COOPERATING TO CREATE A NATIONAL SECURITIES REGULATOR IN CANADA

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Summary

On November 9, 2018, the Supreme Court of Canada ("**SCC**") unanimously upheld legislation that supports the creation of a national securities regulator under a cooperative system. The decision clarifies the constitutional validity of the law and upholds the establishment of the Cooperative Capital Markets Regulatory System ("**CCMRS**").

Background to Cooperative System

It remains unclear the exact timing the CCMRS will be implemented and practically speaking, functional. It is up to each provincial and territorial government to determine whether it will participate in the cooperative system since, as its name suggests, it is voluntary. Currently, Ontario, British Columbia, Saskatchewan, Prince Edward Island, New Brunswick and the Yukon Territory ("**Cooperating Jurisdictions**") are the six Canadian jurisdictions participating and Nova Scotia has announced its intention to join. It is unlikely Alberta or Québec will sign-on as these two provinces have historically resisted a national securities regulator (although this has not been tested under the current provincial governments).

A plan for a national securities regulator is not new. Over the years, there have been numerous attempts to unify the regulation of the Canadian securities market. This topic has been discussed for over 80 years, with proposals as early as 1935. While provincial markets were historically localized, national and international trade has increased as financial markets and technology have evolved. Accordingly, efforts to form a national regulator have intensified in the past decade.

Currently, securities regulation is a patchwork of 13 separate jurisdictions, as each province and territory has its own statute and regulator. As one of its overarching goals, the umbrella organization of the Canadian Securities Administrators seeks to have a harmonized approach to securities regulation across Canada. All the jurisdictions have come together to approach certain requirements in the same manner, including for example, continuous disclosure obligations for reporting issuers. Although our system reflects cooperative approaches to certain securities regulatory requirements, it has often been criticized as being antiquated,

inadequate to address financial instability, inefficient and lacking global presence. Canada is one of the only industrialized countries that does not have a national securities regulator.

In the 2013 budget, the federal government announced that it was working to form a cooperative securities regulator through provincial agreement, or draft federal legislation consistent with the federal powers outlined in the 2011 decision of the SCC, discussed further below.

The Cooperating Jurisdictions entered into a memorandum of agreement with the federal government in September 2016 setting out the framework for CCMRS. CCMRS limits federal regulation to national concerns and provides for a harmonious cooperative federal-provincial scheme that includes:

1. a model uniform provincial/territorial statue (the Capital Markets Act)[1];
2. a complementary federal statute to manage systemic risk and establish criminal offences (the Capital Markets Stability Act)[2];
3. the Capital Markets Regulatory Authority (the "**CMRA**"), which is a single regulator presiding over the Cooperating Jurisdictions; and
4. the Council of Ministers (composed of provincial and territorial ministers and the federal Minister of Finance) to supervise the national regulator.

Supreme Court of Canada, 2011

The SCC previously considered the constitutionality of a national regulator in the Reference re Securities Act,[3] including a review of draft federal legislation that proposed to create a national scheme to govern securities that permitted provinces and territories to opt-in to the system.

The Court considered whether the draft legislation was constitutionally valid by falling within the federal power of general trade and commerce. While the federal government has jurisdiction over trade and commerce that is national in scope, the general trade and commerce power does not extend to centralizing regulation over local economies. Ultimately, the SCC found that the draft federal legislation was unconstitutional and that it extended beyond federal power and regulated all aspects of securities regulation within the province and local markets.

Notwithstanding their decision on the draft legislation being beyond the scope of the authority of the federal government, the SCC did raise a potential path forward to unify regulation. In its 2011 decision, the SCC signalled that national securities regulation legislation could be constitutionally valid based on: 1) federal regulation of national concerns under the federal trade and commerce power, or 2) a cooperative federal and provincial scheme.

Québec Court of Appeal, 2017

In 2015, the Québec government referred the matter of the CCMRS to the Québec Court of Appeal ("QC CA"). In 2017, the QC CA made a finding that the CCMRS was unconstitutional.

In coming to its decision, the QC CA considered the following questions:

1. Does the Constitution of Canada authorize a national securities regulator based on the cooperative system model.
2. Does the draft federal Capital Markets Stability Act exceed the authority of Parliament over the general branch of the trade and commerce power.

