

Reference re Securities Act: What are the Remaining Options for a National Securities Regime?

DEE PHAM*

Dans le Renvoi relatif à la *Loi sur les valeurs mobilières*, la Cour suprême du Canada a statué que le projet du gouvernement fédéral visant à créer un organisme canadien unique de réglementation des valeurs mobilières était inconstitutionnel. La Cour n'a cependant pas définitivement exclu la possibilité qu'un organisme national de réglementation des valeurs mobilières soit constitutionnel selon une structure différente. Le but visé par ce commentaire d'arrêt est d'examiner quelles sont les options dont dispose encore le gouvernement fédéral pour pouvoir créer un organisme national de réglementation des valeurs mobilières.

In *Reference re Securities Act*, the Supreme Court of Canada ruled that the Federal government's proposed national security regulator was unconstitutional. Nevertheless, the Court did not conclusively rule out the possibility of a national securities regulator being constitutional under a different structure. The purpose of this case note is to examine what options remain available for the Federal government to create a national securities regulator.

* B.Hum., J.D.

Table of Contents

563	I.	INTRODUCTION
564	A.	The Supreme Court of Canada's Decision
567	II.	REMAINING OPTIONS FOR A NATIONAL SECURITIES REGIME
568	A.	Administrative Delegation & Referential Incorporation
569	B.	European Union Model
570	III.	CONCLUSION

Reference re Securities Act: What are the Remaining Options for a National Securities Regime?

DEE PHAM

I. INTRODUCTION

In *Reference re Securities Act*,¹ the Supreme Court of Canada (SCC) ruled on the constitutionality of a proposed national securities regulator. The federal government's proposal was outlined in the *Canadian Securities Act*.² The idea of a national securities regulator has been around for more than 60 years.³ The idea has been highly contentious and many notable scholars have argued for⁴ and against it.⁵ Prior to the SCC decision, the provincial governments of Alberta⁶ and Quebec⁷ brought their own references in their respective courts of appeal. The Alberta Court of Appeal ruled in a unanimous decision that the *Securities Act* was *ultra vires* the federal government, while the Quebec Court of Appeal came to the same conclusion in a majority decision. Similarly, the SCC ultimately ruled in a unanimous decision that the *Securities Act* was *ultra vires* the federal government. Nevertheless, many have commented that the SCC decision did not conclusively close the door to a national

1 *Reference re Securities Act*, 2011 SCC 66, [2011] 3 SCR 837 [*Securities Act Reference*].

2 The text of the proposed Canadian Securities Act can be found online: Department of Finance Canada <<http://www.fin.gc.ca/drleg-apl/csa-lvm.pdf>> [*Securities Act*].

3 For a brief summary of the history of a proposed national securities regulator see *Securities Act Reference*, *supra* note 1 at paras 11-28.

4 See e.g. Philip Anisman & Peter W Hogg, "Constitutional Aspects of Federal Securities Legislation" in Consumer and Corporate Affairs Canada, ed, *Proposals for a Securities Market Law for Canada*, vol 3 (Ottawa: Consumer and Corporate Affairs Canada, 1979) 135; Anita I Anand & Andrew J Green, "Why is This Taking So Long? Moving Towards a National Securities Regulator" (2010) 60:2 UTLJ 663.

5 See e.g. Jeffrey MacIntosh, "National securities regulation: A saga of political futility" (18 February 2011), online: University of Toronto Faculty of Law <<http://www.law.utoronto.ca/news/article-macintosh-saga-political-futility>>; Institute for Research on Public Policy, "IRPP Senior Scholar Thomas J. Courchene challenges the appropriateness of a single national securities regulator", online: Institute for Research on Public Policy <http://www.irpp.org/show_study.php?id=368>.

6 *Reference re Securities Act (Canada)*, 2011 ABCA 77, 510 AR 200.

7 *Québec (Procureure générale) c Canada (Procureure générale)*, 2011 QCCA 591, [2011] R]Q 598 [*Québec c Canada*].

securities regime.⁸ The purpose of this case note is to analyze the SCC decision and determine what options remain available for a national securities regime.

