collateral or systemic risk. The delay increased the participants' cost and implementation risk, because they required the file feed as early as possible to be ready for the tax reporting season; and d) Fixing errors in exempt market dealer rules: The checks and balances provided by multiple reviewers have been offered as a reason to retain multiple jurisdictions. However, despite the need for jurisdictional signoff, significant mistakes can still be made. One example is the recent concern year with the unintentionally wide range of activities that can be undertaken by exempt market dealers. This now has to be corrected and will have to be approved by all jurisdictions.

3 Proposed *Securities Act*, sections 9(c), 16 (2) (d), 228 (4) (b), 224 (1) and 163 (1) (b).

4 Proposed *Securities Act*, section 13 (2).

5 On March 29, 2008, Australia was named as the first jurisdiction with which the US Securities and Exchange Commission (SEC) would engage in formal discussions to develop a mutual recognition arrangement for the two nations' securities markets. The SEC hopes that the discussions will enhance coordination of law enforcement and regulatory activities as well as increase access to well-regulated capital markets. Australia, a country 14 hours and 15,989 kilometres away from the US, was chosen over Canada, a similar-sized jurisdiction that is in the same time zones as and a short flight away from the US.

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