The Supreme Court Law Review: Osgoode's Annual Constitutional Cases Conference

Volume 51 (2010) Article 20

The Capital Markets Perspective on a National Securities Regulator

Poonam Puri
Osgoode Hall Law School of York University, ppuri@osgoode.yorku.ca

Citation Information
Puri, Poonam. "The Capital Markets Perspective on a National Securities Regulator." *The Supreme Court Law Review: Osgoode's Annual Constitutional Cases Conference* 51. (2010).
https://digitalcommons.osgoode.yorku.ca/sclr/vol51/iss1/20

The Capital Markets Perspective on a National Securities Regulator

Poonam Puri*

I. INTRODUCTION

Over the last four decades, successive federal governments (and at least one provincial government) have constituted panels, commissioned studies, and drafted legislation intended to lead to the creation of a national securities regulator for Canada. These attempts can be traced back at least as far as the 1979 *Proposals for a Securities Market Law for Canada*,[1] to more recent attempts including the 2003 Wise Persons' Committee[2] ("WPC"), and the most recent 2009 Expert Panel on Securities Regulation ("Hockin Panel").[3]

Following the release of the Hockin Panel Report, the federal government created the Canadian Securities Transition Office ("CSTO") in July 2009 to effectively transition to a Canadian securities regulator.[4] The CSTO was given the mandate to (i) develop a draft Securities Act for the approval of the Minister of Finance; (ii) create a Transition Plan which would act as a roadmap for establishing a Canadian securities regulator and integrating the regulators of the participating jurisdictions into a new agency with a common organizational structure; and (iii) consult with the

---

* Associate Professor of Law, Osgoode Hall Law School, York University. Co-Director, Hennick Centre for Business and Law, York University. An earlier version of this paper was presented at 2009 Constitutional Cases: The Thirteenth Annual Analysis of the Constitutional Decisions of the Supreme Court of Canada (April 16, 2010). Stephanie Kam, Sheetal Nanda, Sylvia Schumacher and Matt Segal provided excellent research assistance in the preparation of this article.

1 Philip Anisman *et al.*, *Proposals for a Securities Market Law for Canada*, vol. 3 (Ottawa: Consumer and Corporate Affairs Canada, 1979).

2 Wise Persons' Committee, *It's Time* (Ottawa: Department of Finance Canada, 2003), online: Wise Persons' Committee <http://www.wise-averties.ca/reports/WPC Final.pdf> [hereinafter "WPC"].

3 Expert Panel on Securities Regulation, *Creating an Advantage in Global Capital Markets: Final Report and Recommendations* (Ottawa: Department of Finance Canada, 2009) [hereinafter "Hockin Panel Report"], online: Expert Panel on Securities Regulation <http://www.expertpanel.ca/eng/documents/Expert_Panel_Final_Report_And_Recommendations.pdf>.

4 For more details on the creation of the CSTO, see online: Canadian Securities Transition Office <http://www.csto.ca/en/about-csto.aspx>.

Advisory Committee of Participating Provinces and Territories as well as other capital markets stakeholders on the draft Securities Act and the Transition Plan.

On May 26, 2010, the federal Department of Finance released the proposed *Canadian Securities Act.*[5] On the same day, the proposed legislation was referred to the Supreme Court of Canada for a determination of the Parliament of Canada's legislative authority to enact such legislation. Quebec and Alberta had previously launched constitutional challenges in their respective provincial courts, based on the draft legislation that accompanied the Hockin Panel Report.

In July 2010, the CSTO released the Transition Plan, which addresses governance, organizational and administrative matters in relation to the proposed securities regulator.[6] The Transition Plan will have to be approved by all of the participating provinces and territories and the CSTO is currently negotiating with the willing jurisdictions. The Canadian government has allocated $150 million to address financial issues as a part of the negotiation that will move Canada from provincial/territorial regulation to a single national regulator. The Transition Plan indicates that the Canadian securities regulator should be up and running by late 2012 or early 2013.[7]

It is expected that the Supreme Court of Canada will hear the case in late 2010 or early 2011. The Transition Plan assumes that the Supreme Court will rule in favour of the Parliament of Canada having the constitutional authority to enact the proposed *Canadian Securities Act*. The specific constitutional issue is whether a federally enacted securities act encroaches on provincial authority to regulate the securities market under "property and civil rights", or whether the Parliament of Canada has the authority to regulate capital markets under its federal "trade and commerce" power. The heavyweights of Canadian constitutional law have opined that there is a valid federal power under the Constitution to regulate the Canadian securities market.[8]

---

[5] Proposed *Canadian Securities Act*, online: Department of Finance Canada <http://www.fin.gc.ca/drleg-apl/csa-lvm-eng.htm>.

[6] Canadian Securities Transition Office, *Transition Plan for the Canadian Securities Regulatory Authority*, (2010), online: Canadian Securities Transition Office <http://www.csto.ca/documents/Transition_Plan_for_the_CSRA .pdf>.

[7] *Id.*, at 7.

[8] See, *e.g.*, the three Constitutional Opinions provided to the WPC in relation to the model proposed by the WPC, online: Wise Persons' Committee <http://www.wise-averties.ca/report_en.html>.

In his paper entitled "'Please, Draw Me a Field of Jurisdiction': Regulating Securities, Securing Federalism",[9] Professor Jean Leclair concludes that the Supreme Court of Canada will likely rule in favour of Parliament having the constitutional authority to regulate the securities market in Canada. He very reasonably argues that if the Supreme Court is to grant this power to Parliament, then its decision and reasoning should be based on empirical facts.[10]

The purpose of this paper is to provide an empirical foundation from a capital markets perspective to ground the discussion and analysis on the constitutionality of a national securities regulator. Based on the data, the case for a national securities regulator for Canada is more evident now than it has ever been.