A. The Supreme Court of Canada's Decision

In defending the constitutionality of the *Securities Act*, the federal government relied primarily on the general branch of the trade and commerce power under section 91(2) of the *Constitution Act, 1867*.⁹ Except for some uncontested criminal offences, the federal government did not try to defend the constitutionality of the *Securities Act* under any other federal head of power, such as its powers over interprovincial and international trade or federal corporations.¹⁰ The likely reason is that these other heads of power could justify only parts of the *Act* rather than the whole regulatory regime. The federal government conceded that the provinces have the power to regulate securities within their territories, but argued that the securities market has evolved over the years from a local market to a national and international market. As a result of this evolution, the federal government argued that the entire securities market now falls under its general trade and commerce power.¹¹

Since the federal government relied primarily on its general trade and commerce power, the SCC focused all of its analysis on this head of power. The Court applied the two-part test that it uses in division of power cases.¹² First, it determines the pith and substance of the proposed act. Second, it determines whether the pith and substance of the proposed act falls under a federal head of power.

With regard to the pith and substance of the *Securities Act*, the SCC analyzed “the purpose and effects of the *Act*, viewed as a single, comprehensive scheme.”¹³ The Court examined the provisions of the *Act* and their effect, and determined that the main purpose of the *Securities Act* was “to provide investor protection, to foster fair, efficient and competitive capital markets and to contribute to the integrity and stability of Canada’s financial system.”¹⁴ Nevertheless, it also noted that the effect of the *Act* was to “duplicate legislative schemes enacted by provincial legislators exercising their jurisdiction over property and civil rights under s. 92(13) of the

8 See e.g. Ramandeep K Grewal & Edward J Waitzer, “National Securities Regulation – Centralization and Its Discontents” (2012) 27 BFLR 529; Philip Anisman, “It’s not over yet” *Financial Post* (28 December 2011), online: *Financial Post* <<http://opinion.financialpost.com/2011/12/28/its-not-over-yet/>>.

9 *Constitution Act, 1867* (UK), 30 & 31 Vict, c 3 s 91(2), reprinted RSC 1985, App II, No 5.

10 *Securities Act Reference*, *supra* note 1 at paras 32-33. For the argument that the federal government has the power to regulate securities under its power over Peace, Order and Good Government, see Don Tse, “Establishing A Federal Securities Commission” (1994) 58 Sask L Rev 427 at 439-41.

11 Notably, Dalphond JA, the lone dissenter in the Quebec reference, relied on this argument to justify upholding the federal government’s power over securities regulation. *Québec c Canada*, *supra* note 7 at paras 395-545.

12 See *RJR-MacDonald Inc v Canada (Attorney General)*, [1995] 3 SCR 199, 127 DLR (4th) 1.

13 *Securities Act Reference*, *supra* note 1 at para 93.

14 *Ibid* at para 95.

What are the Remaining Options for a National Securities Regime?

Constitution Act, 1867.¹⁵ The Court held, however, that the fact that the *Act* was a duplication of provincial legislation was not determinative of its constitutionality since it could still be directed at a federal concern, such as ensuring competitive markets and a stable financial system throughout Canada.¹⁶

Having determined the pith and substance of the *Securities Act*, the SCC then went on to determine whether it fell under the federal government's general trade and commerce power. The Court applied the test established in *City National Leasing Ltd v General Motors of Canada Ltd*:¹⁷

- (1) Is the law part of a general regulatory scheme?;
- (2) Is the scheme under the oversight of a regulatory agency?;
- (3) Is the law concerned with trade as a whole rather than with a particular industry?;
- (4) Is the scheme of such a nature that the provinces, acting alone or in concert, would be constitutionally incapable of enacting it?;
- (5) Would failure to include one or more provinces or localities in the scheme jeopardize its successful operation in other parts of the country?¹⁸

The Court noted that the test attempts to constrain the general trade and commerce power to truly national concerns, since a literal reading of the power would have the effect of significantly encroaching on provincial heads of power, particularly the provincial power over property and civil rights.¹⁹

The SCC held that the *Securities Act* clearly satisfied the first two indicia of the *General Motors* test.²⁰ The *Act* would establish a regulatory regime that applies generally to securities throughout Canada. Furthermore, it would establish the Canadian Securities Regulatory Authority as the regulatory agency with oversight over the regime.

