Moving Forward after the *Securities Act Reference*: The Future of Securities Regulation in Canada

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Introduction

On December 22, 2011, in the *Securities Act Reference*, the Supreme Court of Canada held that the federal government's proposed national *Securities Act* was not constitutionally supportable under its general trade and commerce power.[1] Ottawa's attempt at the comprehensive regulation of capital markets and securities trading throughout the country, the Court held, would be an improper "wholesale takeover of the regulation of the securities industry,"[2] and therefore an unjustified intrusion into provincial spheres of power. With this decision went any hope of a quick transition to a single, comprehensive national securities regulator. The federalism principle upon which Canada's makeup rests, the Court stated, precluded unilateral federal action towards that end.[3] However, the Court recognized—really for the first time—a legitimate federal interest in aspects of securities regulation, including preventing and responding to systemic risk, maintaining fair, efficient and competitive capital markets and collecting data nationwide.[4]

The issue on which the Court did not opine (and properly so) was whether having a national securities regulator was in Canada's best interest from a policy perspective.[5] Hence the conundrum the two levels of government now face: determining the best way forward with securities regulation in Canada, recognizing not only its provincial character but also its federal aspects.

This article considers this conundrum in context, first by reviewing the *Reference* and the Court's reasoning and then by considering the options going forward. We conclude that there are two primary options: (1) unilateral federal action of a limited scope, or (2) cooperative action on a broader scheme, involving joint delegation of powers to a common authority.

The *Reference*

The Question

The Governor in Council referred the following constitutional question to the Court: *Is the annexed Proposed Canadian Securities Act within the legislative authority of the Parliament of Canada?*[6] Both Quebec and Alberta had already initiated references on the validity of federal securities legislation to their Courts of Appeal.[7] The federal government moved unsuccessfully to suspend those two references in favour of its reference. By the time the federal reference was heard, both provincial appellate courts had held that the proposed federal securities legislation would be unconstitutional.

In brief, the Act's stated purposes included protecting investors, fostering fair, efficient and competitive markets and contributing to the stability of the financial system.[8] It was intended to result in a single national securities regulatory scheme, though that scheme would not be imposed on the provinces. The Act provided for the provinces to opt in to the scheme.[9] There was no opt-out provision for provinces or territories. The Act was largely modeled on existing provincial securities legislation.

Constitutional Arguments in Support of the Act

The federal government chose to base its case for the validity of the Act solely on the general trade and commerce branch of s. 91(2) of the *Constitution Act, 1867*.[10] The Court had earlier upheld the validity of federal competition and trade-marks legislation under the general trade and commerce power.[11] Canada did not rely on other powers,

such as the power to regulate interprovincial and international trade[12] or criminal law power.[13]

To make its case for validity of the Act under the general branch of s. 91(2), the federal government had to address the following five factors, first set out by the Court in its 1989 *General Motors v. City National Leasing* decision, which upheld the federal *Competition Act:*[14]

(1) whether the law is part of a general regulatory scheme;

(2) whether the scheme is under the oversight of a regulatory agency;

(3) whether the legislation is concerned with trade as a whole rather than with a particular industry;

(4) whether it is of such a nature that provinces, acting alone or in concert, would be constitutionally incapable of enacting it; and

(5) whether the legislative scheme is such that the failure to include one or more provinces or localities in the scheme would jeopardize its successful operation in other parts of the country.[15]

Canada and its supporting interveners argued that capital markets have evolved from local to national and international, and that emerging systemic risks to securities markets and the national economy now also give securities regulation a national character.[16] Canada maintained that while certain aspects of securities regulation remained within provincial power, the Act went beyond those powers and the existing provincial and territorial legislation by creating comprehensive securities regulation concerned with trade as a whole, as opposed to a particular industry.[17] Canada also submitted that the Act was one that the provinces, acting alone or in concert, were incapable of enacting.[18]

Constitutional Arguments against the Act

Quebec and Alberta, as well as the other provinces and interveners supporting them, argued that the Act was an unconstitutional intrusion on provincial jurisdiction over property and civil rights.[19] Under this power, provinces have authority to regulate contracts, property and professions.[20] Quebec argued that the Act sought to regulate a particular industry, with an identical purpose and effect as the existing provincial legislation. Quebec also contended that the provinces were capable of enacting law similar to the Act, and have, in essence, already done so.[21] Alberta made similar arguments to Quebec's, and also focused on what it described as distinct provincial capital markets, requiring provincial regulation. It characterized securities transactions that might appear interprovincial or international in nature as involving, in reality, a series of discrete intraprovincial transactions. Alberta also focused on the opt-in provision of the Act,[22] branding it fatal to Canada's constitutional arguments.