This paper first explores the academic and empirical literature on the relationship between regulation and the strength of that jurisdiction's capital markets, as measured by the cost of capital, liquidity and investor protection. Studies have found that Canadian companies have a higher cost of capital than their U.S. counterparts, even after accounting for risk,[11] meaning that Canadian companies pay more financing than their peers. Canadian companies also receive lower valuations. This, in part, can be attributed to the limitations associated with our fragmented regulatory structure, as well as concerns about weak enforcement.

The paper then explores the data on Canadian retail and institutional investors and their investing patterns, as well as the financing needs and preferences of Canadian businesses. The data show that the capital markets are now more important than ever to Canadian investors and businesses alike. Capital markets have become a preferred vehicle for investing the savings of individual Canadians, as compared to other investment opportunities. Similarly, institutional investors such as pension funds invest a significant proportion of their assets in the public capital

---

9 Jean Leclair, "'Please, Draw Me a Field of Jurisdiction': Regulating Securities, Securing Federalism", in this volume.

10 *Id.*

11 Luzi Hail & Christian Leuz, "International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?" (2006) 44:3 Journal of Accounting Research 485 [hereinafter "Hail & Leuz"], where the authors observed that the cost of equity capital is 25 basis points higher in Canada than in the United States. See also Michael King & Dan Segal, "Valuation of Canadian- vs. U.S.-Listed Equity: Is there a Discount?" (2003) Bank of Canada Working Paper 2003-6 [hereinafter "King & Segal"], which came to the conclusion that Canadian public companies are valued significantly lower than those in the United States while attempting to control for a number of variables; Task Force to Modernize Securities Legislation in Canada, *Canada Steps Up: Final Report* (Toronto: Task Force to Modernize Securities Legislation in Canada, 2006), at 24 [hereinafter "Allen Report"], online: Task Force to Modernize Securities Legislation in Canada <http://www.tfmsl.ca>.

markets. In terms of financing growth and expansion for Canadian businesses, capital markets play a more dominant role than they have ever done in the recent past.

Finally, the paper explores how changes in the regulatory and global capital markets environment further exacerbate the negative impact of Canada's fragmented regulatory system and highlight the need for national regulation.

This paper proceeds as follows: Part II reviews the academic and empirical literature on the relationship between regulation and regulatory structure and the strength of capital markets. Part III examines the data on the changing needs and preferences of Canadian investors and businesses. Part IV highlights the changes in the regulatory environment and global capital markets that would have an impact on the discussion of the necessity of federal versus provincial/territorial regulation of capital markets. Part V concludes.

II. The Role of Regulation of the Capital Markets

This part of the paper first explores the policy rationales underlying capital markets regulation and explains how high investor confidence in a jurisdiction's capital market helps to increase liquidity in that market and decrease the cost of capital that businesses in that jurisdiction must pay. This part then reviews the academic literature on the relationship between strong regulation and the development of capital markets. It finds that academic studies show that Canadian companies suffer from a "Canadian discount" in that they pay more for capital than their U.S. counterparts. Canadian companies also suffer from lower valuations. This can be attributed, in part, to our inefficient securities regulatory framework with 13 provincial regulators as well as concerns about ineffective enforcement.

1. Fundamental Principles of Capital Markets Regulation

The purposes of capital markets regulation are often stated as: [12]

- promoting fair and efficient capital markets;
- protecting investors from unfair, improper or fraudulent practices; and

[12] See, *e.g.*, Ontario's *Securities Act*, R.S.O. 1990, c. S.5, s. 1.1.

- maintaining public/investor confidence in the capital markets.

In an efficient capital market, the price of stocks reflects all relevant information that is available about their intrinsic or true value.[13] A stock represents a claim on future cash flows, and thus the intrinsic value is the present value of the cash flows the owner of the security expects to receive. If stock prices accurately reflect all information, new investment by capital goes to its highest-valued and best use.

Investor confidence in the capital markets impacts liquidity and cost of capital for businesses. Liquidity relates to the volume of outstanding shares that are freely trading and refers to the concept of buying or selling shares in the capital markets without causing a significant movement in the price.[14] Having many buyers and sellers trading shares in the capital markets assists in achieving liquidity.

The cost of capital is the price that businesses must pay to access investors' money.[15] If investors lose confidence in the market, they are less likely to invest in the market, resulting in reduced liquidity. If investors continue to invest in the market, they are likely to demand high returns for their investments, resulting in a higher cost of capital for businesses that want to access public capital. If businesses cannot raise money from outside investors, they will not be able to invest in profitable projects. This decreases growth, employment and wealth-creation.[16]

Capital markets regulation in Canada governs the capital-raising process for businesses. It also regulates intermediaries in the capital markets, such as underwriters who assist issuers in accessing the market and

---

[13] Richard Brealey & Stewart Myers, *Principles of Corporate Finance* (New York: Irwin McGraw Hill, 2006), at 351-77. For detailed discussions of efficient markets theory, see Eugene Fama, "The Behavior of Stock Market Prices" (1965) 38:1 Journal of Business 34; Eugene Fama, "Efficient Capital Markets: A Review of Theory and Empirical Work" (1970) 25:2 Journal of Finance 383; Eugene Fama, "Efficient Capital Markets II" (1991) 46:5 Journal of Finance 1575; Burton Malkiel, *A Random Walk Down Wall Street*, 9th ed. (New York: W.W. Norton & Company, 2007).

[14] Utpal Bhattacharya, "Enforcement and its Impact on Cost of Equity and Liquidity of the Market" in *Canada Steps Up: Final Report*, vol. 6 (Toronto: Task Force to Modernize Securities Legislation in Canada, 2006) 131, at 144.

[15] *Id.*, at 138.

[16] *Id.*, at 137. Bhattacharya states:

> If securities laws are not enforced, outside investors will doubt whether they will get their money back with a fair return. So outside investors will not give their money to firms (this leads to low liquidity in capital markets) or, if they give money to firms, they will demand a higher return (this leads to a higher cost of equity). If firms cannot raise money from outside investors, they will not be able to invest in profitable projects. This decreases growth, employment, and wealth-creation.

brokers, advisors and mutual fund salespeople who assist investors in investing their savings in the capital markets.