What was more contentious was whether the *Securities Act* satisfied the three other indicia. The third indicium looks at whether the regulatory regime is concerned with trade as a whole rather than a particular industry. This indicium constrains the general trade and commerce power to truly national concerns that affect the whole Canadian economy, and ensures that the provincial power to regulate local industries is not encroached upon. In deciding that this indicium was not satisfied, the SCC made an important distinction between the parts of the *Act* which were directed at "management of systemic risk and at national data collection" and those concerned with "the day-to-day regulation" of securities.²¹ The Court held that,

15 *Ibid* at para 101.

16 *Ibid* at para 102.

17 *General Motors of Canada Ltd v City National Leasing*, [1989] 1 SCR 641, 58 DLR (4th) 255 [*General Motors*].

18 *Securities Act Reference*, *supra* note 1 at para 108.

19 *Ibid* at para 85.

20 *Ibid* at para 110.

21 *Ibid* at para 117.

although the management of systemic risk and national data collection were a national concern, the day-to-day regulation of securities was properly a provincial concern. The day-to-day regulation of securities, such as the regulation of securities registration and of the conduct of brokers and investment advisors, is an area historically regulated by the provinces. The Court noted that this alone did not confer to the provinces constitutional authority over the activity to the preclusion of the federal government.²² Nevertheless, the Court held that the federal government did not provide sufficient evidence to convince it that the securities market had evolved in such a way as to make the day-to-day regulation of securities a national concern.

The fourth indicium looks at whether the provinces, acting alone or in concert, would be constitutionally capable of enacting a similar regulatory regime. This indicium ensures that the general trade and commerce power is limited to matters the provinces are incapable of regulating. Many legal scholars have been critical of this indicium because of the potentially broad scope given to the federal government in its application.²³ They point out two major flaws. First, the provincial incapacity test as developed in *General Motors* has been construed to mean whether the federal government would be a more functionally effective regulator.²⁴ This interpretation has led the SCC to prioritize economic efficiency over other values, such as regional diversity. Second, the Court has not required the federal government to satisfy this indicium with empirical rigour.²⁵ Rather than require qualitative and quantitative evidence, the Court usually relies on general observations that the federal government has the superior ability to regulate, or that the provinces are inferior at regulating.

In the decision, the SCC narrowed the scope of the test set out in *General Motors*. The Court emphasized that:

[R]eferences in past cases to promoting fair and effective commerce should be understood as referring to constitutional powers that, because they are essential in the national interest, transcend provincial interests and are truly national in importance and scope. Canada must identify a federal aspect distinct from that on which the provincial legislation is grounded. The courts do not have the power to declare legislation constitutional simply because they conclude that it may be the best option from the point of view of policy. The test is not which jurisdiction — federal or provincial — is thought to be

22 *Ibid* at para 116.

23 See e.g. Noura Karazivan & Jean-François Gaudreault-DesBiens, "On Polyphony and Paradoxes in the Regulation of Securities Within the Canadian Federation" (2010) 49 Can Bus LJ 1 [Karazivan & Gaudreault-DesBiens]; Jean Leclair, "Please, Draw Me a Field of Jurisdiction': Regulating Securities, Securing Federalism" (2010) 51 Sup Ct L Rev (2d) 555 [Leclair].

24 Karazivan & Gaudreault-DesBiens, *supra* note 23 at 25.

25 Leclair, *supra* note 23 at 594-95.

What are the Remaining Options for a National Securities Regime?

best placed to legislate regarding the matter in question. The inquiry into constitutional powers under ss. 91 and 92 of the *Constitution Act, 1867* focuses on legislative competence, not policy.²⁶