Two provinces, B.C. and Saskatchewan, advanced a more qualified argument, stating that while they did not in principle oppose the idea of a national securities regulator, the Act did not appropriately respect the division of powers and was, as a result, unconstitutional.[23] B.C. went as far as to liken the Act, in particular its opt-in provision, to a legislative Trojan horse, a stratagem allowing the federal government entrance into the hallowed halls of provincial power, which would inevitably lead to erosion of other provincial powers.

The Opinion

The Court unanimously held that the Act was not a valid exercise of federal power under the general trade and commerce branch of s. 91(2) of the *Constitution Act, 1867*.[24]

Purpose and Effects of the Act

Noting that the Act would stand or fall as a whole,[25] the Court assessed its purpose and effects. On the basis of the record and the terms of the Act, the Court determined that the main purpose of the Act was exclusive regulation of all aspects of securities trading in Canada, including day-to-day trading in securities and the occupations relating to those activities in each of the provinces. The Court held that the direct effect of the Act was to create a federal securities regulation scheme, one intended to displace and subsume existing provincial securities regulation schemes.[26]

Application of the Factors Relevant to General Trade and Commerce

The Court reaffirmed and applied the five non-exhaustive factors for determining whether a law is valid under the general branch of the trade and commerce power set out in *General Motors*.[27] Before doing so, it cautioned that this power must be (and has been) interpreted and applied in a manner that does not eviscerate established provincial powers.[28]

The Court focused on factors 3, 4 and 5.

Its decision on factor 3—whether the legislation is concerned with trade as a whole rather than with a particular industry—was key. The Court accepted that the preservation of capital markets to fuel Canada's economy and maintain Canada's financial stability is a matter concerned with trade as a whole, rather than a particular industry. It acknowledged that "legislation aimed at imposing minimum standards applicable throughout the country and preserving the stability and integrity of Canada's financial markets might well relate to trade as a whole."[29] It also stated that "[a]spects of the Act, for example those aimed at management of systemic risk and at national data collection, appear to be directly related to the larger national goals which the Act proclaims are its raison d'être."[30] It had earlier acknowledged that "[p]revention of systemic risk may trigger the need for a national regulator empowered to issue orders that are valid throughout Canada and impose common standards, under which provincial governments can work to ensure that their market will not transmit any disturbance across Canada or elsewhere."[31]

However, it held that these national concerns could not constitutionally justify "a complete takeover of provincial regulation."[32] The Act overreached the proper scope of the general trade and commerce power by descending into the day-to-day regulation of the securities business. The Court rejected, based on its assessment of the record, Canada's argument that securities trading had evolved into a matter transcending local, provincial interests. It saw the fact that the structure and terms of the Act largely replicate the existing provincial schemes as belying the suggestion that the securities market has been wholly transformed.

With respect to factor 4—whether the provinces would be constitutionally incapable of enacting the scheme—the Court held that the provinces acting in concert would not be able to *sustain* a national scheme addressing systemic risk or nationwide data collection, primarily because provincial governments could always decide to remove themselves from the scheme.[33] However, this resulted in a determination on this factor only partially favourable to the validity of the Act. The Court reiterated that the Act overreached by extending to the detailed regulation of all aspects of securities. Unlike federal competition law, it was not limited to the aspects of economic activity that fall within the federal domain.[34]

With respect to factor 5—whether the failure to include one or more provinces would prevent successful operation of the scheme—the Court again distinguished between the elements of the Act that address day-to-day regulatory matters and those ad-

dressed to "genuine national goals, related to fair, efficient and competitive markets and the integrity and stability of Canada's financial system, including national data collection and prevention of and response to systemic risks." On the latter, the Court stated that "the answer must be yes"[35]—that on these matters "a federal regime would be qualitatively different from a voluntary interprovincial scheme."[36] But again, because the scope of the Act was much broader, the absence of one province would not jeopardize the operation of the Act read as a whole. The Court also noted that the opt-in feature of the scheme "[weighed] against Canada's argument that the success of its proposed legislation requires the participation of all the provinces."[37]

The Court concluded that federal legislation adopted with the main purpose of controlling the Canadian securities market as a whole would be constitutional under the general branch of the trade and commerce power. It also suggested that the provisions of the Act that relate to this concern might be valid on their own. But based on the record, these provisions could not serve to validate the entire Act when the Act swept in "the day-to-day regulation of all aspects of trading in securities and the conduct of those engaged in this field of activity."[38] These legitimate federal concerns could not justify "a wholesale takeover of the regulation of the securities industry."[39]