Capital markets regulation requires disclosure of information by issuers so as to enhance the efficiency of the market by allowing stock prices to reflect publicly available information. It also mandates disclosure of information so that investors can make informed investment decisions, resulting in higher investor confidence. Capital markets regulation also provides for public and private enforcement remedies if there is non-compliance with the disclosure regime to ensure a high level of investor protection.

Capital markets regulation requires market intermediaries such as brokers and salespeople to be licensed and registered in order to protect the investing public by ensuring that the investors do not entrust their money to unscrupulous or incompetent financial services providers, again to ensure a high level of investor confidence.

Currently, the 13 provincial/territorial securities commissions regulate the capital markets to promote efficiency, investor protection and investor confidence. If the 13 provincial/territorial securities commissions are regulated well, investors will likely keep their money in or bring their money to Canada and not take it elsewhere. In addition to the 13 provincial/territorial securities commissions, the self-regulatory organizations ("SROs") such as the Investment Industry Regulatory Organization of Canada ("IIROC") and the Mutual Fund Dealers' Association ("MFDA") also play a role in regulating some aspects of the Canadian capital markets.[17]

2. Positive Correlation between Strong Capital Markets Regulation and Capital Markets Development

Many academic studies indicate that the quality and strength of capital markets regulation in a country has a positive relationship with the capital markets development in that country. The quality of a country's

[17] See IIROC website for further details of its mandate, online: IIROC <http://www.iiroc.ca/english/about/pages/default.aspx>. IIROC was created in 2008 through the consolidation of the Investment Dealers Association of Canada ("IDA") and Market Regulation Services Inc. ("RS"). It is the national SRO that oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. It carries out its regulatory responsibilities through setting and enforcing rules regarding the proficiency, business and financial conduct of dealer firms and their registered employees, and through setting and enforcing market integrity rules regarding trading activity on Canadian equity marketplaces. See MFDA website for details of its mandate, online: MFDA <http://www.mfda.ca/about/aboutMFDA.html>.

regulation (including disclosure requirements, governance requirements and actual enforcement) can also have a positive effect on efficient pricing, liquidity and cost of capital for businesses.[18]

Some studies have found that stricter and better enforced securities regulation is positively associated with development of the capital market, including the size of a country's equity capital market and level of initial public offerings.[19] While this study focused on the value of private enforcement, other studies conclude that public enforcement is at least as important as private enforcement in the development of stock markets.[20]

Other studies have analyzed international differences in firms' cost of equity capital across 40 countries and found that firms from countries with more extensive mandated disclosure requirements, stronger securities regulation and stricter enforcement mechanisms have a significantly lower cost of capital.[21] Similarly, another study found that improvements in the capital market governance index (including degree of earnings opacity, enforcement of insider trading laws and removal of short selling restrictions) are associated with decreases in the cost of equity, increases in market liquidity and increases in market-pricing efficiency.[22]

Recent scholarship has also found that there is a relationship between countries' institutional features and outcomes such as accounting quality, corporate transparency and firms' cost of capital. For example, a study by Leuz, Nanda and Wysocki shows that a country's legal environment (including the strength of its investor protection laws and the enforcement of those laws) directly impacts firms' incentives to comply with financial

---

[18] Christopher Nicholls, "The Characteristics of Canada's Capital Markets and Illustrative Case of Canada's Legislative Response to *Sarbanes-Oxley*" [hereinafter "Nicholls"] in *Canada Steps Up: Final Report*, vol. 6 (Toronto: Task Force to Modernize Securities Legislation in Canada, 2006) 127; Bernard Black, "The Legal and Institutional Preconditions for Strong Securities Markets" (2001) 48 UCLA L. Rev. 781; Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, "What Works in Securities Law?" (2006) 61:1 Journal of Finance 1.

[19] La Porta, Lopez-de-Silanes & Shleifer, *id.*

[20] Howell Jackson & Mark Roe, "Public and Private Enforcement of Securities Laws: Resource-Based Evidence" (2009) 93:2 Journal of Financial Economics 207.

[21] Hail & Leuz, *supra*, note 11. See also Michael Greenstone, Paul Oyer & Annette Vissing-Jorgesen, "Mandated Disclosure, Stock Returns, and the 1964 Securities Acts Amendments" (2005) 121:2 Quarterly Journal of Economics 399; Andrei Shleifer & Daniel Wolfenzon, "Investor Protection and Equity Markets" (2002) 66:1 Journal of Financial Economics 3; Allan Ferrell, "If We Understand the Mechanisms, Why Don't We Understand the Output?" (2003) 28 J. Corp. L. 503.

[22] Hazem Daouk, Charles Lee & David Ng, "Capital Market Governance: How Do Security Laws Affect Market Performance?" (2006) 12:12 Journal of Corporate Finance 560.

reporting rules and provide high quality financial reports to outside investors.[23]

Similarly, Ball, Kothari and Robin examine the influence of financial reporting standards as well as other economic factors on the reporting decisions of firms in Hong Kong, Malaysia, Singapore and Thailand.[24] The authors find that even in those countries that have high quality accounting standards that may parallel those of the U.S. and International Accounting Standards, other institutional and enforcement factors limit the effectiveness of the accounting standards, which ultimately leads to lower quality financial reporting by firms in these countries.[25]

Some recent studies show that foreign investors invest more in countries with better disclosure regulations. Leuz, Lins and Warnock found that firms with governance problems attract significantly less foreign investment and the association between governance and investment by foreign U.S. investors is most pronounced in countries with overall governance weaknesses and weak disclosure requirements.[26]

3. The Canadian Discount

Studies show that Canadian public companies pay investors more for using their capital than companies in the U.S. and that Canadian companies are valued lower than their U.S. counterparts. Leuz and Hail found that the cost of equity capital is 25 basis points higher in Canada than in the United States.[27] Another study by King and Segal concluded that Canadian public companies are valued significantly lower than those in the United States while attempting to control for a number of variables.[28]

---

[23] Christian Leuz, Dhananjay Nanda & Peter Wysocki, "Earnings Management and Investor Protection: An International Comparison" (2003) 69:3 Journal of Financial Economics 505.

