# Securities Regulation

# Structure & Process

John Howard
October 1975

# SECURITIES REGULATION - STRUCTURE AND PROCESS

John L. Howard*





*ADM Corporate Affairs, Department of Consumer and Corporate Affairs.
The opinions in this paper are those of the author. They do not reflect the policy of the Government of Canada or the Department of Consumer and Corporate Affairs.

# ABSTRACT
## SECURITIES REGULATION - STRUCTURE AND PROCESS

1. Introduction

The purposes of this paper are generally to review a number of basic assumptions about the Canadian securities market and, more specifically, to explain the concept of economic regulation and its application to securities markets, to analysis alternative regulatory mechanisms, and to propose the means the federal government can employ to regulate the Canadian securities market if it decides that it should regulate that market.

2. Nature of economic regulation

In a contemporary mixed economy there is an inevitable mix of the institutions of both command and market economies to achieve the three basic functions of government: to allocate resources among alternate uses, to adjust the distribution of income and wealth among individuals, and to stabilize the operation of the overall economy to achieve a high level of resource use with a minimum of inflation. To reconcile command institutions - particularly planning - with market institutions, the mixed economies have developed a hybrid institution called economic regulation to constrain the market activities of enterprises by equalizing market power, institutionalizing responsibility within the enterprise, or directing the structure and operation of a particular market through an external agency with power to control entry, conduct and prices in that market.

Regulation through an external agency to plan and direct the structure and operation of a particular industry is applied in two common cases: first, where there is a natural monopoly as in the infrastructure industries - energy, transportation and communications;

second, where the government has artificially created a monopoly or cartel structure with a view to achieving stability or security for specific actors in a market, for example, an agricultural marketing board to protect producers or a securities commission to protect investors, long-term political goals that are consciously given priority over the goal of ideal market efficiency.

3. Economic function of securities markets

The regulation of capital markets to ensure investor security from fraud is a typical example of a government legitimated cartel structure, but the regulation of securities markets has one unique characteristic: much of the regulatory power is delegated to private sector agencies that exercise this power under the surveillance of the securities commissions. Within the overall capital market complex, however, the securities market complex - made up of a stock exchange, clearing house, brokers, transfer agents and depository - is one more financial intermediary. Its distinguishing characteristic is that it permits the investor to participate directly in the ownership and control of enterprises on such conditions that the investor bears directly the risk of loss.

The national accounts of Canada for 1974 disclosed that the capital markets allocated some $2.7 billion out of an approximate total of $27 billion of savings that were employed in the economic system. Although the securities market allocated a relatively small amount of these total savings, the securities market is a valuable institution not only because of the still very large absolute value of the transactions executed in that market but also because of the catalytic effect of an issue of securities, which frequently enables a corporation to obtain credit from other sources simply because it has been closely and objectively scrutinized by underwriters, investment advisors and investors. But perhaps even more important are general public benefits that are extraneous to the goals of the securities market actors: securities markets induce investment in productive enterprise; they empower investors to participate in the ownership and control of firms; and they tend to decrease the need for and so reduce the undesirable effects of extensive foreign direct investment.

4. Development of securities market regulation

Securities market regulation did not develop from preconceived premises but grew out of a number of separate policy initiatives set out in corporation laws and securities laws. Although the rhetoric to justify securities market regulation varies from one jurisdiction to another, depending upon the prevalent political doctrine and economic dogma, there is an implied consensus that a securities market should be cartelized - at least in part - to ensure investor confidence and, as a corollary, should be subjected to close government surveillance, employing techniques analogous to those applied to regulate the public utilities or, in other words, the natural monopolies.

Recent developments in the securities market, particularly the immense growth of the financial intermediaries such as banks, pension funds and mutual funds and the implementation of computer-communications technology, have compelled reconsideration of the cartel-like structure and operations of the market and of the institutions designed to regulate that market. Current proposals - all of which assume a central information system - can be distinguished as three models: (1) a continuation of the present quasi-cartel structure with only service competition, managed by a private sector agency under the close surveillance of a securities commission; (2) a straightforward cartel system with only service competition, regulated as a public utility by a securities commission having full powers over entry, conduct and prices; and (3) management of the central information system by government as a public utility but with no constraints on market entry or prices and only those conduct constraints required to ensure full and fair disclosure and to prohibit fraud with a view to achieving full price and service competition.