This suggests that the inquiry is not into whether the federal government or provinces are the superior regulator from the standpoint of policy. Rather, the focus is solely on which level of government has the constitutional competence to regulate the matter. In the Court's application of the fourth indicium to the *Securities Act*, it held that the provinces could not enact a similar regulatory regime that could effectively address the goals of preventing systemic risk and promoting efficient national capital markets on a sustained basis.²⁷ A province's power to leave an inter-provincial regime at any time would undermine the regime's ability to address these concerns. Nevertheless, the Court was still troubled by the Act because it went beyond these national concerns and attempted to regulate all aspects of securities.²⁸

The last indicium looks at whether the failure to include one or more provinces in the regulatory regime would undermine its successful operation in other parts of the country. The SCC acknowledged that the parts of the *Securities Act* that address systemic risk and national data collection would be undermined if all the provinces were not included.²⁹ Nevertheless, since the Act's main focus was on the day-to-day regulation of securities, the Court held that it would still be successful even if all the provinces were not included. Notably, the Court also held that the *Securities Act*'s opt-in provision weighed against the federal government. This holding is problematic because the federal government frequently uses opt-in provisions to encourage provinces to join national regulatory regimes. The federal government may now be reluctant to include opt-in provisions in future regimes.

In light of its analysis of the *Securities Act*, the Court ultimately concluded that the Act was *ultra vires* the federal government's general trade and commerce power.³⁰ The Act went too far by attempting to occupy the entire field of securities regulation. The general trade and commerce power only gave the federal government the power to regulate aspects of securities that are of genuine national concern, such as regulation dealing with systemic risk and national data collection.

II. REMAINING OPTIONS FOR A NATIONAL SECURITIES REGIME

The SCC decision is consistent with division of power jurisprudence, which favours a cooperative and flexible approach to federalism over the use of restrictive doctrines such as paramountcy.³¹ Indeed, even though it ruled that the *Securities Act* was

26 *Securities Act Reference*, *supra* note 1 at para 90.

27 *Ibid* at paras 120-21.

28 *Ibid* at para 122.

29 *Ibid* at para 123.

30 *Ibid* at para 125.

31 *Ibid* at paras 58-60.

ultra vires, the Court nevertheless encouraged the federal government to cooperate with the provinces to create a national securities regime.³² By emphasizing the distinction between aspects of securities regulation that are genuinely national in scope, such as regulation dealing with systemic risk and national data collection, and those that are local in scope, such as regulation dealing with registration and the conduct of brokers and investment advisors, the Court provided a way forward for a national securities regime. The following sections will outline approaches the federal and provincial governments can take in establishing a national securities regime that will be consistent with the Court's decision.

A. Administrative Delegation & Referential Incorporation

The SCC has been highly encouraging of federal-provincial regimes that have used administrative delegation³³ and referential incorporation.³⁴ For instance, in *Fédération des producteurs de volailles du Québec v Pelland*,³⁵ the Court upheld as constitutional a federal-provincial marketing scheme established to control the sale and production of chicken across Canada. Under the scheme, a federal agency sets quotas for chicken production for each province. Provincial agencies would then administer the quotas in their respective province. In order to ensure that farmers could not subvert the quota by selling their chickens in another province, the federal agency delegated its authority over interprovincial trade to the provincial agencies. As a result, the national marketing scheme could only function properly if the federal and provincial governments cooperated together. Administrative delegation and referential incorporation were necessary because the federal government had power over interprovincial trade, while the provinces had power over agricultural production.

Similarly, the federal and provincial governments could use administrative delegation and referential incorporation to create a national securities regime. The federal government could create a national securities regulator with the power to regulate with regard to systemic risk in the Canadian securities market and national data collection. The provincial governments could then delegate their power over the day-to-day regulation of securities to the national securities regulator. This arrangement would allow for uniform rules and consistent administration of securities in each province and create a regulatory agency that could properly deal with systemic issues in the Canadian economy. The difficulty with this regulatory regime would be convincing the provinces to voluntarily delegate their powers over securities to a federal agency. It is unlikely that Quebec and Alberta, the provinces which

32 *Ibid* at paras 130-31.

33 Administrative delegation is when one level of government delegates its authority to another level of government's regulatory agency.

34 Referential incorporation is when one level of government passes legislation which incorporates provisions found in another level of government's legislation.