[24] Ray Ball, S.P. Kothari & Ashok Robin, "The Effect of International Institutional Factors on Properties of Accounting Earnings" (2000) 29:1 Journal of Accounting and Economics 1.

[25] See also Raphael La Porta, *et al.*, "Investor Protection and Corporate Governance" (2002) 57:3 Journal of Finance 1147; Stijn Claessens, *et al.*, "The Benefits and Costs of Internal Markets: Evidence From Asia's Financial Crisis" (2001) CEI Working Paper Series 2001-15; In-Mu Haw *et al.*, "Ultimate Ownership, Income Management, and Legal and Extra-Legal Institutions" (2004) 42:2 Journal of Accounting Research 423; Ray Ball & Lakshmanan Shivakumar, "Earnings Quality in UK Private Firms: Comparative Loss Recognition Timeliness" (2005) 39:1 Journal of Accounting and Economics 83; David Burgstahler & Michael Eames, "Management of Earnings and Analysts' Forecasts to Achieve Zero and Small Positive Earnings Surprises" (2006) 33:5-6 Journal of Business Finance & Accounting 633.

[26] Christian Leuz, Karl Linz & Francis Warnock, "Do Foreigners Invest Less in Poorly Governed Firms?" (2009) 22:8 Review of Financial Studies 3245.

[27] Hail & Leuz, *supra*, note 11.

[28] King & Segal, *supra*, note 11.

As such, Canadian public companies must be content with this "Canadian discount" which puts them at a disadvantage internationally *vis-à-vis* other firms seeking capital and investors. The lower valuations of Canadian companies and the higher cost of capital that our companies must pay can, in part, be attributed to our inefficient securities regulatory framework with 13 provincial regulators as well as perceptions and concerns about ineffective enforcement.[29]

III. THE CHANGING FACE OF INVESTORS AND ISSUERS

This part of the paper discusses some changes that have taken place in both Canadian and international capital markets with respect to investors and issuers. The data show that both Canadian investors and Canadian businesses rely more heavily on capital markets for their savings and financing needs, respectively. As well, in light of the globalization of capital markets, both investors and issuers have more choice about where they invest and where they seek capital, respectively. As such, Canada needs to mobilize its regulatory structure to respond to globalization if it wants to remain competitive in retaining and attracting investors and issuers.

1. Increasing Importance of Capital Markets to Investors

The capital markets matter to investors, whether they are Canadian or foreign, retail or institutional. The data show that the Canadian capital markets have become increasingly important to Canadians for savings. In the early 1960s an estimated 44 per cent of annual personal savings were put into life insurance as a wealth-building vehicle; by the 1990s this had dropped to 22 per cent, in favour of other alternatives, such as mutual funds and pension funds.[30] As of 2003, almost one-half of all Canadians owned publicly traded equities, either directly or indirectly through mutual funds, double the amount in 1990.[31]

---

[29] Paul Halpern & Poonam Puri, "Reflections on the Recommendations of the Task Force to Modernize Securities Regulation in Canada: A Retail Investor Perspective" (2008) 46:2 Can. Bus. L.J. 199. See also Gordon Boissonneault, "The Relationship between Financial Markets and Economic Growth: Implications for Canada" [hereinafter "Boissonneault"] in A. Douglas Harris, ed., *It's Time: Research Studies* (Ottawa: Department of Finance, 2003).

[30] Tarek Harchaoui, *Two Decades of Financial Intermediation by the Canadian Insurance Business* (Ottawa: Statistics Canada, April 1997), at 2, online: Statistics Canada <http://www.statcan.gc.c/pub/63f0002x/63f0002x1997011-eng.pdf>.

[31] WPC, *supra*, note 2, at 6, citing TSX Group, *Canadian Shareowners Study* (2003).

If pension fund holdings are included, then almost all Canadians participate in the equity markets.[32] For example, the Canada Pension Plan ("CPP") holds 55 per cent of its portfolio in public equities.[33] More generally, the data show that stocks traded in the public capital markets account for about 40 per cent of Canadian pension funds asset portfolio.[34] This percentage has been stable between 1993 and 2006.

However, foreign holdings by pension funds have more than doubled to 30 per cent, while holdings of Canadian securities have correspondingly fallen.[35] Moreover, in recent years, Canadian capital markets seem to have experienced difficulty attracting foreign investors, as growing foreign holdings of Canadian stocks have not kept pace with Canadian holdings of foreign stock.[36] Considering Canada's strong economic performance, some commentators hypothesize that this disparity may be due to inefficiencies in the regulation of Canadian capital markets, which ends up taxing capital market transactions in Canada.[37]

2. Increasing Importance of Capital Markets to Canadian Businesses

The data also show that Canada's capital markets have been playing an increasingly important role in funding the growth of Canadian businesses. Chart 1 shows that from the early 1960s through the mid-1990s Canadian corporations sourced funding predominantly through loans and borrowing, while the next decade saw a dramatic increase in the relative importance of share issuances. The public equity markets accounted for over one-half of corporate fundraising in 2000-2005.[38] A similar upward trend can be observed in respect of long-term financing: in 1990, the capital markets provided 73 per cent of long-term financing of Canadian firms; by 2002, this had grown to 88 per cent.[39]

---

32 WPC, *id.*, at 6.

33 CPP Investment Board 2010 Annual Report at 17, online: CPP Investment Board <http://www.cppib.ca/files/PDF/CPPIB_AR_2010_EN_Online.pdf >.