While the Court noted three times in its reasons that Canada did not invoke its authority over interprovincial and international trade and commerce,[40] doing so would likely have done little to change the Court's ruling. The Act was aimed at creating "a single Canadian securities regulator, supported by a comprehensive statutory and regulatory regime that applies across Canada."[41] This proposed regulator would have been given powers over all aspects of securities regulation in Canada, including intraprovincial activities.[42] It would have been exceedingly difficult to justify the comprehensive scheme envisioned by the Act by relying on the international and intraprovincial branch of s. 91(2), or on any other federal power apart from the general branch of s. 91(2). As clear as the Act's intentions was the Court's opinion that provinces have jurisdiction to regulate securities within their borders, and have been "deeply engaged" in doing so for many years.[43] Indeed, Canada admitted as much in its submissions.[44] Invoking the first branch of trade and commerce would have necessitated reliance on incidental effects or rational, functional connection justifications,[45] and given the Court's conclusions about the overreaching character of the Act as a whole and the nature of day-to-day securities trading, those justifications too would likely have failed to persuade the Court of the Act's constitutional validity.

Availability and Desirability of a Cooperative Approach

Having expressed the conclusion that the Act as drafted would be unconstitutional, the Court noted that "a cooperative approach that permits a scheme that recognizes the essentially provincial nature of securities regulation while allowing Parliament to deal with genuinely national concerns remains available."[46] It referred to the various proposals advanced over the years to develop a new model for regulating securities in Canada as suggesting that "each level of government has jurisdiction over some aspects of the regulation of securities and each can work in collaboration with the other to carry out its responsibilities."[47] It stated:

> *Such an approach is supported by the Canadian constitutional principles and by the practice adopted by the federal and provincial governments in other fields of activities. The backbone of these schemes is the respect that each level of government has for each other's own sphere of jurisdiction. Cooperation is the animating force. The federalism principle upon which Canada's constitutional framework rests demands nothing less.*[48]

Moving Forward

Following the Court's opinion, the federal government has signaled its intention to attempt to create a national securities regulator through cooperation with the provinces.[49] What this body would look like is not clear; there are many unknowns, including the provinces' appetite to engage the federal government on the issue.

Based on the Court's opinion, there are two options open to the federal government: (1) unilateral federal action of a limited scope, or (2) cooperative action on a broader scheme, likely involving joint delegation of powers to a common authority.

While a third option theoretically exists—the federal government could attempt to put in place a federal regulator with more expansive powers, drawing on other federal heads of power in addition to the general branch of s. 91(2)—an approach along these lines would be antithetical to the cooperative federalism endorsed by the Court. It would likely result in renewed opposition from many provinces and a further constitutional challenge.

Unilateral Federal Action of a Limited Scope

Federal legislation establishing a national regulator empowered to address the federal aspects of securities regulation recognized by the Court, such as systemic risk and nationwide data collection, would be constitutionally feasible. The difficulties with this approach, however, would include separating the monitoring and addressing of systemic risk from the day-to-day regulation of securities trading. The Court was unequivocal in its view that the latter is a provincial or local concern. However, the International Organization of Securities Commissions has stated, in its *Objectives and Principles of Securities Regulation*[50] and its February 2011 discussion paper, *Mitigating Systemic Risk: A Role for Securities Regulators*,[51] that systemic risk permeates all aspects of securities regulation, including regulation of day-to-day trading activities. A federal systemic risk regulator would also give Canada a 14th securities regulator, which is just the thing Canada sought to avoid.

However, a federal systemic risk regulator could create valuable national and international linkages, which could support market stability objectives. It could, for example, allow for greater policy and informational coordination with the Bank of Canada, Office of the Superintendent of Financial Institutions, Department of Finance and Canada Deposit Insurance Corporation, which are all to some degree mandated to oversee economic stability in Canada.[52] A potential model for how legislation establishing a unilateral federal systemic risk regulator might work is the federal *Payment Clearing and Settlement Act*.[53] Under this legislation, the Bank of Canada and its Governor are given designation, directive, information-collecting, audit, enforcement and other powers relating to clearing and settlement of payment obligations, contingent in large part on the existence of systemic risk.