35 *Fédération des producteurs de volailles du Québec v Pelland*, 2005 SCC 20, [2005] 1 SCR 292.

What are the Remaining Options for a National Securities Regime?

resisted the proposed national securities regulator, would consent to delegating their powers to a federal agency. Nevertheless, the provinces which were not opposed in principle to the idea of a national securities regulator would be more likely to give their consent. The federal government could potentially convince these provinces to delegate their power by ensuring that there will be a significant amount of provincial input in the formulation of regulatory rules and administrative policy, and by promising to establish strong regional offices.

B. European Union Model

As a confederation of 27 diverse member states, the European Union (EU) has had to be creative with regard to its regulatory regimes. For this reason, examining the EU securities regime could provide useful ideas for a Canadian regime. In the EU, each member state has a regulatory agency. Nevertheless, the EU has adopted the Market in Financial Instruments Directive (MiFID), which establishes an EU-wide securities regime.³⁶ The MiFID establishes uniform rules that each member state has to incorporate into its domestic legislation. It also establishes a passport system so that registration in one member state will allow an investment firm to operate throughout the EU. Although Member States are in charge of administering securities regulation, the EU established the European Securities and Markets Authority (ESMA) to provide oversight of the EU financial system.³⁷ The ESMA cooperates with the national regulatory agencies in their regulation of the EU securities market by collecting data, providing advice and coordinating the national regulatory agencies in times of crisis. In addition, the ESMA contributes to the harmonization of securities regulation by issuing guidelines and recommendations that assist national regulatory agencies in their application of securities regulation.

Although the SCC decision made clear that the federal government could not usurp the provinces' authority over the day-to-day regulation of securities, it could still play a unifying and supervisory role similar to that of the ESMA. The federal government could establish a national securities authority with the mandate to facilitate uniform securities regulation. Uniform securities legislation would be drafted in consultation with the provinces. While it would be up to the discretion of each province to incorporate the legislation into provincial law, the provinces' role in drafting the uniform legislation would likely motivate them to do so. The national securities authority could also issue guidelines and recommendations that promote uniformity in the application of securities regulation among the provincial regulatory agencies. In addition to the national securities authority's role in facilitating uniform securities regulation, it would also have an important role in ensuring that

36 EC, *Directive 2004/39/EC of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC* (2004) Official Journal of the European Union, L 145/1.

37 ESMA, "European Securities and Market Authority", online: ESMA <<http://www.esma.europa.eu>>.

Canadian securities markets are functioning efficiently and properly. The national securities authority would monitor for systemic risk and collect data. For this reason, the national securities authority would play an important role in supervising and advising provincial securities regulators in their application of securities regulation. It would issue bulletins and coordinate provincial regulatory agencies in times of crisis. Although this national securities regime would require a significant amount of trust and cooperation between the federal and provincial governments, it has a higher likelihood of adoption because each level of government would not have to delegate any of its powers.

III. CONCLUSION

The federal government has not given up on the idea of a national securities regulator and is in talks with the provinces to establish a cooperative model.³⁸ If it considers a national securities regulator a truly worthwhile project, then the federal government should see the SCC decision in *Reference re Securities Act* not as an obstacle, but as an invitation to establish a regulatory regime that respects provincial autonomy and is consistent with Canada's brand of cooperative federalism. The alternative proposals outlined above provide paths for the federal government to achieve this goal. If the federal government can obtain the required provincial consent, then creating a national securities regulator through administrative delegation and referential incorporation would be ideal. Alternatively, if the provinces are reluctant to delegate their powers to a federal agency, then creating a national securities regulator based on the EU model would still be a worthwhile pursuit.

38 Janet McFarland, "Flaherty not giving up on national securities regulator" *The Globe and Mail* (29 March 2012), online: The Globe and Mail <<http://www.theglobeandmail.com/report-on-business/flaherty-not-giving-up-on-national-securities-regulator/article2386461>>. See also Theresa Tedesco, "Ottawa pushes for national securities regulator within year" *Financial Post* (27 April 2012), online: Financial Post <<http://business.financialpost.com/2012/04/27/ottawa-pushes-for-national-securities-regulator-within-year>>.