34 Poonam Puri & Palladam Vasudev, "Canadian Pension Funds: Investments and Role in the Capital Markets and Corporate Governance" (2010) 25:2 B.F.L.R. 247, at 251.

35 *Id.*, at 259.

36 Boissonneault, *supra*, note 29, at 58.

37 *Id.*, citing Charles Freedman & Walter Engert, "Financial Developments in Canada: Past Trends and Future Challenges" (Summer 2003) Bank of Canada Review 3.

38 Allan Tomas, *Recent Trends in Corporate Finance: Some Evidence form the Canadian System of National Accounts* (Ottawa: Statistics Canada, 2006), at 9 [hereinafter "Tomas"], online: Statistics Canada <http://www.statcan.gc.ca/pub/13-604-m/13-604-m2006050-eng.pdf>.

39 WPC, *supra*, note 2, at 4, citing Bank of Canada.

It is also important to note that most businesses that access public capital in Canada do not do so locally, but rather nationally. Approximately two-thirds of all reporting issuers in Canada are reporting issuers in more than one province/territory.[40] Approximately 30 per cent of the issuers listed on the TSX and the TSX Venture Exchange are "national issuers" reporting in all 10 provincial jurisdictions.[41]

Although a full two-thirds of Canadian issuers report in more than one province, the Canadian capital market does segment by region based on different concentrations of industry and expertise. Oil and natural gas companies, for example, tend to be headquartered in Alberta, financial services in Toronto and mining small cap in British Columbia.[42]

However, the location of a company's headquarters often bears little relationship to the economic impact of the company's activities. Financial services, for example, are frequently headquartered in Ontario, but they account for between 12 per cent and 23 per cent of the GDP of other provinces.[43] Similarly, oil and gas companies may be headquartered in Alberta but their exploration activities extend from Newfoundland and Labrador to Iqaluit. In a very real sense, then, such companies are national and indeed international in scope and should be subject to consistent national regulation rather than a checkerboard of provincial and territorial rules. To the extent that regulatory expertise has developed in the provinces and territories where, for instance, oil and gas or financial services are regulated, that regulatory expertise should be harnessed in the new single regulator.

---

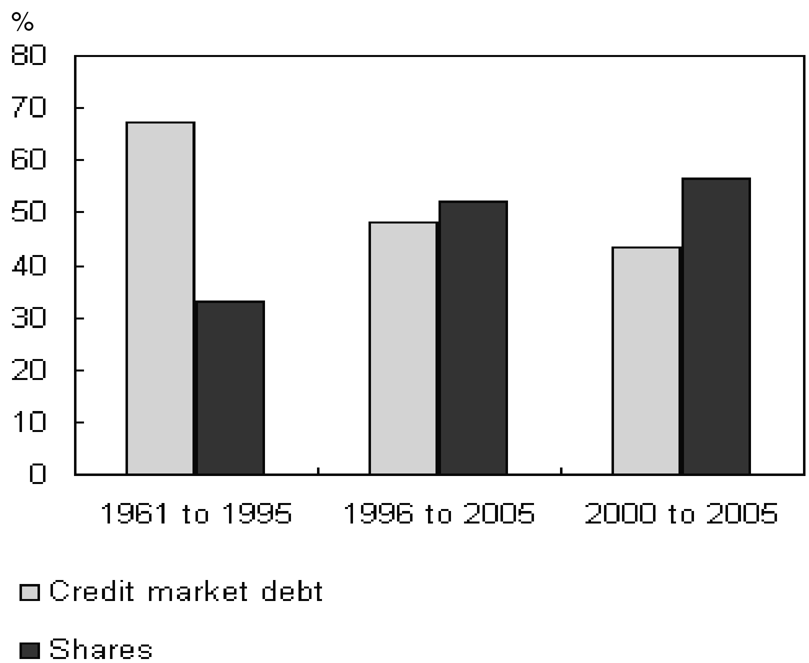
[40] *Id.*, at 5.

[41] *Id.*

[42] Poonam Puri, "Local and Regional Interests in the Debate on Optimal Securities Regulatory Structure" (2004) for the WPC, at 214.

[43] *Id.*, at 215.

Chart 1: Share Issuance Overtakes Borrowing in Importance[44]



3. Greater Global Competition and Cross-Listings on the Rise

Canadian businesses are increasingly accessing foreign capital markets, as evidenced by the data on cross-listings of Canadian firms abroad. The significant use of U.S. capital markets in particular by Canadian firms suggests that access to global sources of capital is also important for Canadian firms.

Canadian capital markets are small by global standards. With a market capitalization of US$1,033,448.50 in December 2008, the TSX Group accounted for 3.2 per cent of global market capitalization, and ranked eighth among the world's 10 largest equity exchanges.[45]

---

44 Tomas, *supra*, note 38.

45 World Federation of Exchanges, *2008 Domestic Market Capitalization*, World Federation of Exchanges, online: <http://www.world-exchanges.org/statistics/annual/2008/equity-markets/domestic-market-capitalization-0> [hereinafter "WFE"]. The 10 largest, in descending order are: NYSE Euronext, Tokyo SE Group, NYSE Euronext (Europe), NASDAQ OMX, London SE, Shang-

The small size of Canadian capital markets implies that when Canadian issuers find the Canadian capital market insufficient to meet their capital needs, they cross-list on foreign exchanges in an effort to attract more investors.[46] Cross-listing in another jurisdiction has generally benefitted Canadian firms by lowering their cost of capital and increasing their valuation while simultaneously increasing their share turnover and their visibility.[47]

As of March 2006, 48 Canadian companies were listed on the London Stock Exchange.[48] As of March 2010, 178 Canadian companies (approximately 12 per cent) were cross-listed in New York.[49] Other Canadian issuers are cross-listed elsewhere in Europe or Australia.