5. <u>Regulatory mechanisms</u>

Regulators of capital markets exploit all three regulatory techniques - balancing power to preclude monopoly control, institutionalizing responsibility within firms, and regulating the market through an external agency. The first technique - balancing power - will continue to concern mainly the distribution of capital market functions among competing intermediaries and the reconciliation of securities law with competition law. The second technique - institutionalizing responsibility - will largely concern the reconciliation of securities law on directors and officers of securities market actors. But the emphasis will continue to be placed on the third technique, that is, the regulation of entry, structure, conduct and prices in the securities market through an external government agency or a self-regulatory agency subject to close government surveillance.

Although there is currently a great deal of criticism of the regulatory commission as an institution, it is probable that legislatures, for political reasons, will continue to invoke the regulatory commission, that is, a commission set up outside of the conventional government departments, in order to resolve problems that are too complex to be resolved through ordinary bureaucratic administrators who apply relatively static statutory rules and standards. The general characteristics of and the advantages frequently attributed to the regulatory commission are set out below.

(1) The independent regulatory commission is a mini-government, which is empowered to exercise legislative, judicial and administrative powers with a view to planning the structure and operations of an industry or a market.

(2) As a general rule, to operate effectively, a commission must have a relatively broad delegation of power under its enabling act if it is to be able to regulate imaginatively and effectively. Delegation under broad "public interest" standards is in effect authority to develop and enunciate policy as distinct from applying value-free rules and standards to specific cases. It is in this sense that each regulatory commission is in politics.

(3) For the same reason - the absence of value-free rules and standards - judicial review of the decisions of a regulatory commission is not a satisfactory means to control commission decisions, except to constrain a commission from acting outside the limits of its jurisdiction, acting arbitrarily, or following unfair procedures. A court should adjudge only the legality of a commission's decision, not the correctness of the policy decision made.

(4) Rather than focus on delegation standards or judicial review, therefore, it is more appropriate, particularly in the Canadian context where scant attention is accorded separation of powers mythology, to structure a commission in a way that achieves a workable balance between the commission's relative independence on the one hand and its responsiveness to the executive as well as its responsibility, through a minister, to the legislature on the other.

(5) Assuming regulation is politically necessary, when undertaking to regulate an industry or a market, the legislators and the regulators should be constantly aware that to displace market competition - and particularly price competition - is to bureaucratize the industry or market, that is, to abandon the price mechanism as a means of determining value and measuring performance and to substitute other performance measures. Wherever possible, therefore, regulation should be limited to conduct rules and standards and should only be extended to govern entry and prices - the strategic elements of a competitive market - when no other solution is politically acceptable.

(6) In summary, in addition to the general economic criticism that regulation is a poor substitute for a competitive market, regulation through a regulatory commission is frequently attacked on three fronts. First, the exercise of very broad discretion within the context of a public interest standard may empower a commission to dilute the force or even subvert the original policy of the law, unless the standard is further refined or the agency subjected to continual policy oversight by the executive. Second, again because of the broad discretion exercised by a typical commission, it may act unlawfully, unfairly or arbitrarily unless it is subjected to judicial review. And third, because of its relative independence, a commission may become ineffective or even become a captive of the regulated industry, unless its planning is closely coordinated with the overall plans of the executive to ensure that the commission's goals and priorities are consistent with the government's goals and priorities.

(7) Nevertheless the regulatory commission is widely acknowledged to have a number of specific advantages over the conventional department structures that outweigh its disadvantages.

- It permits flexible and expert administration where bureaucratic administration of rules and standards as interpreted by the courts would not work. A commission can take on a novel and complex task, explore and analyse an industry, apply its expertise to refine very broad statutory policy through adjudication and regulation making, and maintain continuous oversight of the regulated market or industry to determine the effectiveness of that policy.

- It permits the resolution of conflicts among rival interest groups, if not free from politics, at least free from the immediate pressure of short-term, partisan politics, permitting it to avoid expedients and so develop policies that will have considerable continuity. A commission can, particularly when adjudicating a specific case, retain enough independence from the executive to decide the case impartially.

- It presumably can, as a collegiate body, render better judgments and permit broader representation in the regulation making process then can an agency with a single head.

- It enables interested persons better to aim their criticisms and to recommend policy changes to government because the establishment of a commission tends to focus program responsibility. A commission can also serve to balance conflicting interests by considering the interests of groups that are not well represented because the benefits of regulation are widely diffused among the public whereas the costs are concentrated and borne, for example, by a small group of producers.