The QC CA answered the first question in the negative and found the cooperative system unconstitutional. The QC CA interpreted the CCMRS as requiring the Council of Ministers' consent for provincial amendments and requiring the provinces/territories to implement all amendments dictated by the Council of Ministers. Based on this interpretation, the QC CA concluded that the process for amendments fettered the sovereignty of the participating provinces' and territories' legislative authority, and was an improper delegation of law-making powers.

The QC CA answered the second question in the negative as well as it found that the draft federal legislation did not exceed the trade and commerce power. Although the draft federal legislation was within Parliament's jurisdiction under its trade and commerce power, the QC CA took issue with the provisions regarding federal regulation and held that if the provisions were not removed they would render the entire legislation unconstitutional. The QC CA found that the impugned provisions required that all federal regulations be approved by the Council of Ministers. The Court was troubled by what it perceived as the ability for Canadian provinces and territories to veto federal legislation.

The Attorney General of Canada appealed the decision.[4]

Supreme Court of Canada, 2018

In 2018, the SCC again considered the issue of a national securities regulator and held:

1. The Constitution authorizes the implementation of a single regulator.
2. The draft Capital Markets Stability Act (Canada) does not exceed Parliament's power over trade and commence under s. 91(2) of the Constitution Act, 1867.

In its decision, the SCC found that the CCMRS does not improperly fetter the legislature's sovereignty or the rule respecting authority to delegate law-making powers. The SCC emphasized that the CCMRS does not require that a Canadian jurisdiction implement amendments to the model provincial/territorial act that have been approved by the Council of Ministers, and a Canadian jurisdiction is not precluded from making other

amendments to provincial legislation.[5] Even if the CCMRS purported to limit provincial authority, it would be ineffective as parliamentary sovereignty preserves the provincial legislatures' right to enact, amend, and repeal securities legislation independent of the Council of Ministers.[6]

Further, the CCMRS is not an impermissible delegation of authority as the Council of Ministers has no authority to unilaterally amend the provinces' securities regulation.[7]

With respect to the second issue, the SCC found that the draft Capital Markets Stability Act is validly within the federal trade and commerce power. The federal act is designed to complement the provincial and territorial legislation by addressing national economic objectives.[8] Its purpose is to "promote and protect the stability of Canada's financial system through the management of systemic risk relates to capital markets" and "to protect capital markets, investors and others from financial crimes".[9]

The SCC found that the federal regulation process, which delegates law-making powers to the regulator under the oversight of the Council of Ministers, is not inconsistent with the principle of federalism. Provided that Parliament has constitutional authority to legislate in respect of a subject matter, it also has the authority to delegate and confer its constitutional powers to a statutory body – even where the statutory body depends on provincial input.[10]

The SCC found that the *Capital Markets Stability Act* is distinguishable from the draft legislation that was proposed in 2011. The prior legislation concerned itself with detailed regulation of all aspects of the securities market. Conversely, the *Capital Markets Stability Act* is limited to issues and risk of a systemic nature that are a material threat to the stability of the Canadian financial market.[11] Therefore, the current framework addresses a matter of national importance and relates to trade as a whole, validly within the federal trade and commerce power.

The Political Challenge for Implementation

In order to for CCMRS to be functional, both levels of government (the relevant province or territory and Parliament) must enact enabling legislation. The political involvement that is required for this could create two challenges: The federal government may delay passing the necessary legislation before the next federal election; and current political disputes between key provinces and the federal government could discourage provincial support for a national regulator.

The Standing Orders that govern Parliament establish the legislative process and the number of sitting days where Parliament is able to move legislation through the necessary steps. With less than a year before the next federal election, the Liberal government will prioritize its "legislative calendar" to focus on items that are key to its political success, particularly with respect to the 2015 Liberal platform promises that are still outstanding. It is

also likely that Parliament rises for the summer of 2019 and does not resume sitting until after the election in the fall of 2019, meaning that the time left to pass legislation is extremely limited. Ultimately, a national securities regulator was not a Liberal platform commitment and therefore, is not a major political objective for the current federal government. As a result, the necessary legislation could be delayed until after the next election, possibly as far as the spring of 2020. If the federal government decides it wants to expedite implementation, it can potentially package the legislation for the national regulator in its 2019 Budget Implementation Act as an "omnibus bill". However, the federal government has recently been criticized for using this legislative tactic at the expense of Parliament's right to scrutinize legislation, meaning the government will be hesitant to have its pre-election budget framed as undemocratic.

Provincial support for the national securities regulator will be crucial but the federal Liberal government is currently in open political disputes with many key provinces. The right-leaning provincial governments in Ontario, Saskatchewan and Manitoba are forcefully opposing Prime Minister Trudeau's plan for a carbon tax. The NDP government in British Columbia is challenging the federal government's decision to take ownership of the Kinder Morgan pipeline because many NDP supporters in British Columbia oppose the pipeline. Although the current NDP government under Premier Rachel Notley is in alignment with Justin Trudeau's federal government, the new United Conservative Party of Alberta, lead by former Conservative Cabinet Minister Jason Kenney, is positioning himself against Trudeau's government on a range of issues and is favoured to become Premier in March 2019. The new Québec provincial government, under the populist Coalition Avenir Québec and its Premier Francois Legault, is another uncertainty for participation in a national securities regulator. As noted above, Québec has historically opposed relinquishing authority for capital markets regulation to the federal government. The new government in Québec has not yet established its approach to intergovernmental relations, but how Premier Legault positions himself politically with respect to the federal government will be a key factor whether or not Québec becomes decides to become a voluntary member of CCMRS.

The increasing group of Premiers opposed to key aspects of Trudeau's agenda will put a further strain on all intergovernmental collaboration. Even though a national securities regulator is not a major political issue, these provincial governments will be cautious of the optics of collaborating with a federal government that they are actively opposing for their own political benefit. It remains to be seen whether provincial relations can cool in time for the necessary collaboration to occur for the CCMRS and the CMRA to become functional.

Public Policy Implications for Stakeholders

The stamp of approval for the CCMRS provides the federal government with new oversight of capital markets, expanding its already considerable authority over the broader financial system. While the CMRA will have shared reporting to the member Canadian jurisdictions, it is likely that the Department of Finance will be a key

influencer of the regulator's decisions because federal government will aim to align its regulation of capital markets with its oversight of the financial system through the Office of the Superintendent of Financial Institutions (OSFI).

In May 2018, the Cooperating Jurisdictions, through the CCMRS, released for comment draft exemptions prepared pursuant to the proposed legislation. It will be interesting to see whether CCMRS will gain traction in its further development now that the decision of the SCC has been released.

The original broad policy objectives for establishing a national regulator were to improve domestic regulatory harmonization and to monitor liquidity and systemic financial risk. However, the federal government may also leverage its new role in securities regulation to achieve additional objectives; including positioning Canada to lead on developing international consensus on modernizing securities regulation, which was previously difficult because of Canada's fractured system. As regulators in other jurisdictions determine how to address current challenges in securities regulation, for example how to regulate the use of advanced technology for trading securities, the Canadian federal government will have a more substantive role to play as a thought leader in this area.

Stakeholders of capital markets regulation should monitor the further establishment of the CMRA in order to determine how the regulator's new tools and objectives might impact their business. In particular, interested parties should examine the rule making authority of the CMRA and whether the required shared federal/provincial/territorial oversight introduces the potential for political interference into what is normally an area of financial regulation that is arms-length from the political level. While regulating capital markets has traditionally been divorced from political decision-making, stakeholders can still influence the outcome of regulatory decisions at the political level. The responsible Ministers, in this case the current federal Minister and his provincial and territorial colleagues, will set the legislative parameters for the CMRA and can signal the government's position on a regulatory issues indirectly, which regulators often take into account. Ultimately, the CMRA should provide integrated oversight of capital markets that is in alignment with the federal governments approach to regulating the entire financial system. Still, the tension between provincial/territorial priorities, federal priorities and competing regulators can create a challenging decision making process which stakeholders should proactively position themselves to navigate and influence.

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[1] Drafts have been released for comment. CCMRS, "Legislation": CCMRS, "Regulations".
[2] *Ibid.*
[3] 2011 SCC 66.
[4] The Attorney General of British Columbia appealed the decision on the first issue and the Attorney General

of Québec appealed the decision on the second issue.
[5] 2018 SCC 48 at para. 50.
[6] 2018 SCC 48 at paras. 61 and 67.
[7] 2018 SCC 48 at paras. 78-79.
[8] 2018 SCC 48 at para. 96.
[9] 2018 SCC 48 at para. 97.
[10] 2018 SCC 48 at para. 126.
[11] 2018 SCC 48 at para. 111.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.