Canadian issuers are particularly well represented on London's Alternative Investment Market ("AIM"), where approximately 20 per cent of foreign issuers on AIM are Canadian issuers.[50] AIM has been quite active in attracting foreign listings, growing from three in 1995 to 157 in June 2005.[51] Two-thirds of AIM's foreign issuers listed between January 2004 and June 2005.[52]

New York is the most popular market in which Canadian firms cross-list. Of the 178 Canadian firms cross-listed in New York in March 2010, 38 were listed on NASDAQ, 75 on NYSE, and 65 on NYSE Alternext.[53] In December 2004, the U.S. Securities and Exchange Commission reported that 40 per cent of the foreign firms registered and reporting with them were Canadian, over four times as many firms as the next-most represented jurisdiction.[54]

---

hai SE, Hong Kong Exchanges, TSX Group (including both the TSX and TSX Venture Exchange), Deutsche Borse and Bombay SE.

46 Scott Hendry & Michael King, "The Efficiency of Canadian Capital Markets: Some Bank of Canada Research" (Summer 2004) Bank of Canada Review 5, at 10.

47 *Id*., at 13.

48 Nicholls, *supra*, note 18, at 159. Of those 48 issuers, three-quarters were listed on the Alternative Investment Market ("AIM"), which is geared to smaller issuers and is therefore more "flexibly regulated".

49 Interlisted Symbols on the Toronto Stock Exchange, online: TSX <http://www.tmx.com/en/pdf/Interlisted.txt> [hereinafter "TSX"]. This includes cross-listings with NASDAQ, New York Stock Exchange (NYSE), NYSE Alternext (TSX).

50 Stéphane Rousseau, "London Calling?: The Experience of the Alternative Investment Market and the Competitiveness of Canadian Stock Exchanges" (2007) 23:1 B.F.L.R. 51, at 55.

51 *Id.*, at 54.

52 *Id*.

53 TSX, *supra*, note 49.

54 Nicholls, *supra*, note 18, at 158-59, citing Office of International Corporate Finance, Division of Corporation Finance, U.S. Securities and Exchange Commission, *Number of Foreign Companies Registered and Reporting with the U.S. Securities and Exchange Commission December*

While the data show that Canadian firms look to foreign markets, Canada is not high on the list for cross listing by foreign issuers. As Professor Nicholls also points out:

> Canada's equity markets are neither a leading choice for cross-listing by foreign issuers (as, for example, the London Stock Exchange is); nor are they large enough to ensure that they will remain the primary markets for the largest Canadian companies (as, for example, the New York Stock Exchange is for most large U.S. issuers).[55]

The data suggest that Canada can do better in attracting foreign issuers and maintaining the listings of domestic issuers. The financial crisis of September 2008 underscored in a dramatic way the interconnectedness of global capital markets. This interconnectedness allows businesses to raise capital where it is most easily available and least expensive. Additionally, technology allows investors to search globally for the best returns, either directly or through intermediaries such as pension funds.[56] This global competition for capital will continue to intensify. This is the environment in which Canadian issuers are competing for capital, from both domestic and international investors. To remain competitive, Canada needs to address the inefficiencies associated with its regulatory structure. Canada has to attract capital markets activity to remain competitive in both retaining and attracting investors and issuers.[57]

IV. DEVELOPMENTS AND TRENDS IN THE GLOBAL REGULATORY ENVIRONMENT

As noted in earlier parts of this paper, regulation and regulatory structure have an impact on the quality of a jurisdiction's capital market and can impact the decisions of both investors and issuers on where to invest and seek capital, respectively. Canada's fragmented regulatory structure, resulting in the Canadian discount, makes Canada less competitive on the global front.

Although Canadian capital markets are increasingly being affected by international regulations and developments, and by competition from

---

31, 2004, online: U.S. Securities and Exchange Commission <http://www.sec.gov/divisions/corpfin/internatl/foreignsummary2004.pdf>.

55 *Id*., at 136.

56 WPC, *supra*, note 2, at 1-2.

57 Eric Pan, *Structural Reform of Financial Regulation in Canada* (Ottawa: Expert Panel on Securities Regulation, 2009), at 3-4 [hereinafter "Pan"].

other jurisdictions, Canada's already limited influence globally in capital markets is declining partially due to constraints inherent in the Canadian regulatory system.[58] This part of the paper describes six trends in the global and regulatory environment that further exacerbate the negative impact of Canada's fragmented regulatory structure.

1. Greater Regulatory Cooperation between Countries and IOSCO Gains Prominence

As trade and financial markets have globalized, countries have been increasingly interested in regulatory cooperation. The International Organization of Securities Commissions ("IOSCO") was founded in 1983 to act as a cooperative regulatory body at a global level to mitigate systemic risk, enhance investor protection and strengthen information exchange and cooperation in enforcement against misconduct.[59] The G20 has encouraged IOSCO to continue its work on cross-border enforcement cooperation.

Currently, because of our regulatory structure, Canada is the only country that does not have a national voice at the IOSCO. Instead, Ontario and Quebec sit as "ordinary members" and Alberta and British Columbia as "associate members".[60] This produces a spectacle of disproportion with Canada holding four seats yet only representing about 3 per cent of global market capitalization, while the United States, which has about 35 per cent of the global market capitalization, holds two seats, one ordinary and one associate.[61] Ironically, none of the four Canadian "seats" has any authority to speak for Canada.

Canada is lacking a strong, consistent and authoritative voice at IOSCO, as well as in negotiating cooperative initiatives such as with the SEC and other leading capital markets jurisdictions.[62]

What other leading regulators think about the Canadian securities regulatory system is important. For example, in 2008, the SEC started negotiating a free trade in securities agreement with Australia but did not do so with Canada, on the basis that our securities structure was too

---

[58] Boissonneault, *supra*, note 29, at 56.

[59] See IOSCO website for further details of its mandate, online: IOSCO <http://www.iosco.org/about>.

[60] See online: IOSCO <http://www.iosco.org/lists/display_members.cfm?memID=1&orderBy=jurSortName>.

[61] WFE, s*upra*, note 45. NYSE has 28.3 per cent of global market capitalization and NASDAQ has 7.3 per cent.

[62] Pan, *supra*, note 57, at 2.

fragmented.[63] If Canada is out of step with other leading jurisdictions, we could be at a competitive disadvantage for reciprocal agreements such as the MJDS and free trade agreements.

2. Regulatory Consolidation, Both Provincially and Internationally

Another important trend in the regulatory environment is regulatory consolidation in the financial services sphere. This is taking place both globally and also within Canada. This trend reflects the blurring of the key elements of the financial sector — banks, trusts, insurance companies and securities dealers[64] — and is also a recognition of the interconnectedness of the financial system.[65] Some commentators have suggested that the asset backed commercial paper crisis in Canada could have been better handled had we had greater consolidation in the financial regulation area.[66]

The Financial Services Authority ("FSA") in the U.K. is a key example of a consolidated financial services regulator. The FSA has held regulatory authority over all financial services providers in the U.K. since December 2001. In November 2004, the FSA was given regulatory power over mortgages, followed by power over general insurance activities in January 2005.[67]

Similarly, some of the Canadian provinces have also consolidated provincial financial market regulation.[68] On February 1, 2004, Quebec launched its regulatory integration with the launch of the Autorité des Marchés Financiers ("AMF"), which oversees the regulation of the financial sector, including insurance, securities, deposit-taking institutions

---

[63] Canadian Bankers Association, "Enhancing Canadian Competitiveness by Reforming the Way Securities are Regulated in Canada" (2008), at 5, submission to the Expert Panel on Securities Regulation.

[64] Boissonneault, *supra*, note 29, at 71.

[65] See, for example, The Department of the Treasury, *The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure* (Washington, D.C.: The Department of the Treasury, 2008). See also Pan, *supra*, note 57.

[66] See John Chant, *The ABCP Crisis in Canada: The Implications for the Regulation of Financial Markets* (Ottawa: Expert Panel on Securities Regulation, 2009).

[67] See FSA website, online: FSA <http://www.fsa.gov.uk/Pages/About/Who/History/index.shtml>. However, this is changing as Britain's finance minister, George Osborne, announced on June 16, 2010 that he would split the FSA and reorganize it as two structures, one focusing on prudential regulation and the other concentrating on supervising the way banks and brokers treat customers and conduct business.

[68] Boissonneault, *supra*, note 29, at 71.

and the distribution of financial products and services.[69] Saskatchewan is also in the process of regulatory consolidation in the financial services sector through Enterprise Saskatchewan.[70]

While other jurisdictions both globally and within Canada are actively considering regulation consolidation, Canada is lagging behind, lacking consolidation even on the securities regulation front.

3. Expectations of Timely Regulatory Action

Technological advances have increased the speed and reach of capital markets activity. As such, another trend in the regulatory environment is a focus on timely delivery of new legal rules and reform to existing rules.

However, under the current system in Canada, it can take months or even years to put in place a national or multilateral instrument through the Canadian Securities Administrators ("CSA") because whatever is agreed to, if anything, must then be approved separately, by each individual province or territory. It generally takes at least 18 months to put a national or multilateral rule in place, since 13 provinces/territories need to come to agreement on the policy and the specific measures being taken.[71]

Moreover, the current fragmented system makes it more difficult for Canada to respond quickly to fast-moving developments. Two examples illustrate well the delay experienced under the current system with the CSA. The first example is the implementation of Canada's response to the U.S.'s *Sarbanes-Oxley Act*.[72] SOX came into force as of July 2002, while the Canadian measures came into effect almost two years later in March 2004. The CSA gave priority to designing suitable measures for the Canadian capital market but the result was a collection of five instruments and policies, only some of which were national and binding

[69] See AMF website, online: AMF <http://www.lautorite.qc.ca/autorite/a-propos/mission.en.html>.

[70] See Enterprise Saskatchewan website, online: Enterprise Saskatchewan <http://www.enterprisesaskatchewan.ca/plan/>. Enterprise Saskatchewan was created to promote and sustain economic growth in the following sectors: Advanced Education and Research and Development Services, Agriculture and Food, Arts and Culture, Construction and Land Development, Co-operatives, Energy, Environment, Financial Services, Forestry, Homebuilding, Information Technology, Life Sciences and Biotechnology, Manufacturing, Mining, Tourism, Trucking and Transportation.

[71] Five Year Review Committee, *Five Year Review Committee Final Report — Reviewing the Securities Act (Ontario)* (Toronto: Ministry of Finance, Ontario, 2003), at 76.

[72] *Sarbanes-Oxley Act* of 2002, Pub. L. No. 107-204, 2002 U.S.C.C.A.N, 116 Stat. 745 [hereinafter "SOX"].

across the country as some jurisdictions refused to participate in the new rules.[73] Canada's slow response to SOX and the much-publicized U.S. accounting failures illustrates both the need for timely and coordinated national responses to significant international events, and the difficulty Canada currently has in implementing one.

The second example involves the delay in implementing the short selling ban in Canada that resulted from the seemingly impending collapse of a number of U.S. banking institutions in 2008. While the FSA in the U.K. and the SEC in the U.S. were able to immediately coordinate a ban on short selling during the market meltdown on September 18, 2008,[74] Canada could only belatedly follow 24 hours later, an eternity in trading terms, because of the coordination that had to take place between the Ontario Securities Commission (the lead regulator for the TSX) and the other provincial/territorial regulators.[75]

Canada was heavily criticized for this 24-hour delay in responding as trading was quite volatile, particularly for financial institutions' stock. For example, on September 18, Citigroup closed 18.7 per cent up over the previous day, American Express closed 14.2 per cent up, the Dow Jones industrials average closed 3.9 per cent up, and S&P TSX composite closed 1.6 per cent up.[76] The 24-hour delay could potentially have had significant and negative consequences for a cross-listed financial institution.

4. Greater Consolidation of SROs and Quasi-Regulatory Bodies

The capital markets are comprised of many players including investors, issuers, intermediaries, stock exchanges and SROs. Other than the securities commissions, which remain provincial, yet which have awkwardly tried to harmonize using the CSA, most of the other players of the Canadian capital markets are national in scope.

---

[73] Nicholls, *supra*, note 18, at 178.

[74] SEC Release No. 34-58592, *Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments*, online: SEC <http://www.sec.gov/rules/other/2008/34-58592.pdf>.

[75] CSA indicated support on September 19, 2008 for the Ontario Securities Commission's Temporary Order prohibiting short selling of securities of certain financial sector issuers listed on the TSX. OSC, Temporary Order Section 127(1), (2) and (5), online OSC <http://www.osc.gov.on.ca/en/15959.htm>.

[76] David Berman, "The Close: Hope Springs" *The Globe and Mail*, September 18, 2008, online: Globe and Mail <http://www.theglobeandmail.com/globe-investor/markets/markets-blog/the-close-hope-springs/article710370/>.

For example, the two main SROs in Canada, the IIROC and the MFDA, are national in scope.[77] Similarly, there has been significant consolidation and harmonization of the stock exchanges in Canada. Prior to 1999, Canada had five stock exchanges: the Vancouver Stock Exchange ("VSX"), the Alberta Stock Exchange ("ASE"), the Winnipeg Stock Exchange ("WSE"), the Toronto Stock Exchange ("TSE", subsequently "TSX"), and the Montreal Exchange ("ME"). Perhaps one of the most obvious indicators of the national scope of capital markets is the 1999-2000 consolidation of the five regional stock exchanges into four national exchanges that are segmented by product type.[78] The four national exchanges currently are the TSX for senior equities, the TSX-V for junior equities, the Bourse de Montréal for derivatives trading and the Winnipeg Commodity Exchange for commodity futures and options.[79]

5. Greater Accountability for Costs

As public institutions, regulators are accountable for the ways in which they spend public funds. There are at least three areas of incremental cost associated with the current regulatory structure in Canada: (1) cost of duplication in the regulatory structure; (2) increased compliance costs for issuers and intermediaries; and (3) opportunity costs for issuers, intermediaries and investors resulting from missed opportunities.[80] One study estimated that consolidating 13 regulators into a single national regulator with one head office and five regional offices would save 37 per cent of the total regulatory operating budget.[81] Much of these savings could be spent on substantive regulatory matters such as rule-making, compliance and enforcement under a single national regulator.

6. Greater Expectations about Enforcement

Studies show that even the best-designed regulation must be enforced effectively if it is to optimally promote investor protection and

---

77 See WPC website for further details on SROs, online: WPC <http://www.wise-averties.ca/main_en.html>.

78 See *TMX History at a Glance*, online: TMX Group <http://www.tmx.com/en/pdf/TMXHistory.pdf>.

79 *Id.*

80 *Supra*, note 2, at 22.

81 *Id.*, at 33-34.

investor confidence.[82] Studies also show that investors and capital markets participants have high expectations about regulatory enforcement.[83] There have been many critiques of Canada's lax public enforcement stance, particularly in comparison to the U.S.'s more stringent, back-ended approach to enforcement.

Some of the criticisms around enforcement include (1) the complexity and inefficient allocation of resources that the duplicative and fragmented structure of the current enforcement system creates; (2) a lack of enforcement action on high-profile cases; (3) delays between detection of misconduct and regulatory action; (4) delays in adjudication; (5) lack of accountability at enforcement institutions; (6) lack of expertise and resources at the regulatory and criminal investigative level; and (7) ineffective enforcement investigations at IMET.[84]

Some of these concerns would be addressed through the single national regulator, which proposes to (1) consolidate and harmonize both regulatory and criminal enforcement in the same body; (2) provide criminal investigators with additional investigative tools; (3) create an independent hearing panel; and (4) establish simplified, consistent national standards for complaint handling and redress.[85]

V. CONCLUSION

This paper has sought to provide an empirical foundation from a capital markets perspective evidencing the current need for a national securities regulator in Canada. The intent of the foregoing empirical assessment has been to provide an empirical footing from which to ground the constitutional discussion and debate.

By first exploring the relationship between Canada's regulatory structure and the strength, or lack thereof, of its capital markets, it is clear that Canadian firms are suffering from a "Canadian discount" that can be attributed, in part, to Canada's inefficient securities regulatory framework. The data also show that Canadian retail and institutional investors increasingly rely on the public capital markets to make investments. Similarly, Canadian businesses are increasingly relying on

---

[82] See, for example, Poonam Puri, *A Model for Common Enforcement in Canada: The Canadian Capital Markets Enforcement Agency and the Canadian Securities Hearing Tribunal* (Ottawa: Expert Panel on Securities Regulation, 2009).

[83] *Id.*

[84] *Id.*

[85] *Supra*, note 6.

public capital markets for their financing needs. The data also suggest that global competition for capital compels a more proactive Canadian response to remain competitive in attracting and retaining both issuers and investors alike. Finally, the paper outlined six trends in the global and regulatory environment that exacerbate the negative impacts of Canada's fragmented regulatory structure, further underscoring the need for a national regulator.

The lack of a Canadian securities regulator not only does a disservice to investors and businesses, it puts Canada out of step with the rest of the world, where the trend is towards consolidation of regulation. Indeed, as has been pointed out, Canada remains the only major industrialized nation not to have a national securities regulator. In determining the constitutionality of federal capital market regulation in Canada, it will therefore be crucial to examine the underlying data, including the changes in the global and Canadian capital markets, indicating the necessity of a national securities regulator at this time.