- It can offer a number of administrative advantages, particularly freedom from the constraint of the bureaucratic rigidities of government personnel and financial management rules and from the requirement of queuing up to receive general services such as legal, data processing and public relations services. A commission can achieve better program performance through term employees or contracts, which also precludes the growth of tenured employees and so facilitates winding-up when a limited program goal has been achieved.

- It permits government to assume a quasi-commercial activity, for example, the administration of a computer-communications system, with less hostility from the business community.

- It facilitates regional representation and also the coordination of programs that cut across the traditional jurisdiction of several departments.

- And finally, it is a versatile institution to coordinate intergovernmental programs, which is an especially important characteristic of a commission in a federal system.

6. <u>Institutions of federal-provincial cooperation</u>

In theory there are three approaches to the development of a system of securities market regulation. The first is a unitary system where the federal government occupies the field and displaces provincial laws. The second is a dual or two-tier system, where the federal parliament and provincial legislatures enact separate laws applying to different subjects or applying different complementary standards to the same subjects. The third is an integrated system that permits Parliament and the legislatures to delegate administrative power to administer separate federal and provincial laws to one regulatory commission.

In view of the historic development of securities regulation in Canada and the realities of provincial powers, only a dual or an integrated system is likely to be adopted in Canada. A dual system, such as that in the United States, has the advantage that it permits coexistence of discrete federal and state systems with a minimum of political conflict. The major disadvantage of a dual system is that it institutionalizes multiple statute systems, making practical administration and compliance with the law both complex and costly. An integrated system has the advantage, in addition to uniform administration, that it will tend over time to the development of uniform laws.

Because of the large number of variables involved, a great many regulatory models can be constructed, depending upon the system of regulation, the system of administration, and the several alternative ways of dividing jurisdiction over securities market functions. Table 4 summarizes the dimensions of each model; Table 5 illustrates a broad spectrum of possible models.

7. Alternative Models - Securities Regulation

Of the several models set out in Table 5, Models 6, 10 and 13 are the models that best reflect the range of alternatives and that probably are most acceptable from a political point of view.

- Model 6 reflects a unitary system in the sense that there would be only one securities law in each province, because the federal government would delegate exclusive powers to each provincial securities commission.

- Model 10 is a dual system, which presupposes separate federal and provincial securities commissions administering separate federal and provincial statutes, paralleling the U.S. system.

- Model 13 is an integrated system, based on the idea of delegation of powers from the federal Parliament and the provincial legislatures to one securities commission. This model does not require uniform laws, but because of the one commission it would tend strongly to the development of such laws and to the development of one disclosure system supported by a common database.

8. Conclusions

Of these three models, Model 13, although it engenders formidable political problems, is technically the most desirable. It continues reasonable provincial autonomy, permitting each province to establish its own substantive standards with respect to market entry and its own additional disclosure requirements. It will, because of the centralized policy making structure, tend strongly to the development of uniform laws and procedures. It also has the advantage that it permits the use of experienced personnel to administer the various laws through completely decentralized administrative offices. And finally, it reconciles central policy making with decentralized administration through a mechanism that, because it contemplates separate federal and provincial laws, is flexible in the sense that it can be responsive to local needs and yet be effective to achieve broad national goals.

## SECURITIES REGULATION - STRUCTURE & PROCESS

### 1. Introduction

In the introduction to its Securities Industry Study the House Subcommittee on Commerce and Finance characterizes the securities market as the "backbone of our economic system".[1] Even if the one discounts this description as the hyperbole of technical experts who tend to see their field of expertise at the centre of the universe, it does reflect a broad consensus among the many vocal critics of the securities industry that the securities market is a cornerstone of a market economy, serving to match the multitude of different liquidity preferences of savers and users of capital and to allocate capital among those enterprises, particularly new enterprises, that can make most profitable use of it.

Notwithstanding the apparent consensus about the essential nature of the securities market, there has been for two generations an almost continuous controversy in the United States, the United Kingdom, Canada and other countries about how the market should be structured, how it should operate, and who should regulate it.[2] Indeed, during the last fifteen years economists and lawyers have relentlessly probed, dissected, analysed and criticized the purposes, functions and performance of the securities market, questioning not

. . . /2

only technical issues such as allocational and operational efficiency but also fundamental issues that had long been accepted as articles of faith, for example, fixed commission rates, private sector control over exchange membership, and confinement of the role of government regulation essentially to the conduct of market actors, particularly the prevention of market manipulation and other fraudulent activities.

The securities industry at first reacted strongly to deny many of the charges laid by its critics, pointing out that even if the securities market does not achieve the economist's conceptual model of a perfect market, it has worked well to allocate capital among business enterprises at relatively low cost. But during the past decade extraneous events overtook the securities industry. Tax laws were changed in a way that rendered high-risk investments less attractive to individual investors. Institutional investors expanded very rapidly, causing many individual investors to abandon the securities markets because they felt they had less information and therefore could not compete with the large intermediaries such as pension funds, mutual funds and trust companies. The institutional investors, seeking cheaper brokerage rates, developed techniques either to avoid fixed commission rates or to trade outside of the formal stock exchange markets. And finally, computer-communications technology developed to the point where it became not only cheaper but obviously essential to automate brokerage office accounting, trading information, clearing, settlement, and, to a limited extent, even trading functions.

These extraneous pressures, particularly the brokerage office management problems in the United States and the increasing balkanization of the securities market into a number of regional and specialized markets, compelled the securities industry itself to re-examine first principles in order to determine whether the securities market should be recharacterized and accordingly whether it should be regulated as an essentially free market, a special kind of cartel, or a closely regulated public utility that will permit the operation of a relatively free market. After years of acrimonious debate the United States Congress decided somewhat ambiguously to adopt the latter policy,[3] that is, a comprehensively regulated but relatively free central market to which all qualified actors will have access to all pertinent information with a view to achieving best execution.

Although it has only been on the fringe of the United States controvery, because the North American capital markets are closely integrated, Canada cannot ignore the

. . . /4

fundamental changes taking place in the United States, some of which - particularly negotiated commission rates and improved information systems - have immediate impact in Canada, as evidenced by the debates about fixed commission rates and computerized trading systems. The purposes of this paper, therefore, are generally to review a number of basic assumptions about the Canadian securities market and, more specifically, to explain the concept of economic regulation and its application to securities markets, to analyse alternative regulatory mechanisms, and to propose the means the federal government can employ to regulate the Canadian securities market if it decides that it should regulate that market.

## 2. Nature of Economic Regulation

In the literature of economics, political science and law there is no concept more nebulous than government regulation, which is invoked to achieve many purposes ranging from authoritarian control to mere persuasion both at the macro- and micro-levels of the economy, which employs many instruments, both direct and indirect, and which, to complicate matters further, is too often seen, analyzed and criticized as a one-dimensional institution, depending upon the professional expertise of the critic. For these reasons it is impossible simply to define "regulation". Instead I shall try to explain briefly the overall context within which the term is used, except those cases in respect of which the term is not appropriate, and so focus on the aspect of the concept of regulation that is the central concern of this paper.

Although an almost infinite variation of themes is possible, if we categorize each in accordance with the coordinating mechanisms it uses to link the activities of all sub-units, there are only three basic economic systems: first, a traditional system where all functions and roles are largely predetermined as in a feudal society; second, a market or, in other words, a price system; and third, a command system based on a planning process.[4] In a traditional feudal system the function of each unit was related to specified lands and the role of each individual actor was largely determined by his social status. The fundamental institution was a tacit or even express agreement between each individual and his superior in the feudal hierarchy that set out the reciprocal obligations of each to the other. The feudal system was stable but essentially static and therefore unable, like the dinosaur, to adapt even to glacial changes in society. Government intervention did exist in the feudal system, particularly in connection with the transfer of titles of nobility, the transfer and use of land, and the prices paid for goods and services, but since even secular change was rare government intervention was infrequent and, because all units were bound tightly together in the system, generally seen as natural and unobtrusive.

In contrast a market system is predicated on the idea of dynamic equilibrium, a system in which each unit is relatively free to decide what, how and when it will produce and consume and to make such decisions with reference to prices that respond generally to the supply and demand for goods and services. How well these conditions are fulfilled depends upon a number of factors - the relative size and power of the different market actors, the free flow of information, and the degree of government intervention, which can include even government ownership if it does not

. . . /7

displace the actual operation of the market as a price setting mechanism.

A command system, although it can be dynamic, deliberately eliminates the market as a price setting mechanism and substitutes, instead, a governmental planning mechanism that determines objectives, priorities, input allocations, input costs, output prices, and ultimate end uses. As a substitute for the price mechanism and the resultant determination of profits to guage the success of an enterprise, the planning authority sets out a number of alternative performance measures. For the invisible hand of the market system the command system substitutes express, detailed controls over each sub-unit in the economy in accordance with an overall economic plan, which may be established centrally by a state agency or through a system of cartels that are coordinated or even directed by a state agency.[5]

There is no such thing as a pure traditional, market or command economy, for each modern economy exploits some of the coordinating techniques that characterize each system in order to carry out the three basic economic functions of government:
(1) to allocate resources among alternative uses;
(2) to adjust the distribution of income and wealth among individuals; and (3) to stabilize the overall

economy with a view to achieving a high level of resource use with a minimum of inflation.[6] The outstanding characteristic of the traditional system is a set of relatively static controls relating to personal status, land use and the fixing of prices of goods and services. The signal characteristic of the command system is a set of quite dynamic controls relating to objectives, input allocations and end uses. The outstanding characteristic of the market system is the allocation of resources in accordance with price bids made by relatively free sub-system units, subject only to a limited number of controls and a broad spectrum of constraints that serve to mitigate blind market forces; to fill in gaps where markets do not work effectively, or to make markets work better.

In sum, both traditional and command economies are essentially distinguished by express, detailed controls, whereas the market economy is distinguished by relatively free decision making by sub-system units in a context where absolute controls are applied only in exceptional cases and where regulatory instruments are employed generally to make markets work better and more equitably. In this paper, therefore, "control" means state power to decide basic resource allocation,

. . . /9

production and consumption issues in a manner that displaces the market as an institution. In contrast, "regulation" includes all of the techniques employed in a market economy to mitigate market forces through transfer payments and stabilization instruments, to restrain market forces through constraints on competition, to reconcile monopoly or cartel activities with an overall market system, particularly in respect of so-called natural monopolies, and to make markets work better by equalizing the respective powers of market actors, institutionalizing responsibility for good market conduct in each actor, or setting up an external agency with power to adjust market structures and operations.[7]

But for the purposes of this analysis even this definition of regulation is too broad, encompassing as it does a very broad range of government activities to manage a market economy, therefore the meaning must be further refined, first by distinguishing between mechanisms used at the macro- as distinct from the micro-level, and second by distinguishing among direct and indirect mechanisms used at the micro-level.

Macro-economics, which deals with national income analysis[8] - aggregate flows such as gross national product, national income, aggregate investment and total consumption as well as analysis of relationships among these aggregates and means to adjust them - involves mainly instruments that have direct impact on aggregate demand, particularly taxes, money supply and credit constraints, and government spending, including spending in the form of transfer payments to equalize imbalances among regions, economic sectors and households. Direct intervention at the macro-level is not pertinent to this paper and therefore will not be considered further.

At the micro-level, where we are concerned with determining how the market or price system allocates and distributes particular goods and services among sub-system units (i.e., the composition of the aggregated national accounts), there exists a broad range of

. . . /11

direct and indirect intervention mechanisms that render the activity of an economic unit more or less profitable and therefore influence both input allocation and output distribution. The techniques of direct intervention at the micro-level include subsidies, tax incentives and disincentives, credit privileges, price supports, supply management, tariffs, foreign exchange controls, import-export restrictions and foreign investment restrictions.[9] Usually these techniques are applied to achieve policy goals that consciously displace or are extraneous to the operation of the market system, therefore they will not be further considered either.[10]

Closely related to these techniques are the methods used by governments to administer public utilities in the infrastructure or natural monopoly sectors, particularly energy, transportation and communications, where a firm is given a specifically circumscribed monopoly licence subject to the conditions that it furnish services to all members of the public on equal terms and that it comply with the policies of the licence-granting authority, policies that are generally determined in accordance with broad public interest, convenience and necessity standards. The state could achieve the same end by directly owning and administering these services, but for ideological reasons it is often more politic to delegate this function to private sector units. In addition, because these utilities operate within the context of at least a proximate market system in which they compete to obtain resources and to sell alternative services, it is frequently possible to apply some extraneous, objective performance measures established by comparison with like units or with the costs of alternative services in order to determine how well the unit performs the economic task assigned to it.[11] This paper does not attempt to analyse or evaluate utility regulation, but since the techniques used to administer utilities apply in part to all forms of market regulation, utility regulation furnishes an abundance of illustrations based on extensive experience and in depth analyses.

What we are concerned with in the securities market context are not micro-level mechanisms that displace market decisions or mechanisms that only constrain market actions but rather indirect micro-level mechanisms that attempt to minimize market inperfections engendered by government policies to protect investors through cartel-like structures. In short, we are concerned not with displacing the market but with making a constrained market work better. The ideal goal is the economist's paradigm of the perfect market in which there are many buyers and sellers, no market actor has enough power to affect prices, all products or services exchanged are homogeneous or interchangeable, all buyers have equal information about all variables, transaction costs are immaterial, all buyers and sellers have freedom of entry and exit, all actors behave rationally, and no government constraints are imposed on the market to achieve extraneous goals.[12] The perfect market, particularly because of the last two conditions, is very much a hypothetical construct, but it furnishes a useful benchmark when evaluating a regulated market system.

The three techniques of indirect regulation - balancing market power, institutionalizing responsibility within market actors, and oversight by an external agency - assume that the market or price system, where it is politically feasible, is the best mechanism to determine the allocation of resources and distribution of goods and services.[13]

The first technique, the balancing of market power, is best illustrated by the competition laws, which prohibit agreements to restrain competition and attempt to block the development of monopoly,[14] and by the industrial relations laws, which confer legitimacy on corporate bodies designated as appropriate bargaining units that have power to bargain effectively on behalf of wage earners with the professional managers of business corporations.[15] The second technique, the institutionalization of responsibility within market actors, is illustrated by the corporation laws[16] and certain labor union laws,[17] both of which attempt to ensure that professional managers and the majority shareholders or members will exercise their powers fairly and in the interests of the corporate body. Other illustrations are, first, the European corporation laws that attempt, through internal supervisory boards on which wage earners are represented, to further solidarity among the wage earners, managers and shareholders within a corporation with a view to reducing industrial disputes, and, second, the various schemes to induce wage earners to become shareholders of the corporation that employs them.[18]

The third technique, the creation of an external private or public sector agency with powers to supervise public utilities or markets such as the securities market are the central concern of this paper, not only because the North American securities markets have been subject to external regulation for a number of years, but also because the external regulatory agency, particularly in a federal context, is the most versatile instrument of regulation. Looking at the myriad agencies that have been set up to regulate infrastructure utilities and markets in various North American jurisdictions, one is at first dazzled by the permutations of purposes, structures and powers of these agencies, but close scrutiny reveals that, although often not too clearly expressed, they have only one goal and a relatively short list of powers. Their goal is to reconcile natural monopoly enterprises or contrived cartel structures with an overall market economy, seeking as far as possible to exploit the respective advantages of planning and market systems.[19] To achieve this goal they exercise policy making, administrative, investigatory, regulation making and adjudicative powers to supervise or constrain the activities of each regulated enterprise. In exercising these powers they tend to concentrate their attention on three market characteristics: first, market entry; second, the structure of the market and the behaviour of the actors in that market; and third, the direct setting of prices or the indirect setting of prices through the management of supply of the goods or services exchanged in that market.[20]

The foregoing discussion concerning alternative economic systems, the functions of government and market regulatory techniques, which are summarized in Table 1, furnishes a background to develop a framework for analysis of the regulatory process that can be applied to analyse the regulation of securities markets. This is not a novel undertaking. In a landmark article published in 1940, Fainsod outlined the concepts of regulation, summarized the basic issues, and recommended that any analysis of the regulatory process should proceed on three levels - analysis of (1) the institutional matrix, (2) the parties in interest concerned with the character of the regulation, and (3) the policy instruments employed.[21] Fainsod particularized the institutional matrix to include technology, economic organization, ideology and law. He defined the parties in interest concerned with the nature of the regulation or, in other words, with the constraints imposed, to include policy makers, investors, managers, employees and consumers. And he described the political instruments invoked to implement a regulatory system to include legislation and regulations, administrative discretion, and judicial review of the substantive law and its application. In short, Fainsod recommends that any analysis of the regulatory process take into account the many dimensions of the issue as seen from the point of view of the economist, the political scientist and the lawyer.

Such an analysis, even if restricted only to the securities industry, is a formidable task, but in view of the current controversy over freely negotiated brokerage commission rates and the rapid development of computer-communications technology this kind of analysis is more important then ever in order to seek answers to questions such as the following. Is there any reason to continue to view the securities industry - particularly the stock exchanges - as a kind of monopoly enterprise that must be treated as a public utility? Can we convert the present utility nature of the enterprise to a free market enterprise by removing fixed commission rates and eliminating barriers to market entry? Or is a central, electronic information and trading system inherently a public utility that cannot be treated as part of a free market system? Are the present constraints on competition - controls over entry, structure, conduct, and rates - essential, or are they required only because the securities industry is artificially structured as a quasi-monopoly? