Why Canada's "Costly" Securities Regulation Regime Ensures Better Decision-making

by

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Abstract

The purported costs of provincial autonomy in Canadian securities regulation have been well documented. Proposals for centralizing the securities regulatory regime, whether under a national regulator or through restricting the scope of provincial divergence from national standards, have consistently cited the costliness of the current regime. However, policymakers' cognitive biases lead them from time to time to overemphasize the need for decisive and swift action, which in turn causes them to abandon sound decision-making processes. Provincial autonomy ensures that policymaking with national reach is process-oriented and is more likely to be guided by facts and rational projections. Supporters of centralization discount or ignore these features of decentralization and are too sanguine about the ability of centralized regulators to adhere to process. Any further proposals for reform should properly account for these effects.
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Introduction

The recent *Securities Reference*\(^1\) decision by the Supreme Court marks the latest in a long series of failures to effect the centralization of Canadian securities regulation. Decades of reform initiatives have characterized the current system as too costly and many have argued for a federal presence in the arena of securities regulation. Recent reform initiatives have invoked the 2007 credit crisis and have lamented Canada's relative inability to react swiftly to it. However, I argue that provincial autonomy benefits the current system by ensuring process-oriented decision-making, which prevents costly and unnecessary policies from being adopted.

Proposals for comprehensive reform date to the 1960s and have been revived periodically since then.\(^2\) The federal act\(^3\) that was the subject of the *Securities Reference* was only the latest in a long line of proposals. Proposals have long criticized the current system of autonomous provincial commissions as unduly burdensome and unnecessarily costly. But experience showed that the status quo has worked well, and the political will to disrupt it never solidified.

The perception that the status quo was adequate was challenged, however, when the global credit crisis hit. The crisis was system-wide and global. Much of the risk was hidden in the shadow banking system, with trade positions that were grossly overleveraged. The crisis was made worse, in part, because of the global movement of investment capital, leaving devastated counterparties around the world. Given these "modern" calamities, supporters of the federal act were convinced of the inadequacy of the current system and focused on the management of systemic risk as a key justification for centralization. According to supporters, the existing regime was unsuitable for this task. Opposition focused on the fact that Canada is the beneficiary of multifarious approaches to similar problems. Similarly, locally constituted regulators are more responsive to issuers and to investors.

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\(^1\) *Reference Re Securities Act*, 2011 SCC 66 ("*Securities Reference*").  
\(^2\) Ibid at paras 11-28.  
The Court largely set the policy literature aside, and decided the case on constitutional grounds, striking down the proposed act. The act was at once too ambitious and too conservative. It was ambitious in the sense that it would have represented the federal government's first foray into a domain that has traditionally been solely within the provinces' jurisdiction.\(^4\) At the same time the act duplicated the provinces' acts, proposing few reforms. This must have been, largely, a strategic decision. The thinking was perhaps that the more the federal act resembles provincial acts, the more likely it will be for provinces to adopt it. The strategy backfired, and the Court faulted the federal act for not making more of a distinction from the existing regime.\(^5\) At bottom, according to the Court, the federal act would have effected too radical a shift of power. And the federal government failed to demonstrate that the industry that the provinces have been regulating for so long was so transformed that it justified such a shift, as evidenced by the duplicative proposed act.

I reject the use of systemic risk as a justification for power consolidation, and I share the Court's conclusion that provincial commissions are more than suitable for regulating the modern securities markets. Proponents of decentralization have long viewed the dispersion of policymaking power as an essential tool for both innovation and for moderation. Monopolistic policymakers have no incentive to innovate or to make themselves more efficient.\(^6\) There is no competitive regulatory regime that could attract issuers' business, and thus discipline the monopoly regulator.\(^7\) Competition between jurisdictions, thus, drives them to innovate. And the same pressures that drive regulators to innovate also restrain them. Thus, whereas a monopoly regulator can institute costly and ill-considered reforms, the threat of capital flight keeps competitive regimes from doing so.

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\(^4\) See Jeffrey G MacIntosh, "A National Securities Commission? The Headless Horseman Rides Again" (2012), forthcoming chapter, at 3-5 (on file with author) (provinces had the "first mover" advantage over the federal government in the Court's determination of the division of power because of their long history of autonomy in the domain).

\(^5\) Securities Reference, supra note 1 at paras 101, 106, 116.


\(^7\) Ibid at para 66.
Commentators have indicated that competitive federalism is at work in Canada, but it is important not to overstate the role that inter-provincial competition plays. Ontario is the site of the overwhelming majority of capital market activity, and the Ontario Securities Commission ("OSC") is the predominant securities regulator,\(^8\) both of which are unlikely to change. Rather, other characteristics of Canada's strong version of federalism restrain regulators or spur them to innovate much like inter-provincial competition would. As evidenced in the *Securities Reference*, the provinces have a long history of autonomy in the domain of securities regulation. This leaves them free to experiment or to tailor regulation to local preferences and needs. But, historically, the provinces have also sought unity over securities regulation policy. Evidence of this can be seen in the strong similarity between the provincial securities acts, the creation of the Canadian Securities Administrators, the adoption of the Passport system and of the many national and multilateral instruments. The inclination towards unity restrains the provincial commissions from espousing radical policies.

A chief criticism of the current system is that it is too restrictive. But this is exactly the point. Proponents of regulation justify policies like investor protection out of a belief in the limits of private individuals' rationality.\(^9\) They must then accept that policymakers are also prone to error.\(^10\) People are subject to a number of cognitive biases. For instance, they tend to misjudge the probability or frequency of events that come to mind easily\(^11\) and may also be inclined to favor action over inaction. Policymakers' perception of a need to act and tendency toward regulatory action often leads to unintended results with sometimes disastrous consequences. This is especially prevalent after financial crises when policymakers seek swift responses. Thus, a system that decreases the chance that policy decisions will be made based on

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8 MacIntosh, *supra* note 4 at 38 ("Eighty to ninety percent of capital market activity takes place in Ontario.").
heuristics without too much cost results in better decision-making, which, in the end, is less costly.

Chapter 1 describes the extant Canadian securities regulatory regime and summarizes historical attempts at centralizing it. The current regime is marked by the autonomy of the provincial commissions. Proponents of centralization indicate that this has led to a variety of unnecessary costs.

Chapter 2 sets forth the arguments for and against the proposed federal securities act. Many of the arguments in support of the act are the same as those that proponents of centralization have used in years past. But the financial crisis of 2007-2009 brought much of the focus to the management of systemic risk, a project shared by the International Organization of Securities Commissions ("IOSCO"). Although opponents of the proposed act contended that the existing regime adequately accounted for systemic risk, their defense of provincial autonomy was more interesting, especially their portrayal of how decentralization disciplines policymakers.

Chapter 3 builds off of the arguments for decentralization outlined in the previous chapter. It explores how monopoly policymakers are prone to suboptimal decision-making, whether because of the influence of heuristics or because of rational calculation. Conversely, I propose an explanation of why the structure of the Canadian securities regulatory architecture leads to policy decisions that are more carefully considered and rely more on rational analysis. I conclude with the advice that, in their attempts to reduce the costs that the current regime imposes, from duplication or uncertainty, for instance, policymakers should be aware of and endeavor to retain the benefits it confers.
Chapter 1: Securities Regulation in Canada

I. The Current Regulatory Landscape

Canada is unique in being the only "major industrialized nation without a national securities regulator."\(^{12}\) Rather, securities regulation is undertaken by thirteen provincial and territorial regulators.\(^{13}\) Each province and territory has its own securities laws and is responsible for the traditional duties of securities regulators everywhere, including: reviewing prospectuses and other disclosure, enforcing the securities laws, and supervising SROs and exchanges.\(^{14}\) In addition, Canadian regulators also play more of a role in corporate governance than many other regulators. One notable example is the supervision of takeover bids and other business combinations.\(^ {15}\)

Regulation regimes are largely similar from province to province. Most of the provincial securities acts created a closed system, which imposes restrictions on the resale of securities that were not acquired under a prospectus offering.\(^ {16}\) Manitoba only partially follows the closed-system approach.\(^ {17}\)

Efforts at national convergence are mostly presided over by the Canadian Securities Administrators ("CSA").\(^ {18}\) The CSA have no authority to impose policies on issuers or on the

\(^{12}\) Jonathan Macey, "An Analysis of the Canadian Federal Government's Initiative to Create a National Securities Regulator" Expert Report, Record vol XII, factum of the Procureur general du Québec, Reference Re Securities Act, 2011 SCC 66 (June 23, 2010) at 1 (on file with the author); Anita I Anand & Andrew J Green, "Why Is This Taking So Long? The Move Toward a National Securities Regulator" (2010) 60 U Toronto LJ 663 at 666-67 (stating that Canada is one of only two members of IOSCO not to have a national securities regulator).

\(^{13}\) Securities Reference, supra note 1 at para 41.

\(^{14}\) See e.g. Macey, supra note 12 at 5-6.

\(^{15}\) Cf NP 62-202, Defensive Tactics, online: <http://www.msc.gov.mb.ca/legal_docs/legislation/rules/62_202.pdf> (governing when poison pills are to be cease-traded, effectively negating a company's attempts to decide when it is up for sale).

\(^{16}\) See e.g. Resale of Securities, NI 45-102, (2001) 24 OSCB 7029.

\(^{17}\) Macey, supra note 6.

\(^{18}\) See Securities Reference, supra note 1 at para 42.
provincial and territorial regulators. Rather, it performs coordinating, review and reporting functions.\textsuperscript{19} A distinct example of the CSA's coordinating function is the passport system, which the CSA devised and which has been adopted everywhere in Canada except in Ontario.\textsuperscript{20} The passport system is a reciprocal arrangement under which a company registers or files its prospectus with a principal regulator and the other jurisdictions defer to the decisions of the principal regulator regarding that company.\textsuperscript{21} "In general, issuers filing a prospectus or seeking a discretionary exemption need only deal with their principal regulator and comply with legislation in effect in the jurisdiction of their principal regulator."\textsuperscript{22} Even though Ontario does not participate in the passport system, it may still act as a principal regulator, and other regulators will defer to its decisions.\textsuperscript{23} The passport system is possible, in large part, because there is little variation between provincial securities laws in key subject areas like prospectus offerings and continuous disclosure.\textsuperscript{24}

In 1999, the securities markets were reorganized to gain a competitive advantage globally.\textsuperscript{25} The purpose of the reorganization was to consolidate functions along the exchanges’

\begin{flushleft}
\textsuperscript{19} Cf CSA, "Securities Regulatory Proposals Stemming from the 2007-08 Credit Market Turmoil and its Effect on the ABCP Market in Canada" (October 2008) available at <https://ozone.scholarsportal.info/bitstream/1873/12949/1/288244.pdf> (describing proposals for reform to be recommended to provincial and territorial securities regulators and describing the CSA's reviews of the adequacy of capital markets supervision).
\textsuperscript{20} See e.g. Anand & Green, supra note 12 at 664, 678-79. See generally Passport System, MI 11-102, (2008) 31 OSCB 1009. In its request for comment regarding the proposed passport system, the OSC indicated that it is holding out because of its desire for a national regulator and its concomitant opposition to ad hoc collaboration. OSC Notice 11-904, Request for Comment Regarding the Proposed Passport System (March 28, 2007) <http://www.osc.gov.on.ca/documents/en/Securities-Category1/sn_20070328_11-904_rfc-passport-system.pdf>.
\textsuperscript{21} See Anand & Green, supra note 12 at 678-79.
\textsuperscript{22} Macey, supra note 12 at 12.
\textsuperscript{23} Ibid.
\textsuperscript{24} Anand & Green, supra note 12 at 677, 679.
\end{flushleft}
specializations. Thus, all trading of senior equities was subsumed by the Toronto Stock Exchange (TSX), junior equities by the TSX Venture Exchange (TSX-V) and derivatives by the Montreal Exchange (ME). Although the TSX is significantly smaller by market capitalization than the six exchanges that are larger than it, a number of Canadian companies list on U.S. exchanges. The overwhelming majority of capital market activity takes place in Ontario. The OSC is the largest securities regulator in Canada, and is considered to be the de facto national regulator.

II. Proposals for National Coordinated Oversight

Despite the similarities between provincial securities regimes and Ontario's domination of the regulatory landscape, attempts to formally coordinate regulatory oversight nationwide have been a constant in Canada. Arguments for centralization are numerous, but one has been repeated since the first proposal in the early 1960s: that the current system of provincial-based regulation is too costly. Costs can be divided into the following categories:

1. the costs arising from duplicative compliance;
2. the costs associated with divergent compliance;
3. lost investment opportunity because of issuers fleeing to jurisdictions with cheaper compliance costs; and
4. lost economies of scale.

Every proposal that followed was designed—whether explicitly or not—to lower these costs.

26 Ibid at 455.
27 Ibid at 457.
28 MacIntosh, supra note 4 at 38.
29 Nichols, supra note 25 at 401.
30 MacIntosh, supra note 28 at 38.
Various arguments and studies in support of a national regulator have arisen over the last few decades, many of which were described in the *Securities Reference*. The first comprehensive regime was proposed by the Porter Commission in 1964. Like most of the proposals that followed, the Porter Commission recommended a federal regulator because of what it saw as "faltering progress" towards harmonization between the provincial regulators. And like many of the proposals that followed, the Porter Commission did not seek exclusivity for the federal regulator. Rather, it foresaw a cooperative relationship between the federal and provincial regulators. The provincial governments would cede some competencies to the federal regulator and retain others. But, most importantly, the Porter Commission proposed a prototypical passport system, whereby offerings registered with the federal regulator would be recognized by the provinces. The federal regulator's role would be to set "high and uniform standards." In short, the Porter Commission foresaw a harmonized scheme that retained much of the provinces' independence.

The proposal was never taken up. Commentators raised constitutional concerns and fretted about the addition of another regulator to an already complicated system. A later proposal advanced by the OSC was less ambitious in the pursuit of provincial devolution of power. The OSC's proposal, known as CANSEC, would not have forced the provinces to cede

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32 *Securities Reference*, supra note 1 at paras 11-28. According to the Court, a national regulator was first proposed in 1935. Ibid at para 11. But that recommendation was limited to companies with federal charters. Ibid. It was only in 1964, when the Royal Commission on Banking and Finance ("Porter Commission") made its recommendation ("Porter Report") for a provincial-federal partnership, that a comprehensive proposal for federal oversight was made. Ibid at paras 12-14.

33 Harris, supra note 31.

34 Ibid at 9 (internal quotation marks omitted) (quoting *Porter Report* at 561 (1964))

35 Ibid.

36 Ibid.

37 Ibid.

any jurisdiction to the central regulator.\textsuperscript{39} Rather, it was designed to work with incomplete participation.\textsuperscript{40} Furthermore, the CANSEC would not have been a truly national body; it "would not enforce national securities policy or be able to deal on equal terms with other national regulators."\textsuperscript{41} Indeed, the scheme would have worked without the participation of the federal government.\textsuperscript{42} Like the Porter Commission proposal, CANSEC was never adopted.

In the late 1970s, the federal government requested recommendations on what role the federal government should play in securities regulation.\textsuperscript{43} The result was a proposed federal act along with commentary that was issued in 1979.\textsuperscript{44} Like the Porter Report, the proposed federal act would have created a federal regulator.\textsuperscript{45} But like CANSEC, the scheme would give provinces the option of joining or going their own way.\textsuperscript{46} Similarly, like the both the Porter Report and the CANSEC proposal, the 1979 proposal did not recommend supplanting the provincial regulators. Rather, the commissions would have cooperated with each other, and jurisdiction would have been a floating concept.\textsuperscript{47} Thus, the federal regulator could have accepted responsibilities delegated by the provinces or delegate powers to provincial regulators.\textsuperscript{48} But the 1979 proposal's indeterminacy was its downfall, and it has never been implemented.\textsuperscript{49}

\textsuperscript{39} Ibid at 14-15.
\textsuperscript{40} Ibid.
\textsuperscript{41} Ibid at 15.
\textsuperscript{42} Ibid at 18 (quoting Langford & Johnston, supra note 38 at 30).
\textsuperscript{43} Ibid at 20.
\textsuperscript{44} Ibid.
\textsuperscript{45} Ibid.
\textsuperscript{46} Ibid.
\textsuperscript{47} Ibid at 21-22.
\textsuperscript{48} Ibid.
\textsuperscript{49} Ibid at 25.
The next proposal was initiated by the Atlantic Provinces in 1994 in the form of a draft memorandum of understanding ("1994 MOU"). Like the Porter Report and the 1979 proposal, the 1994 MOU proposed a federal regulator, and, like CANSEC and the 1979 proposal, its scheme would have been optional.\(^{50}\) The 1994 MOU was quickly rejected by a number of provinces,\(^{51}\) which effectively ended the proposal.

A more ambitious proposal came in 2003 when the federally-created Wise Persons' Committee ("WPC") published its recommendations. The WPC recommended a single regulator that would have incorporated both provincial and federal governments.\(^{52}\) The WPC was solicitous of provincial entrenchment, and its proposal attempted to strike a balance between centralization and regionalism. To that end the WPC envisioned the provinces consulting on the selection of ministers, drafting of legislation and setting policy.\(^{53}\) Ongoing provincial participation would have been conducted through a ministerial committee, consisting of the provincial ministers charged with oversight of the capital markets in their provinces.\(^{54}\) And the process of selecting commissioners would have begun with a nominating committee made up mostly of provincial representatives.\(^{55}\)

Like the proposals that came before it, the main problems the WPC Report addressed were the costs of the status quo. Other studies had tried to quantify the costs of regulatory fragmentation.\(^{56}\) But it is difficult to quantify compliance costs because of problems with

\(^{50}\) Ibid at 28.

\(^{51}\) Québec announced its intention not to participate soon after the 1994 MOU was announced. Ibid at 28. British Columbia, Manitoba and Ontario later rejected the proposal. Ibid at 32.


\(^{53}\) Ibid.

\(^{54}\) Ibid at 60.

\(^{55}\) Ibid at 61. Although the largely-provincial membership of the committee would have recommended candidates the final selection would have been made by the federal Minister of Finance.

\(^{56}\) See e.g. Harris, supra note 31 at 80.
methodology and a resultant lack of empirical evidence.\textsuperscript{57} For instance, a 1996 study surveyed market participants on their views of the transaction costs of provincial regulation.\textsuperscript{58} Although the survey indicated that respondents believed that more could have been done to reduce regulatory duplication and that they would prefer a national regulator, the results were not reliable because the evidence was anecdotal and the sample was small.\textsuperscript{59} Another study using better methodology focused only on a small segment of costs attributable to regulatory duplication: registration costs for dealers and advisors.\textsuperscript{60}

The WPC, in turn, "sought to determine the costs associated with complying with a regulatory regime in which there are both multiple regulators and inconsistencies in securities regulation among provincial and territorial jurisdictions."\textsuperscript{61} It did so by interviewing market participants in four areas of securities regulation: registration, IPOs, exempt distributions, and acquisition transactions.\textsuperscript{62} It then compared the "material incremental costs incurred under the current system" with three alternative regimes: a passport system, uniform securities regulation or a national securities regulator.\textsuperscript{63} One class of market participants were affected by the disunity of the then-existing regime: Registrants—i.e., those who "trade securities, underwrite securities issuances or give advice with respect to securities investments"\textsuperscript{64}—who were more

\textsuperscript{57} Ibid.

\textsuperscript{58} Ibid at 80-81.

\textsuperscript{59} Ibid at 81.

\textsuperscript{60} Ibid at 81-82.


\textsuperscript{62} Ibid at 526.

\textsuperscript{63} Ibid at 521. "Incremental costs" are "costs incurred by the issuer or registrant that would not have arisen if the issuer or registrant needed to comply only with the securities laws of its province or territory in conducting business throughout the country." Ibid at 525.