Cooperative Action by Joint Delegation of Powers to a Common Authority

Assuming the requisite political will, there remains despite the *Reference* decision no legal reason why Canada cannot establish a comprehensive single national securities regulator. It is well established that both Parliament and provincial legislatures may delegate powers to agencies established by the other.[54] This technique has traditionally been employed to delegate powers "down" from Parliament to provincially established agencies. A prominent current example is the delegation of federal power to regulate interprovincial and international marketing of agricultural products. The federal *Agricultural Products Marketing Act* delegates powers as follows:

> *The Governor in Council may, by order, grant authority to any board or agency authorized under the law of any province to exercise powers of regulation in relation to the marketing of that agricultural product locally within the province, to regulate the*

> *marketing of that agricultural product in interprovincial and export trade and for those purposes to exercise all or any powers like the powers exercisable by the board or agency in relation to the marketing of that agricultural product locally within the province.*[55]

Of course, in the securities regulation context, the preferred delegation (assuming the objective is a single, national regulator) would be delegation "up" from the provinces to a federal agency. There are, however, a number of obstacles to the successful implementation of this approach, even assuming the political will. Each province would have to delegate identical powers to the federal agency, to avoid the potential for patchwork regulation and disputes as to which regime applied. The cooperative scheme would also remain vulnerable to the possibility of withdrawal, so that the sustainability of the scheme could never be indefinitely guaranteed.

Conclusion

While the rest of the G20 nations may scratch their heads at the thought, it remains uncertain whether national, comprehensive regulation of Canada's capital markets and securities trading will be implemented in the foreseeable future, if ever. But the Supreme Court's *Reference* opinion at least leaves open the possibility for progress towards this end, either through more limited federal legislation or federal engagement with willing provinces in a broader, cooperative national securities regulation scheme.

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1 *Reference Re Securities Act*, [2011] S.C.J. No. 66, 2011 SCC 66.
2 *Ibid*. at para. 128.
3 *Supra* note 1 at para. 133.
4 *Ibid.* at paras. 104-105, 117, 121, 123, 125.
5 *Ibid.* at paras. 10, 90, 127.
6 *Supra* note 1 at para. 1.
7 *Québec (Procureure générale) v. Canada (Procureure générale)*, [2011] Q.J. No. 2940, 2011 QCCA 591; *Reference re Securities Act (Canada)*, [2011] A.J. No. 228, 2011 ABCA 77.
8 *Proposed Canadian Securities Act*, at Preamble and s. 9.
9 *Ibid*. at s. 250.
10 *Supra* note 1 at para. 32.
11 *General Motors of Canada Ltd. v. City National Leasing*, [1989] S.C.J. No. 28; *Kirkbi AG v. Ritvik Holdings Inc.*, [2005] S.C.J. No. 66, 2005 SCC 65.
12 *Constitution Act, 1867* at s. 91(2); *Citizens' Insurance of Canada v. Parsons* (1881), 7 App. Cas. 96 (P.C.) at 113.
13 *Constitution Act, 1867* at s. 91(27).
14 R.S.C. 1985, c. C-34.
15 *General Motors*, *supra* note 11; *Kirkbi*, *supra* note 11 at paras. 16-17; Note 1 at para. 108.
16 *Supra* note 1 at paras. 32-33.
17 *Ibid.* at paras. 4, 32-33, 97, 102, 113-14.
18 *Ibid.* at para. 102.
19 *Ibid.* at paras. 3, 34.
20 *Supra* note 13 at s. 92(13).
21 *Supra* note 1 at para. 121.
22 *Ibid.* at para. 123; *supra* note 8 at Preamble, s. 250.
23 *Ibid.* at para. 35.
24 *Ibid.* at para. 134.
25 *Ibid.* at para. 91.
26 *Ibid.* at paras. 93-107.
27 *Ibid.* at para. 84.
28 *Ibid.* at paras. 71, 85.
29 *Ibid.* at para. 114.
30 *Ibid.* at para. 117.
31 *Ibid.* at para. 104.
32 *Ibid.* at para. 117.
33 *Ibid.* at para. 121.
34 *Ibid.* at para. 122.
35 *Ibid.* at para. 123.
36 *Ibid.*
37 *Ibid.*
38 *Ibid.* at para. 125.
39 *Ibid.* at para. 128.
40 *Ibid.* at paras. 32, 47, 129.
41 *Supra* note 8 at Preamble.
42 *Ibid.* at ss. 14-17, 24.
43 *Supra* note 1 at paras. 43, 115.
44 *Ibid.* at paras. 4, 100.
45 *Multiple Access v. McCutcheon*, [1982] S.C.J. No. 66, [1982] 2 S.C.R. 161 at 183; *General Motors*, *supra* note 11; *Kirkbi*, *supra* note 11 at paras. 32-33, 35-36; *Re GST*, [1992] S.C.J. No. 62, [1992] 2 S.C.R. 445.
46 *Supra* note 1 at para. 130.
47 *Ibid.* at para. 131.
48 *Ibid.* at para. 133.
49 *The Globe and Mail*, "Ottawa Still Aims for National Securities Body: Flaherty", January 26, 2012, Online: <http://www.theglobeandmail.com/globe-investor/ottawa-drops-plan-for-national-securities-regulator/article2316130/>.