\textsuperscript{64} Ibid at 534.
materially impacted by the current system than were issuers.\textsuperscript{65} For instance, they "uniformly reported that they incur[red] incremental pre-trading expenditure."\textsuperscript{66} The Cost Study also found that smaller registrants and issuers were especially affected by the provincial system.\textsuperscript{67} For a number of market participants engaging in a variety of activities, the Cost Study found that a single regulator would reduce costs.\textsuperscript{68}

One would think that the Passport system would negate most of the costs the Cost Study found. However, an analysis of the Passport system conducted by the authors of the Cost Study concluded that, at least in the areas of duplication and uncertainty, costs arising from the existence of thirteen jurisdictions would still exist.\textsuperscript{69} According to the authors, a single regulator appeared to be more cost efficient than the Passport system.\textsuperscript{70}

Centralization has long been on the policy agenda. But, because of a lack of political will or because of federalism concerns, the federal government never itself made a proposal. Like the \textit{WPC Report}, two panels convened in the years after the \textit{WPC Report} recommended the creation of a Canadian Securities Commission, which would have administered a national securities act.\textsuperscript{71} Seizing the moment, the federal government proposed a federal act in 2010 that incorporated many of the features that the \textit{WPC Report} and its progeny recommended, including that provinces may opt in.\textsuperscript{72} When the act came before the Supreme Court, the debate over efficiency and costs that had been simmering since the days of the Porter Commission was played out in the

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{65} Anita Indira Anand & Peter Charles Klein, "Inefficiency and Path Dependency in Canada's Securities Regulatory System: Towards a Reform Agenda" (2005) 42 \textit{Can Bus LJ} 41 at 49.
  \item \textsuperscript{66} Anand & Klein, \textit{supra} note 61 at 522.
  \item \textsuperscript{67} See e.g. ibid at 546, 565.
  \item \textsuperscript{68} See e.g. ibid at 565, 570.
  \item \textsuperscript{69} Anand & Klein, \textit{supra} note 65 at 31-38.
  \item \textsuperscript{70} Ibid at 27.
  \item \textsuperscript{71} \textit{Securities Reference}, \textit{supra} note 1 at paras 25-27.
  \item \textsuperscript{72} Ibid at para 31.
\end{itemize}
\end{footnotesize}
expert opinions submitted to the Court. The next chapter summarizes the cost-benefit arguments at the heart of that debate.
Chapter 2: Arguments For and Against a National Regulator and Their Roots

Although the debate over regulatory consolidation is broader than the Canadian example, the dispute over the Securities Act nicely reflects the larger debate. Proponents of the federal act, like champions of centralization more generally, largely focused on compliance cost and inefficiency arguments.\(^73\) The credit meltdown added another aspect to the argument that has become a key justification for centralization: systemic risk, which proponents of consolidation asserted is best managed on as broad a scale as possible. Opponents deployed more varied arguments, such as pointing to the failures of monopolistic regulatory regimes in other countries and to the benefits of shared regulatory responsibility.

I. Support for Centralization

The arguments in favor of a national regulator largely echo those underpinning the proposals outlined in the previous chapter. Those arguments I do not duplicate here. The most significant addition to the national-regulator position was the use of the credit crisis as evidence of the need for a national response. Supporters of a national regulator saw the credit meltdown as an opportunity to champion a federal response to systemic risk. Michael Trebilcock's expert reports to the Court focused on this justification. According to Trebilcock, issuing and trading securities create the potential for jurisdictional externalities that are not adequately detected and managed by provincial regulators.\(^74\) And no externality justified a national response more than systemic risk.\(^75\)

First turning to the issue of centralization, Trebilcock contended that the Passport system did not do away with the problem of uncoordinated decision-making: "[T]he process of harmonization is likely to be protracted and to be characterized by compromises that may not reflect first-best policy options, especially given the ability of provinces to threaten or in fact exit

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\(^73\) See e.g. Trebilcock, "Report" supra note 9 at para 61.
\(^74\) Ibid at para 7.
\(^75\) Ibid at para 30.
at any time, rendering the system unstable.” Where this could be problematic, Trebilcock indicated, is in areas where the law is not harmonized or there are wide variations in the implementation of substantively harmonized laws. This is where Trebilcock sees a possible "need for an overseeing authority to monitor the quality of the decision-making processes and outcomes of the participating provinces, as well as a mechanism to address any shortcomings that are discovered.” Moreover, the Passport system "does not promote full transparency and accountability for decisions reached through the process of negotiated inter-provincial harmonization of substantive laws.” Finally, the Passport system undermines arguments for provincial autonomy, such as experimentation and regional responsiveness.

Although Trebilcock acknowledged that decentralization confers some benefits, he contended that the advantages of regulatory competition materialize in efficiency rather than in investor protection. The stumbling block, according to Trebilcock, is the presumed lack of "knowledge and sophistication to assess the relative impacts of different jurisdictions' securities regulation regimes on their interests.”

76 Trebilcock, "Report" supra note 9 at para 61.
77 Ibid.
78 Ibid.
79 Ibid.
80 Ibid.
81 For instance, Trebilcock conceded that decentralization of economic regulation had some benefits, including that it may "encourage more sources of policy experimentation and innovation and mitigate the risk of major systemic (nation-wide) policy errors that may be associated with national policy-making." Trebilcock, "Report" supra note 9 at para 19. Similarly, he touted decentralization for its "increased scope for policy innovation and experimentation; increased ability to respond to local or regional preferences; and mitigation of the risks of major systemic policy errors." Michael J Trebilcock, "National Securities Regulator: Report in reply to Québec and Alberta Experts" at para 1 (Aug 23, 2010) (on file with author) <Trebilcock, "Reply">. And, in the context of securities regulation, he indicated that there are efficiency advantages to regulatory competition, one being that it creates a contractual relationship that aligns the interests of its parties. Ibid at paras 52-53.
82 Ibid at para 54.
83 Ibid. The lack of sophistication is presumed because sophisticated investors do not require protection. Ibid.
Trebilcock also questioned the assumption that "decentralization [is] always superior to centralization."\textsuperscript{84} He argued that, in areas like the regulation of banks and even fisheries, the national government regulates the activity.\textsuperscript{85} This is so, Trebilcock claimed, because the externalities stemming from those industries, almost by definition, spill over into jurisdictions other than the home jurisdiction.\textsuperscript{86} Because "almost no public offerings of securities today are confined to only one province of Canada[,] . . . extra-provincial jurisdictional externalities are pervasive in the securities field."\textsuperscript{87} A regulatory architecture that enables a coordinated response is needed for times when externalities threaten interests outside the province; a provincially driven response would not do.

The federal government's push to nationalize systemic risk management is part of an initiative to do so globally. So far, concrete proposals for the management of risk are few beyond cooperation between regulators. The prime mover behind seeking a global strategy for managing systemic risk is IOSCO, which has advanced the furthest on a coordinated response to systemic risk.\textsuperscript{88} To wit, IOSCO has proposed eight principles that it hopes will guide national securities regulators in that project:\textsuperscript{89}

\begin{itemize}
  \item[6] The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.
  \item[7] The Regulator should have or contribute to a process to review the perimeter of regulation regularly.
\end{itemize}

\textsuperscript{84} Trebilcock, "Reply" \textit{supra} note 81 at para 2.
\textsuperscript{85} Ibid.
\textsuperscript{86} See Trebilcock, "Report" \textit{supra} note 9 at para 22; Trebilcock, "Reply" \textit{supra} note 81 at para 2.
\textsuperscript{87} Trebilcock, "Reply" \textit{supra} note 81 at para 7. Trebilcock observed that "94.9 percent of [Canadian] exchange listings involve more than one securities regulator, and 70.6 percent involve three or more securities regulators." Ibid at para 9.
\textsuperscript{88} Roberta S Karmel, "IOSCO'S Response to the Financial Crisis" (2012) unpublished paper at 1, available at \texttt{<http://works.bepress.com/roberta_karmel/91>}. The other component of its response to the credit crisis was subjecting hedge funds, credit reporting agencies and auditors to oversight. Ibid.
The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.

* * *

19 Auditors should be subject to adequate levels of oversight.

20 Auditors should be independent of the issuing entity that they audit.

* * *

22 Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.

23 Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.

* * *

28 Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.90

Guiding these principles is IOSCO's conviction that a broad response to systemic risk is essential: "Because systemic risk in today's markets transcends borders, international collaboration among regulators is also essential."91

IOSCO conceded that the management of systemic risk is not a traditional policy objective of securities regulators.92 But IOSCO's Technical Committee suggested that, because promoting confidence in capital markets is one of the mandates commonly charged to securities

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90 IOSCO, *Objectives and Principles of Securities Regulation* (June 2010) at 4, available at <http://www.compliance-exchange.com/governance/library/ioscoprinciples2010.pdf>. Admittedly, the latter five principles do not deal directly with systemic risk. However, the lack of oversight over auditors, credit rating agencies and hedge funds no doubt contributed to the systemic credit crisis.

91 IOSCO, *supra* note 89 at 49.

92 IOSCO, *supra* note 89 at 8.
regulators, facilitating the distribution of information about systemic risk is within the regulators' purview. 93

II. Opposition to the Federal Act

Commentators have taken issue with the project of centralization and the scholarship underpinning it. Regarding the suitability of the current system to manage systemic risk, Choi argued that systemic risk regulation is an odd fit for securities regulators. 94 Rather, national-level prudential regulators have more expertise in the management of systemic risk than do securities regulators. 95 Canada is no different from other countries, according to Choi. Its prudential regulators are the Office of the Superintendent of Financial Institutions ("OSFI") and the Bank of Canada. 96 Securities regulators do play a role in reducing systemic risk, but it is a limited and subsidiary one. 97 There are, indeed, micro-level systemic risk concerns, for which provincial commissions are particularly well-suited. 98 Macey also observed that it is possible that local governments could be affected more deeply by systemic risk than national governments. 99

Aside from debating the suitability of the current regime to managing systemic risk, much of the discussion in the expert reports disputed the issue of costs. Along those lines,

93 Ibid at 7-8. This assertion was echoed in the context of Canadian securities regulation in Anita I Anand, "Is Systemic Risk Relevant to Securities Regulation?’ (2010) 60 U Toronto LJ 941.
94 Choi, supra note 6 at para 3.
95 Ibid.
96 Ibid.
97 Ibid.
98 Ibid.
99 Ibid. By way of illustration, consider the credit crisis that began in 2007. If, in 2007, a jurisdiction were home to a large insurance company that insured massive amounts of home loans against default, that jurisdiction would have been particularly exposed to the collapse of home prices. The same would be true of a jurisdiction that was the home of that company's counterparties. However, continuing with the illustration of the recent meltdown, it would have been impossible to predict the extent, both the breadth and the depth, of the crisis. More impossible still would have been the task of foreseeing who was exposed to the risk. Counterparties abounded.
opponents of the federal act indicated a number of flaws with the *WPC Report*'s methodology. In particular, they observed that the WPC's sole empirical analysis resulted from twelve ninety minute interviews with confidential sources. The WPC's assertion that the cost of capital for Canadian issuers is higher than it would be under a centralized regime was also seen as problematic. Calculating the cost of capital with any accuracy is a fraught exercise. "[S]tandard errors of more than 3.0% per year are typical in the estimation of the cost of capital." Thus, there is only a sixty-eight percent probability that a given cost-of-equity percentage will be in a six percent range. In addition, different industries entail different cost of capital. Carpentier et al gave the example of natural resources and utilities. They asserted that natural resources impose a higher cost of capital than utilities do. Thus, making accurate comparisons of the cost of capital is nearly impossible. This is illustrated by the fact that studies not cited by the *WPC Report* found a lower or nearly equal cost of capital in Canada compared to the U.S.

But the *WPC Report*'s more serious flaw, in the eyes of its critics, was that it overstated the costs of the current system and the benefits of centralization. Macey, for instance,

100 Macey, supra note 12 at 15.
101 Ibid.
103 Ibid.
104 Ibid at 302.
105 Ibid at 302-03 (summarizing studies comparing Canadian and U.S. costs of capital). Similarly, according to a study Macey cited, Canadian issuers bore lower costs than those in the U.S. and in Australia and the direct costs of regulation in Canada "are only a small fraction of costs incurred by issuers and investors." Macey, supra note 12 at 16 (internal quotation marks omitted) (quoting Jean-Marc Suret & Cecile Carpentier, "Securities Regulation in Canada," working paper undertaken for the Commission des valeurs mobilières du Québec (July 29, 2003) at 6).
106 Critics of the WPC's proposal, including MacIntosh and Macey, also disagreed with the WPC's correlative suggestion that granting a regulatory monopoly would lead to innovation. See e.g. Macey, supra note 12 at 15-16; Jeffrey G MacIntosh, "Not a 'wise' idea," *National Post* (Dec 18 2003) FP15 ("[The WPC Report] gives short shrift to the various innovations that have been adopted by a single provincial regulator and then spread to other jurisdictions. The truth is that a decentralized system both permits and encourages innovative thinking, and supplies the
challenged the WPC's assertion that Canada is competitively disadvantaged in attracting new listings by its balkanized structure, contending that this claim is based on scant empirical evidence.\textsuperscript{107}

On the contrary, according to data collected from 1990 to 2008 of market capitalization, number of listed companies, and trading volume, from Canada and other countries, Canada was competitive on a number of metrics.\textsuperscript{108} First, Canadian exchanges listed a high number of stocks compared to other jurisdictions.\textsuperscript{109} Second, the growth of the Canadian stock market, as measured by market capitalization, was comparable to similar markets.\textsuperscript{110} Finally, even though trading volume was lower on Canadian exchanges than on exchanges in similar markets, Canadian shares kept up when combined with Canadian companies cross-listed in the U.S.\textsuperscript{111}

Macey argued that, even if this were not conclusive evidence of Canada's competitiveness,\textsuperscript{112} it still demonstrates that the WPC and other commentators claiming that Canada's fractured approach to securities regulation is overly burdensome overstated their case. At the very least, Canadian markets kept up with other large stock markets such as those in the laboratories in which to test new ideas. A good illustration of this is to be found in the small firm sector, the importance of which the WPC scarcely wastes an opportunity to tout."\textsuperscript{112}

\textsuperscript{107} See e.g. ibid at 16-17.
\textsuperscript{108} Ibid at 18.
\textsuperscript{110} Ibid.
\textsuperscript{111} Ibid.
\textsuperscript{112} For instance, Carpentier, L'Her & Suret found that the stock market's growth was not as dynamic as some had claimed. Carpentier et al, \textit{supra} note 102 at 299.
U.S. and Japan.\textsuperscript{113} Thus, Macey, citing the Carpentier, L'Her & Suret study, endeavored to demonstrate that the WPC overlooked empirical evidence of Canada's strength.\textsuperscript{114}

Commentators also took issue with the claim that centralized regimes are capable of innovation, and thus nimbly respond to novel problems. MacIntosh conceived of the problem as a matter of which approach created the most data for empirical study:

At least from a normative perspective (and increasingly from a descriptive perspective) law takes as competing inputs virtually all of the other social sciences at every step of policy formation, encompassing the identification both of the ends that the law should pursue and the means whereby those ends can and should be achieved. Because of the enormous uncertainty that legislators face in relation to both (not to mention constitutionality, particularly in light of the Charter), the formulation of legislation is necessarily a process of Baysian updating. That is, a vector of hypotheses is formulated regarding desired ends and means. Then, legislation – the functional cipher linking hypotheses to societal outcomes – is unleashed on the world. Finally, data flows back to legislators regarding the correctness of its vector of hypotheses, and (at least if they are acting as responsible legislators) suitable changes are made. Because of the complexity and uncertainty involved in defining both means and ends, making good legislation is essentially a never-ending iterative process. Any experimental process of this nature, however, requires data – the more the better. A monopoly regulator generates a limited number of data points. By subjecting alternative legal regimes to the process of Baysian updating, decentralized decision-making furnishes many more.\textsuperscript{115}

But the dearth of data suggests a more pervasive problem. According to Macey, regulatory homogeneity increases, rather than decreases, the potential that regulators will fail to respond to problems in the market.\textsuperscript{116} The idea is that a global system of loosely coordinated regulators, who are free to diverge from one another, will inevitably concoct different schemes to

\textsuperscript{113} Ibid.

\textsuperscript{114} See Macey, supra note 12 at 16 ("[T]here is scarce empirical evidence of the current and past situation of the Canadian stock market relative to other developed markets. In fact, what evidence does exist often leads to the opposite conclusion." (footnotes omitted)).

\textsuperscript{115} MacIntosh, supra note 28 at 30 (internal footnotes omitted).

\textsuperscript{116} See Macey, supra note 12 at 23, 25, 34-43.
deal with perceived risk. This diversity of approaches gives regulators a better chance of detecting dangers and mitigating them.

Thus, Macey differed with the conclusion that the global credit crisis proved the necessity of a national or even supra-national response. As evidence, he first noted that Canada fared better in the crisis than did other large economies. Next, he noted that even monopolists saw the wisdom of local specialization. For example, the Expert Panel on Securities Regulation proposed maintaining local offices at least partly dedicated to that region's specialty: a British Columbia office that specializes in the mining sector, in Alberta, the energy sector, in Ontario, financial services, and in Quebec, derivatives. According to Macey, the financial crisis does not lead to the conclusion that a lack of centralization was to blame.

Macey's and MacIntosh's arguments derive from the work of Roberta Romano. Romano posited that the competition to attract securities business, like the competition over corporate charters, disciplines regulators and forces them to respond to issuers, which, in turn, respond to investors.

To Romano, the emblematic monopolistic regulator is the SEC. The SEC has long occupied the domain of securities regulation in the U.S., preempting states' attempts at oversight. Indeed, until relatively recently, the SEC had few competitors globally because the U.S. had few rivals for securities listings. It was argued at the time that, because of its

117 Ibid at 21.
118 Ibid.
120 See e.g. ibid at 28.
122 Eric J Pan, "Why the World No Longer Puts its Stock in Us" (December 13, 2006) Cardozo Legal Studies Research Paper No. 176 at 14 <http://ssrn.com/abstract=951705>. The globalization of securities markets has subjected the U.S. to competition, however. Many of the IPOs that would formerly have been done in the U.S. are being done in London, either on the
regulatory monopoly, the SEC had little incentive to adopt measures that would benefit investors.\textsuperscript{123} If the SEC were subject to competition—from the states, for instance—\textsuperscript{124} investors' needs would be better met. In an oft-cited article, Romano proposed a new regulatory framework in which responsibility would be shared between the SEC and state regulators.\textsuperscript{125} Romano contended that there was little empirical justification for the SEC's regulatory monopoly. For instance, she challenged the SEC's mandatory reporting requirement, arguing that corporations have an incentive to provide, and investors to demand, information in exchange for capital.\textsuperscript{126} She observed that, even though European securities regimes required far less disclosure than the SEC did, European stock markets were not less efficient than their counterparts in the U.S.\textsuperscript{127}

Romano challenged the assumption that SEC staff knew better what disclosure the market needs to make an informed decision than investors do.\textsuperscript{128} Romano provided a poignant

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main exchange or on the AIM exchange. Whereas the SEC is process-oriented, the FSA focuses on results. The SEC's process-oriented approach arguably produces rigid enforcement. The FSA eschews hard, one-size-fits-all rules and encourages firms to experiment with practices that fit within the FSA's stated principles. Cf Pan, \textit{supra} at 14. It has been argued, however, that there has been a decrease over time in the number of firms that would normally have listed their shares. See Craig Doidge et al, "Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time" (2007) \textit{Fisher College of Business Working Paper} at 14-21, <ssrn.com/abstract=982193> (Doidge et al, "New York").
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\textsuperscript{124} See e.g. ibid (proposing increased regulatory participation from the states in the provision of securities law in order to foster regulatory competition).
\textsuperscript{125} Ibid.
\textsuperscript{126} Ibid at 2373-74. Romano drew heavily from the literature regarding the competition for corporate charters. Ibid passim. See e.g. Ralph K Winter, "State Law, Shareholder Protection, and the Theory of the Corporation" (1977) 6 \textit{J Leg Stud} 251.
\textsuperscript{127} Ibid at 2374-75.
\textsuperscript{128} Ibid at 2375-76 ("The failure to provide voluntarily the information that the SEC mandates does not demonstrate that such disclosure enhances investor welfare. It does so only with an additional assumption—that the SEC, and not the firms, has made the correct cost-benefit calculation."); ibid at 2378 ("Emphasis on registration withdrawal data presupposes gross
example of the SEC's incapacity to respond to investors. It was the SEC's long-term policy to prohibit the disclosure of projected earnings.\textsuperscript{129} The concern was that "unfounded predictions of success"\textsuperscript{130} would mislead investors. Thus, the SEC determined that disclosures should include only "objectively verifiable facts."\textsuperscript{131} But, since an investor's assessment of a company's future earnings determines how the investor prices the present value of the company's securities, projected earnings were a key omission that arguably harmed investors.\textsuperscript{132} Even though investors requested the information, companies refused to disclose it given the SEC's prohibition. The SEC has since changed its position,\textsuperscript{133} but Romano presented the decades-long policy as an example of the insularity of monopoly.\textsuperscript{134}

Using Romano's framework,\textsuperscript{135} commentators like Choi made the case for federalism as an engine for experimentation and innovation. In a competitive regime, successful innovations would be mimicked by other jurisdictions if they would be appropriate in that jurisdiction. Regulators would thus be held accountable because choice gives issuers, and ultimately investors, a mechanism to discipline them.

\textsuperscript{129} Ibid at 2378-79.


\textsuperscript{131} Ibid.

\textsuperscript{132} See Romano, supra note 123 at 2378-79 ("Such information [projected earnings], however, is far more valuable to investors than the accounting information the SEC required, because stock value is a function of future cash flows not historical data."); Hiler, supra note 130 at 1119 n12.

\textsuperscript{133} 17 CFR s 240.3b-6.

\textsuperscript{134} Romano, supra note 123 at 2379-80. Similarly, Romano contends that there is little evidence that the Securities Exchange Act's anti-fraud provisions has prevented any fraud. Ibid at 2382-83. Accordingly, Romano concludes: "[A] fair reading of the empirical literature on the effects of the federal securities laws points to an expansive regulatory apparatus with no empirical validation for its most fundamental objectives. The SEC appears to be a regulatory edifice without foundation." Ibid at 2383.

\textsuperscript{135} Macey, supra note 12 at 4 n13.
Decentralization also gives provinces the freedom to experiment, which allows them to specialize. Macey proposed that "in the Canadian context, some provinces may cater to large-cap issuers, supplying strong antifraud protections and requiring significant disclosure." Presumably, mostly issuers large enough to absorb the compliance costs of such a regime would choose to list there. In a study on foreign private issuers in the U.S. who voluntarily delisted, companies that benefited from higher U.S. trading volumes tolerated the U.S.'s relatively high compliance costs. Companies with low trading volumes on U.S. exchanges were more likely to voluntarily delist. Likewise, some provinces may lower compliance costs by relaxing disclosure obligations in order to attract small-cap issuers.

Whereas proponents of reform look to the U.S. as a model for a future Canadian securities regime, Macey proposed the European system as a preferable model. The Eurozone countries have a single central bank, which is responsible for financial stability, but state-level securities regulators, like Italy's Commissione Nazionale per le Società e la Borsa ("CONSOB"), Germany's BaFin, and France's AMF.

III. The Court's Opinion

As previously noted, the Court took little notice of the expert reports, focusing instead on the constitutionality of the proposed act. The Court observed that the provinces have traditionally had jurisdiction over the bulk of securities regulation, and that there is a constitutional basis for this outcome: the property and civil rights head of power. The federal government asserted its jurisdiction to regulate securities under the trade and commerce head of

\[^{136}\text{Ibid at 38.}\]
\[^{137}\text{Hung Nie Woo, supra note 215 at 174.}\]
\[^{138}\text{Ibid.}\]
\[^{139}\text{Macey, supra note 12 at 38.}\]
\[^{140}\text{See e.g. Macey, supra note 12 at 18.}\]
\[^{141}\text{Ibid at 18, 20.}\]
\[^{142}\text{Ibid at 20, 24.}\]
\[^{143}\text{Securities Reference, supra note 1 at paras 43-45.}\]
power, even though aspects of securities law touch upon property and civil rights.\textsuperscript{144} Because of its potential to usurp great swaths of provincial jurisdiction, the general trade and commerce power is construed narrowly.\textsuperscript{145} Thus, the trade and commerce power extends only "to matters that are genuinely national in scope."\textsuperscript{146} Without detailing the Court’s constitutionality discussion, it suffices to say that the Court concluded that the proposed act would have duplicated the provincial governments’ endeavors to regulate the securities trade.\textsuperscript{147} Thus, the act was not "genuinely national."\textsuperscript{148}

Notably, the Court faulted the federal act for not distinguishing itself enough from existing provincial law. Although the federal act included provisions concerning the management of system risk, a matter that is by definition almost never intra-provincial,\textsuperscript{149} and nationwide data collection, the Court observed that the act was a "duplication of provincial legislation"\textsuperscript{150} that would replace the network of provincial securities regulators with a comprehensive national regime.\textsuperscript{151} Indeed, the Court went so far as to state that proposed act "largely replicate[d] the existing provincial schemes."\textsuperscript{152} This, the court concluded, belied the

\begin{itemize}
\item \textsuperscript{144} Ibid at para 68.
\item \textsuperscript{145} Ibid at para 70.
\item \textsuperscript{146} Ibid.
\item \textsuperscript{147} Ibid at paras 97-101, 117. See also ibid at para 71 ("The Canadian federation rests on the organizing principle that the orders of government are coordinate and not subordinate one to the other."). Cf ibid at para 112 ("Opponents of the Act argue that it is aimed at a particular industry — the securities industry."), para 117 ("Individuals engaged in the securities business are still, for the most part, exercising a trade or occupation within the province.").
\item \textsuperscript{148} Ibid at para 111-12. See also ibid at para 114 ("[T]he proposed Act reaches beyond such matters [as imposing minimum standards applicable throughout the country and preserving the stability and integrity of Canada’s financial markets] and descends into the detailed regulation of all aspects of trading in securities, a matter that has long been viewed as provincial.").
\item \textsuperscript{149} Ibid at para 103.
\item \textsuperscript{150} Ibid at para 102.
\item \textsuperscript{151} Ibid at para 106.
\item \textsuperscript{152} Ibid at paras 115-17.
\end{itemize}
federal government's contention that the securities markets have been so transformed from what they were at the current system's inception.\footnote{Ibid.}

The decision surprised some observers.\footnote{See e.g. Drew Hasselback & Barbara Shecter, "Supreme Court rules against Ottawa’s single-regulator move" (22 Dec 2011) Financial Post, online: <business.financialpost.com/2011/12/22/supreme-court-rejects-national-securities-regulator-plan/>.} Some believed that the federal government had handicapped itself by invoking only the general trade and commerce head of power.\footnote{See e.g. Sébastien Grammond, "Flaherty’s Supreme Court loss is federalism’s gain" (22 Dec 2011) National Post, online: <fullcomment.nationalpost.com/2011/12/22/sebastien-grammond-flahertys-supreme-court-loss-is-federalisms-gain/>.} It could be argued that the breadth of that head of power—and the potential for federal overreaching it represented—almost required the Court to reject it as the source of the federal government's jurisdiction.\footnote{Ibid ("[T]he courts have always given a cautious interpretation to that latter phrase [i.e., 'the regulation of trade and commerce'].").} However, given the comprehensiveness of the federal government's scheme and the success of the regime it was proposing to replace, the federal government had little choice but to seek approval under the interprovincial trade and commerce head of power.\footnote{Ibid.} And it is likely that the Court would have reached the same conclusion had the federal government cited some other head of power, like the inter-provincial and international trade provisions. For instance, the Court indicated that, regardless of the head of power, the proposed act would still have preempted provincial attempts to diverge from the national scheme.\footnote{This is so even though the act the federal government intended to allow provinces to opt into the scheme rather than forcing them to adopt it:}

If implemented as contemplated, all provinces and territories will eventually join the scheme. This will produce follow-through effects. Once a sufficient number of jurisdictions opt in, the current provincial and territorial securities regulation schemes will be effectively displaced. Indeed, in order to be included in the comprehensive regulatory scheme created by the Act, provinces and territories must suspend their own securities laws. The follow-
conclusion that "the day-to-day regulation of securities within the provinces . . . remains essentially a matter of property and civil rights within the provinces and therefore subject to provincial power."159

Implicit in the Court's conclusion that the federal government failed to demonstrate a significant enough transformation in the securities domain160 was its determination that the provincial commissions are up to the task of overseeing the modern securities market.161 In fact, the distinct brand of federalism preserved by the Court ensures that regulatory responses will be measured and result from sound processes. In this era of frequent booms and busts and self-confirming media loops, any system that ensures rational decision-making is welcome. If thoughts of centralization are further entertained, reformers would do well to ponder what has enabled the current regime to be so suitable thus far.

through effects of the proposed Act will therefore be to subsume the existing provincial and territorial legislative schemes governing securities under the federal regulation scheme.

Securities Reference, supra note 1 at para 99.

159 Ibid at para 116.

160 Ibid at para 115.

161 Grammond, supra note 161 ("[T]he Supreme Court relied, instead, on the hard facts: Canada’s current security-regulation system is among the world’s best, and affords a high degree of protection to investors. The Court (which released its decision unanimously) saw no reason why the federal takeover of securities regulation would be necessary to the accomplishment of the current legislation’s goals of investor protection and market efficiency.")
Chapter 3: Decentralization as a Check on Poor Decision-making

At the heart of the regulatory decentralization argument, is the idea that policymakers must be subject to some sort of discipline. If a regulator has a monopolistic franchise, it will inevitably cause problems, such as waste, overreaching, and inertia. Some commentators seem to prefer the simplicity of competitive federalism, whereby the work of discipline is done by the market.\textsuperscript{162} Competitive federalism, however, is not at work in Canadian securities markets the way it is with, say, corporate charters in the U.S. But the question remains: what is to fear in a regulatory monopoly?

I. The Bounded Rationality of Policymakers

An emerging body of scholarship in behavioral economics and cognitive psychology may explain what lies beneath their fear. We are used to commentators relying on the assumption that market participants must be protected to support the argument for greater regulatory oversight.\textsuperscript{163} That investors need protection is currently the prevailing paradigm in securities regulation; indeed, the only mandate for securities regulators, originally, was investor-protection.\textsuperscript{164} Under this conception of investor behavior, investors are imperfectly rational, meaning that they sometimes act \textit{against} their self-interest.\textsuperscript{165} They, thus, require oversight by an actor who will represent the investors' best interests. This is what a regulator's role is.

\textsuperscript{162}See e.g. Choi, \textit{supra} note 6 at paras 65-80. MacIntosh allows that decentralization need not feature true competition in order to produce "superior policy outcomes." MacIntosh, \textit{supra} note 28 at 30.

\textsuperscript{163}Cass R Sunstein, "Empirically Informed Regulation" (2011) 78 U Chi L Rev 1349.

\textsuperscript{164}See Anand, \textit{supra} note 93 at 943 n9 ("Initially, securities law focused only on one of these objectives [i.e., investor protection and fostering fair and efficient markets and confidence in markets]: investor protection.").

\textsuperscript{165}This concept supplements perfect-rationality assumptions, which holds that humans make choices to maximize their satisfaction. R.J. Herrnstein offered the following analogy to illustrate the concept that perfect-rationality is limited by real-world concerns: "The theory of rational choice seems to stand in relation to the behavioral sciences as the Newtonian theory of matter in motion stands to the physical sciences. It is held, by its proponents, to be the law that behavior would obey if it were not for various disruptive influences, the behavioral analogues of friction,
Recent scholarship has turned the bounded rationality lens on the policymakers. Like private individuals, policymakers are cognitively limited. They do not always make choices that are likely to further their stated goals and are susceptible to biases that disrupt the rational decision making process. If those who use the cognitive errors of private individuals to justify regulating their behavior accept that proposition as true, they must also accept that policymakers are prone to cognitive error. Thus, the argument justifying the oversight of private individuals suggests that policymakers be subject to some sort of disciplining mechanism.

This is especially so when recent public failures are used to rationalize government action. So much government intervention is a reaction to a historic threat. Public policy is often to act in that arena—by passing laws or heightening the enforcement of existing laws—rather than to do nothing. This phenomenon is known as "action bias." Action bias leads policymakers to believe that they must respond to some event or phenomenon with new regulation or with heightened enforcement, even when doing nothing may be the optimal response. It creates the illusion that action is superior to inaction. Exacerbating the problem of action bias is the tendency of policymakers, like all individuals, to allow vivid—sometimes wind, measurement error, and the like." RJ Herrnstein, "Rational Choice Theory" (1990) 45 American Psychologist 356 at 356.


Sunstein, supra note 163 at 1363.

Tasic, supra note 166 at 424-25.

Tasic, supra note 166 at 424-25; see also Sunstein, supra note 163 at 1362-63 (empirical findings relating to human behavior may suggest that less, rather than more, regulation is necessary).
recent—events to affect their assessment of the necessity of preventing that event from happening again.170 Put another way, humans are susceptible "to overestimate[ing] the likelihood of the salient or recent events that come to mind easily," or "availability bias."171

Government intervention to protect market participants, or paternalism, is not without its successes. This is especially so when the pervasiveness of a problem cannot be disputed, its cause is readily apparent and the response is clear-cut.172 But policymakers have difficulty resisting bias and rationally responding to events even when the cause appears to be unambiguous.173 Because of a failure to take into account costs and because of a bias toward regulation, government action often does not have the intended result and often has unintended consequences. Commentators have collected dozens of examples. Garrick Blalock et al gave the illustration of air-travel regulation after the September 11 attacks. In reaction to September 11, governments overhauled airport security. Airport inspections took longer and were more invasive. Closer inspection and security checkpoint waiting times drove up the cost of air travel, which prompted more people to drive.174 Road travel is, of course, a more lethal mode of travel than flying, and Blalock et al attributed 1,200 road deaths to the U.S. government's reaction to September 11.175 Glaeser gave the example of Prohibition in the U.S., "which appears to have had only a modest impact on alcohol abuse while supporting a large, violent, underground alcohol-based economy."176

Naturally, it is even more challenging to prescribe solutions to complex problems with ambiguous causes. For example, In the 1930s, the U.S. had a problem with enforcing corporate

170 Sunstein, supra note 163 at 1359.
171 Tasic, supra note 166 at 424.
172 See Glaeser, supra note 166 at 148.
173 For a few examples, like higher unemployment for people with disabilities after the enactment of the Americans with Disabilities Act, see Tasic, supra note 166 at 431.
175 Ibid at 1-2.
176 Glaeser, supra note 166 at 148.
financial disclosure. Accordingly, in 1936, the Office of the Comptroller of the Currency ("OCC"), which regulates nationally chartered banks, decreed that banks could not hold bonds that were below investment grade as determined by a credit rating agency ("CRA"), effectively "requiring major transactors in the bond markets to pay attention to the ratings of the bond rating firms."\(^{177}\) Likewise, in 1975, the SEC sought to link the capital requirements of broker-dealers to the quality of the bonds in their portfolios.\(^{178}\) But, unlike the OCC, the SEC required that the ratings come from a reputable CRA, or nationally recognized statistical rating organization ("NRSRO"), lest the broker-dealer attempt to manipulate the rating by employing an unscrupulous CRA.\(^{179}\) The SEC designated three NRSROs—Moody's, Standard and Poors and Fitch—which today dominate the credit rating business.\(^{180}\)

In hindsight, the SEC's delegation of the investment-evaluation function to an oligopoly of CRAs proved to be a bad idea. Before the recent credit meltdown, the CRAs, which are responsible for evaluating the riskiness of investments, assigned top, investment-grade scores to bundles of subprime mortgages.\(^{181}\) Based on these evaluations, the bonds were massively overvalued, leading to "massive levels of leverage and excessive degrees of asset concentration" in financial institutions.\(^{182}\) Arguably, competition in the investment-evaluation business would


\(^{178}\) Ibid at 6.

\(^{179}\) Ibid.

\(^{180}\) Ibid. The SEC subsequently designated six more NRSROs, but, through mergers and attrition, the three CRAs mentioned here are still dominant and form a de facto oligopoly over the credit rating business. Ibid at 6-8.


have resulted in better due diligence. And regulatory sanctioning of CRAs certainly encouraged dependence on the CRAs' assessments to the point that those assessments affected market participants' independent evaluations of investments. But, predictably, Congress responded by layering more government-imposed duties—in the form of the Dodd-Frank Act—over those created in the 1930s and 1970s.

The credit meltdown also illustrates how the centralization of banking regulation contributed to firms' vulnerability to unforeseen threats and heightened systemic risk. The Basel Accords have harmonized great swathes of the banking business globally. This has "resulted in nearly all large banks' following a similar business strategy, with respect to assets held, securitization programs undertaken, and risk models used." For instance, in the recent U.S.-based credit crisis, banks in the U.S. and Europe invested in supposedly low-risk residential mortgages. Because mortgage-backed securities and collateralized debt obligations entailed lower capital requirements than other assets, banks were drastically overleveraged. As Romano noted, "when that business strategy failed catastrophically, the crisis was not restricted to one nation and a few institutions, but was instead worldwide." That a catastrophic event would stem from a downturn in a national real estate market was not foreseeable when bank regulators agreed to implement the Basel Accords does not ease any concerns about the ability of

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183 See e.g. Ekins & Calabria, supra note 182 at 32.
184 See Partnoy, supra note 182 at 10-11.
185 Ekins & Calabria, supra note 182 at 30. Some of the reforms Dodd-Frank introduced were "improved 'internal controls' for the ratings process, separating the sales and marketing functions of the agencies from the ratings process, increasing the number of independent directors on the agencies' boards of directors, and increasing the responsibilities of the ratings agencies' boards." Ibid; see Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), 15 USC s 78o-7(c)(3). To those familiar with the Sarbanes Oxley Act of 2002, these reforms track analogous corporate governance reforms contained in that act. See infra this chapter, Part II. See generally Sarbanes-Oxley Act of 2002, Pub L 107–204, 116 Stat 745 ("SOX").
187 Ibid at 16 n23, 17.
188 Ibid at 17.
189 Ibid at 16.
regulators to forestall future crises. The next crisis will be as unforeseeable as the last. Rather than lessen systemic risk, it is also possible that centralization can increase it.\textsuperscript{190} It is at least arguable that regulatory heterogeneity is less risky than regulatory monopoly.

II. Biases, Rationality and the Example of Sarbanes-Oxley

Not only are policymakers, like private individuals, biased in favor of action over passivity and are inclined towards believing that the recency and vibrancy of events are evidence of their frequency, the political process may make it rational for them to allow recent events to impel them to action. Put another way, sometimes policymakers make bad policy not—or not only—because they are blinkered by bias. Rather, sometimes bad policy may be the result of rational decision making. Public servants must respond to the public. And, often, rather than make their case to their constituents and beseech them to set their passions aside, it is rational to demonstrate that they are responding to the perceived crisis. Often, because of their own biases, policymakers themselves agree with their constituents on the need to act, and thus would not see any need to stall for the sake of deliberation. Whether they believe in the need to act swiftly or not, it is perfectly rational for policymakers to favor action over inaction when their constituency perceives the need to act.\textsuperscript{191} In addition, in times of perceived crisis, reformers are emboldened, whether or not empirical support is on their side, while opponents of reform are politically weakened.\textsuperscript{192} Thus, whether or not it is rational, policymakers are inclined to perceive a crisis and to respond with decisive action to it. And, often, because the decision-making process in such an environment is poor, far-reaching, unintended consequences remain unforeseen.

The archetypal example of a robust government reaction to a vivid event that had unforeseen consequences—and the one that has likely sparked the most cost-benefit

\textsuperscript{190} See ibid.

\textsuperscript{191} See e.g. Roberta Romano, "The Sarbanes-Oxley Act and the Making of Quack Corporate Governance" (2005) 114 \textit{Yale LJ} 1521 at 1600 ("Retaining one's public office is an understandably powerful motivating force, and financial crises are often accompanied by a media frenzy searching for scapegoats that plays into public discontent and generates expectations of government solutions (as occurred with SOX).”).

\textsuperscript{192} For a thorough account of how "financial exigencies" embolden "policy entrepreneurs" to seek radical financial reforms, see ibid.
analysis—is SOX. SOX, which reformed and imposed federal supervision on corporate governance and auditor oversight, was enacted after the collapse of Enron, and was, in large part, designed to prevent another such catastrophe from occurring. The critical reform, and by far the one that has garnered the most attention, is Section 404, which require[s] companies . . . to include in their annual reports a report of management, and an accompanying auditor’s attestation report, on the effectiveness of the company’s internal control over financial reporting, and to evaluate, as of the end of each fiscal quarter . . . any change in the company’s internal control over financial reporting that occurred during the period that has materially affected, or is reasonably likely to materially affect, the company’s internal control over financial reporting.

The frenzy and furor amid which SOX was enacted can hardly be overstated. The Enron collapse itself was high-profile and was covered by the media for months. Later high-profile business failures featuring irregular accounting kept corporate scandal in the news.

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194 See e.g. Lawrence A Cunningham, "The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)" (2003) 35 Conn L Rev 915 at 955-56 (SOX requirement of certification that "the CEO and CFO designed corporate internal controls to ensure the information flows to the officer" is related directly to Enron senior executives' claims of ignorance of financial fraud); ibid at 957-58 (same: disclosure of whether a company has a code of ethics related to Enron's changing its "ethics code to permit insiders to hold various positions otherwise constituting conflicts of interest"); ibid at 962-63 (same: annual disclosure of off-balance-sheet transaction is directly related to Enron); ibid at 969 (same: new criminal code provisions and enhanced criminal penalties for alteration, destruction or falsification of documents directly related to Enron's auditor).

195 Codified as 15 USC s 7262.


197 See Romano, supra note 191.

198 See ibid at 1528 & n17.

199 Ibid at 1557-58. "[T]he major network evening news coverage between January and July 2002 contained 613 stories on business, of which 471 (77%) were about corporate scandals; of
Also weighing on the public's mind was the simultaneous drop in the stock market. These considerations, combined with looming elections, meant that Congress was highly motivated to enact a bill. It is thus not surprising that "[t]he SOX corporate governance mandates were not carefully considered by Congress; in particular, they were not evaluated in light of the empirical literature questioning their efficacy."\(^\text{201}\)

The empirical literature on the benefits of SOX before and since its enactment is mixed but calls into question the efficacy of many of SOX's core provisions. For instance, SOX requires that all members of a company's audit company be independent to reduce the likelihood that earnings will be misstated. But "[t]he compelling thrust of the literature on the composition of audit committees . . . does not support the proposition that requiring audit committees to consist solely of independent directors will reduce the probability of financial statement wrongdoing or otherwise improve corporate performance."\(^\text{204}\) Similarly, for the remaining core provisions of SOX, there is compelling evidence that, on balance, they do little to benefit investors.\(^\text{205}\)

Setting aside the debate about the purported benefits of SOX, it is undeniable that it has imposed significant costs, and that the costs have been borne disproportionately by smaller companies and, by extension, by U.S. stock markets and investors. For companies with annual revenues of over $5 billion, expenditures for complying with SOX internal controls provisions

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\(^\text{200}\) See ibid at 1567.
\(^\text{201}\) Ibid at 1585.
\(^\text{202}\) 15 USC s 78j-1(m)(3).
\(^\text{203}\) Romano, supra note 191 at 1529-30.
\(^\text{204}\) Ibid at 1533.
\(^\text{205}\) See generally ibid at 1529-43 (summarizing and commenting on the empirical findings).
were projected to average $2.9 million.\textsuperscript{206} By contrast, companies with annual revenues under $25 million were projected to expend $222,000, a much more significant burden given the size of the companies.\textsuperscript{207} The costs of being public—a burden disproportionately borne by smaller companies—have driven a number of companies private.\textsuperscript{208}

Studies indicate that compliance with SOX has also driven IPO activity away from the U.S., which once dominated the IPO market. The numbers demonstrate that U.S. IPO activity has severely dropped off:

Although the worldwide share of IPO activity by U.S. firms still ranks near the top, during the 2000s, U.S. IPOs have not kept up with the economic importance of the U.S. In the 1990s, the yearly average of the number of U.S. IPOs comprised 27% of all IPOs in the world while the U.S. accounted for 27% of world Gross Domestic Product (GDP). Since 2000, the U.S. share of all IPOs has fallen to 12% whereas its share of worldwide GDP has averaged 30%. The average size of a typical IPO in the U.S. is larger than that in the rest of the world so that IPO proceeds may be a more relevant metric. Yet, in the last five years of our sample, IPO proceeds raised by U.S. firms drop to 16.2% of world IPO proceeds, despite the fact that the stock market capitalization of the U.S. relative to that of the world averages 41% during this period.\textsuperscript{209}

A number of companies have also delisted or deregistered in the past decade.\textsuperscript{210} Much of the blame for the trend in delisting, deregistering or listing elsewhere has been leveled at the passage of SOX, especially section 404, which required executives to give an assessment of the reliability of their companies' internal financial controls.\textsuperscript{211}

\textsuperscript{206} Ibid at 1587.
\textsuperscript{207} Ibid.
\textsuperscript{208} Ibid at 1588-89.
\textsuperscript{209} Ibid.
\textsuperscript{210} Hung Nie Woo, supra note 215 at 144.
Those who defend SOX indicate that, though compliance with it is expensive, it does important work, including in the area of investor protection.\(^{212}\) There is also a sort of perverse benefit to the high compliance costs. Complying with stringent corporate governance standards boosts the reputation of a company that is subject to them.\(^{213}\) Because they voluntarily submit to SOX-mandated rules, this is especially the case with foreign private issuers,\(^{214}\) particularly from Asia, who see it as a boon to their reputations if they demonstrate that they can comply with demanding, U.S.-style regulation.\(^{215}\)

But, continuing with the example of non-U.S. companies, not all of the delisting companies had weaker corporate governance and provided less investor protection. Some were

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Tasic also argues that SOX-compliance has "diverted corporate resources away from actual risk monitoring toward formal compliance with 'transparency' measures that only add to information clutter." Tasic, *supra* note 166 at 424-25.

\(^{212}\) See e.g. Prentice, *supra* note 211. Cf Speech by David A Brown, Chair, OSC, at McMaster University (Hamilton, ON; 10 March 2005) at 9, online: <http://www.osc.gov.on.ca/documents/fr/News/sp_20050310_db-corp-gov-in-cdn.pdf> ("[T]he higher people estimate their costs will be to develop effective internal controls, the more worried I feel I should be about the current quality of their financial reporting.").

\(^{213}\) The same can also be said about U.S. securities compliance and corporate governance standards more generally. See Craig Doidge, George Andrew Karolyi, Rene M Stultz, "The US Left Behind: The Rise of IPO Activity Around the World" working paper (Mar 2011) at 1 available at <http://ssrn.com/abstract=1795423> ("The law and finance literature shows that IPO activity depends on country-level laws and governance institutions. It also shows that IPO activity is higher in common law countries compared to countries with other legal origins. From this perspective, IPO activity has been vibrant in the U.S. because of better laws and better governance institutions."); see also ibid at 2 ("[G]lobal IPOs can be used to overcome the adverse effects of poor home country institutions.").

\(^{214}\) A "foreign private issuer" is any foreign issuer except one that is a foreign government or has more than fifty percent of its outstanding voting securities held by residents of the United States and also: (1) has U.S. citizens or residents make up the majority of its executive officers or directors; (2) has more than fifty percent of its assets located in the U.S.; or (3) administers its business principally in the U.S. 17 CFR s 230.405; see also ibid s 240.3b-4.

subject to relatively stringent regulations in their home countries.\textsuperscript{216} These companies consistently reported that a prime reason for delisting with the SEC were the compliance costs imposed by SOX.\textsuperscript{217} Presumably, these are the types of companies that U.S. investors should not be discouraged from investing in. On balance, there is a compelling argument that SOX failed to address the problems that Congress intended and that it imposed costs Congress did not foresee.

I present the experience of the U.S. with SOX as an illustration of how—almost necessarily—policymakers will abandon the deliberative process from time to time and how doing so ensures that resulting policy will be worse for it. Policymakers—whether through their biases or rationality—can be captured by events and public opinion to forego the deliberative process that ensures good law. Lawmakers are very responsive to public opinion. And savvy and influential people with policy agendas seize upon occasions when public opinion is in their favor.\textsuperscript{218} In such an environment, when events jar the public, who demands a prompt response to that event, and when agendas are not discerned, bad policy is sure to result. The next section discusses how, due to its strongly federalist structure, Canada has built-in protections from against this happening.

III. The Canadian Response to Calls for Corporate Governance Reform

Commentators decry the current securities regime in Canada as too inefficient.\textsuperscript{219} For instance, as noted above, Trebilcock complained that the ability of provinces to renounce an instrument or policy at any time "render[s] a rapid co-ordinated response to a financial crisis highly problematic (setting aside divergent interpretations and enforcement of policies that are adopted)."\textsuperscript{220} But, just as the thirteen colonies benefitted from England's salutary neglect,\textsuperscript{221} the

\textsuperscript{216} Hung Nie Woo, \textit{supra} note 215 at 169.

\textsuperscript{217} See ibid at 170-73.

\textsuperscript{218} For an exhaustive account of how Congress formed many of SOX's key provisions from a proposal by former SEC Chairman Arthur Levitt that had earlier been defeated, see Romano, \textit{supra} note 191 at 1550-85.

\textsuperscript{219} See e.g. Trebilcock, \textit{supra} note 81 at para 19.

\textsuperscript{220} Ibid.

public benefits occasionally from what may be termed salutary policymaking inefficiency. As demonstrated above, rapid responses are destined to be ill-considered, neglectful of process and captive to cognitive blind spots. Arguably, then, discouraging rapid responses should be welcome.

The mechanism for doing so that has gained favor with Romano, Macey and Choi is competitive federalism. But, contra Macey and Choi, competitive federalism does not exist in Canada. Rather, as discussed earlier, Canada has one dominant listing jurisdiction, Ontario, whose regulator has significant influence over the national agenda. The other provinces do not and cannot really compete by, say, stealing securities business from Ontario. Nevertheless, even given their "junior" status, other provinces act as a check on Ontario's hegemony. Even though Ontario dominates the Canadian trading and listing business, and issuer migration to another province is not a credible threat, the other jurisdictions act as checks on Ontario unilateralism. This is so for reasons that stem from Canada's robust version of federalism.

A key reason for Canada's sound decision-making is that Ontario has an interest in unity and, like a majority shareholder in a corporation, is responsive to dissenters' rights. The OSC refrains from unilaterally adopting policies radically different from the other members of the CSA as evidenced by the uniformity of key provisions across provinces. Its membership in the CSA furthers its close coordination with the other provinces. And even though the OSC does not participate in the passport system, it abstains out of a commitment to a national regulator as a sort of protest to ad hoc collaboration.

An illustration of how robust federalism drives good policy even in the absence of competitive federalism comes by way of Canada's own brush with SOX-era hysteria. Canada was confronted with the decision of whether to adopt SOX. SOX was to apply extraterritorially. Thus, Canadian companies that cross-listed in the U.S. were going to have to comply with SOX's corporate governance provisions. There were also questions about the interaction of SOX with

222 See supra note 24.
223 See supra note 20.
the Multi-Jurisdiction Disclosure System, which allows Canadian issuers to seek U.S. investors using Canadian disclosure documents.224

The OSC proposed to adopt SOX-compatible policies nationwide.225 But it was particularly concerned with the internal control provisions found in Section 404 because issuers would be required to disclose their efforts at internal controls, their managers would have to certify it, and an external auditor would have to attest to the appropriateness of the certification.226 A cost-benefit analysis the OSC commissioned found that both the benefits and the costs of an internal-controls rule would disproportionately accrue to smaller issuers.227 The analysis also found that the net effect of implementing internal controls would have a negative net impact on those issuers.228 Despite this, the OSC wanted to press on.229 But other provincial securities commissions resisted. Notably, "[t]he Alberta and British Columbia Securities Commissions were . . . concerned with the heavy cost burden and disproportional negative impact SOX would impose on smaller firms since, to a large extent, the costs of compliance are fixed rather than variable."230

The pushback resulted in the rejection of SOX and a consensus decision to modernize corporate governance policy without espousing SOX's "overly elaborate and costly

225 Ibid at 24-25.
228 CRA Report, supra note 227 at 48. The analysis did caution that the analysis was biased towards finding a net cost because, whereas it quantified most of the costs, it was not able to quantify all of the benefits. Ibid at 8.
229 Brown, supra note at 9-11.
230 Ibid.
impositions."\textsuperscript{231} Although the reforms retained the management certification requirement from SOX,\textsuperscript{232} they did not include the external auditor attestation or internal controls disclosure requirements.\textsuperscript{233} They also wisely excepted venture issuers and issuers with controlling shareholders from the more expensive requirements.\textsuperscript{234}

The reforms the commissions did adopt instituted meaningful reform but remained flexible enough to cater to all sizes of issuers. The management certification requirement requires an issuer's CEO and CFO to vouch for its internal control of financial reporting and for the authenticity of its reports concerning "the financial condition, results of operations and cash flows."\textsuperscript{235} But it does not require management to disclose the details of how the issuer implements its internal controls.\textsuperscript{236} "The companion policy to MI 52-109 indicates that this ambiguity was deliberate to allow management to identify the appropriate standard for the company 'based on various factors that may be particular to an issuer, including its size, the nature of its business and the complexity of its operations.'\textsuperscript{237}

Because it would have been difficult to unilaterally adopt significant corporate governance reforms, like those requiring internal-controls reporting or auditor attestation, the OSC was compelled to give due process to the costs and benefits of corporate governance

\begin{itemize}
  \item \textsuperscript{232} See MI 52-109, \textit{supra} note 231.
  \item \textsuperscript{233} Ben-Ishai, \textit{supra} note 226 at 479.
  \item \textsuperscript{234} Lortie, \textit{supra} note 224 at 24.
  \item \textsuperscript{235} MI 52-109, \textit{supra} note 231 s 2.1; see e.g. ibid, \textit{Form 52-109F1}.
  \item \textsuperscript{236} Ben-Ishai, \textit{supra} note 226 at 488.
  \item \textsuperscript{237} Ibid (quoting 27 OSCB 944).
\end{itemize}
reform. Even were the OSC inclined to commission a cost-benefit analysis Section 404 without the other commissions' pressure, the absence of monopoly power meant that it practically could not avoid doing so. Had there been a national regulator, it is likely that the costly and ill-considered SOX provisions would have been mimicked in Canada. And the impact would have been worse in Canada than in the U.S. because of the higher proportion of smaller issuers in Canada.238

IV. The Salutary Effects of Canadian Regulatory "Inefficiency"

Since its adoption, section 404 has come under fire, particularly for its impact on small issuers. A number of influential parties called on the SEC to adopt an exemption for small issuers, primarily asserting that Section 404 was strangling the market for financing on Wall Street.239 Congress provided relief for small-cap issuers in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"),240 exempting issuers with "an aggregate worldwide market value of the voting and non-voting common equity held by its non- affiliates" of less than $75 million from the auditor attestation requirement.241

Because there was no mechanism to slow it down, the policymaking process during the debate over Section 404 was driven by the exigencies of the moment. Policymakers, if they were

238 Very few large Canadian companies inter-list on U.S. exchanges. Macey, supra note 12 at 8. "Out of approximately four thousand (4,000) public companies, only one hundred and seventy-seven (177) of the largest have securities trading in U.S. markets." Ibid. This may be because "Canadian companies go public at an earlier stage in their development and therefore, by U.S. standards, are much smaller." Ibid. Canada also has a higher proportion of closely-held companies than the U.S., demanding a lower intensity of oversight. Christopher C Nicholls, "The Characteristics of Canada’s Capital Markets and the Illustrative Case of Canada’s Legislative Regulatory Response to Sarbanes-Oxley" published in Task Force to Modernize Securities Legislation in Canada, Canada Steps Up (June 15, 2006) at 167-68 <http://www.tfmsl.ca/docs/V4(3A)%20Nicholls.pdf>.


240 124 Stat 1376 (21 July 2010).

241 15 USC s 7262(c); 17 CFR s 240.12b-2. The SEC had previously proposed some relief to small issuers by extending the compliance date of their internal-controls reports. SEC, supra note 196.
so inclined, did not have the opportunity to critically assess the reforms they were espousing. Instead, the process was governed by the policymakers' heuristics and bias. Policymakers must have known that they were raising compliance costs by adopting Section 404, but they could not have known the ramifications for small issuers. By the time Congress acted to repair the problem, much of the damage had been done to the U.S.'s market for securities business, to say nothing of the uncertainty costs arising from Congress's reversal.

In contrast, the Canadian regime struck a sensible balance that has been perpetuated throughout different reforms. The TSX long ago adopted an optional, best-practices approach to corporate governance regulation, which the provincial commissions later espoused. This approach was used for the SOX-era reforms as well, which required management to adopt internal controls and certify them, thus opening themselves up to civil liability for false statements, without mandating how to do so. As noted above, issuers could tailor internal controls to their own circumstances, an approach that has garnered much less criticism than SOX's corporate governance mandates. Perhaps even the OSC would acknowledge now that abandoning the principles-based approach, as the OSC had advocated, would have been a costly mistake.

I present the story of corporate governance reforms not to demonstrate what the results of the reforms were, but to illustrate that better processes lead to better policy. There are many examples, but this should be self-evident. It is disingenuous for supporters of centralization to claim that they desire a regime that both centralizes policymaking power and is dedicated to process-oriented decision-making—a regime in which good decision-making would be somehow written in to the regulator's operating guidelines. The passport system, an innovation made possible by the already broad agreement between securities acts, negates a significant amount of the compliance costs. At least one reason then, and likely a key reason, supporters seek centralization is to streamline decision-making, especially in times of financial crisis. Hence,

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243 Ibid.
Trebilcock's criticism of the current regime for impeding rapid responses to financial crises\textsuperscript{244} and for slowing the project of harmonization down.\textsuperscript{245} Little consideration is given to the existing features of the current regime that are already known to work: the commissions' strong interest in consensus and the relatively slower process needed to build it. On the contrary, implied in the desire for a regime capable of rapid response is the acknowledgement that consensus and process would be abridged, no matter how many assurances had been given to the contrary.\textsuperscript{246} Rational policymaking needs time, not only to allow passions to wear off, but also to marshal facts and interpret them. It was just over two years from the first reports of the Enron scandal in late-2001 to the adoption of MI 52-109, the certification rule.\textsuperscript{247} It was another several months until Charles River Associates had concluded it cost-benefit analysis of Section

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\textsuperscript{244} Supra note 220.
\textsuperscript{245} Supra note 76.
\textsuperscript{246} This is even more worrying given the nebulous authority the national regulator would have been given under the proposed act:

The Chief Regulator may, if he or she considers that it would not be prejudicial to the public interest to do so, disclose any information obtained under this Act, to another securities or financial regulatory authority, an exchange, a self-regulatory organization or another governmental or regulatory authority, in Canada or elsewhere, if the disclosure is for the purpose of the administration of this Act, including contributing to the integrity and stability of the financial system, or of assisting in the administration of securities or financial legislation in Canada or elsewhere.

\textit{Proposed Canadian Securities Act, supra} note 3 s 224(1)

404. The enactment of SOX on July 31, 2002, proved to be a rapid response indeed, taking only nine months from the date the SEC filed of fraud charges on November 1, 2001.249

This is not to say that innovation should be stymied. Indeed, decentralization spurs innovation as well as restraint.250 I merely acknowledge the necessity of making policymakers accountable to a process. Experience has shown that Canada has an effective structure for doing this and for compelling its securities commissions to adhere to process, whether or not the structure's establishment was intentional. Some commentators indicate that there is little to stop provinces from going their own way, throwing market participants into a state of costly uncertainty. But this is not what experience has demonstrated. Large portions of the securities acts are identical to one another, and the passport system ensures nation-wide compliance. The commissions have an interest in unity that keeps them finding national solutions by collective action and consensus. These concerns assure a measured approach even in the face of crisis.

248 See CRA Report, supra note 227 at cover page.


250 See e.g. MacIntosh, supra note 106 ("[The WPC Report] gives short shrift to the various innovations that have been adopted by a single provincial regulator and then spread to other jurisdictions. The truth is that a decentralized system both permits and encourages innovative thinking, and supplies the laboratories in which to test new ideas. A good illustration of this is to be found in the small firm sector, the importance of which the WPC scarcely wastes an opportunity to tout."). In the context of corporate charters in the U.S., Romano argued that successful innovations are copied by other jurisdictions. Romano, supra note 123 at 2392. As an illustration, she cited Delaware's response to a "perceived crisis in directors' and officers' liability insurance." Ibid. Both the number of claims against directors and officers and the costs of defending those claims increased dramatically in the mid-1980s. Roberta Romano, "What Went Wrong with Directors' and Officers' Liability Insurance" (1989) 14 Del J Corp L 1 at 6-8. At the same time, possibly as a response to the growing costs, insurance companies began restricting coverage. Ibid at 9-13. Some worried that the increased exposure would drive talented, potential directors away from corporate boards. Roberta Romano, "Corporate Governance in the Aftermath of the Insurance Crisis" (1990) 39 Emory LJ 1155 at 1160. Delaware responded by enacting a law that insulated directors from liability for damages. Ibid. The law allowed corporations to amend their charters to eliminate their directors' liability. Ibid. Romano observed that, within two years of the enactment of the statute, forty-one states had adopted the measure. Ibid.
Conclusion

The accounting fraud cases alerted the U.S. to a problem that policymakers were not prepared to address. With the public demanding a policy response, Congress could not slow the decision-making process down even if it wanted to, and there is little indication that it did. Without a sound process or decision aids like cost-benefit analyses, the inclination of policymakers to enact further regulation was unchecked. Given a small window of time in which to act, Congress cast about for a corporate governance reform idea. The one it found and enacted had already been defeated, but it was deemed good enough.\footnote{251} Its adoption led to huge costs, affecting capital markets worldwide. The entire process was a breakdown in rationality.

The Canadian experience could not have been more different. In Canada, the accounting fraud cases sparked a debate over corporate governance reforms. With some advocating for deep reform and others advocating for lighter reform, and with no one having the ability to act unilaterally, more time was taken. This gave policymakers the opportunity to collect facts and to create objective projections of costs and benefits. The regulatory response was, in turn, measured and rational. It is difficult to find complaints about the costs it imposes.

Most of the debate over the national regulator—and over centralization—has focused on costs. But the costs arising from duplication, divergence and lost opportunity have proved difficult to fix. And nobody has satisfactorily demonstrated which costs are significant. What is not disputed is that there are costs and that there are opportunities for reform. But the project of reform should take into account the, admittedly esoteric, benefits that the current regime preserves.

The debate over what national regulation in Canada should look like is the corporate governance debate writ large. A defeated policy agenda, simmering on the back burner for some time, suddenly burst into public consciousness thanks to a perceived crisis. Perpetual proponents

\footnote{251 According to Senator Phil Gramm: "If people on Wall Street are listening to the debate and trying to figure out whether they should be concerned about this bill, I think they can rightly feel that this bill could have been much worse. I think if people had wanted to be irresponsible, this is a bill on which they could have been irresponsible and almost anything would have passed on the floor of the Senate." Romano, supra note 191 at 1548 n72.}
of reform endeavored to use that crisis to demonstrate the timeliness of the policy proposal. But the process was slowed down by Canada's strong version of federalism. The future of national regulation is now in the provinces' hands.\textsuperscript{252} The commissions' response to the "national regulator problem" will no doubt be measured. Let us hope that they will remember why.

\textsuperscript{252} See Jeremy Fraiberg, "Renewed quest," \textit{Financial Post} (18 July 2012), online: <http://opinion.financialpost.com/2012/07/18/renewed-quest/>
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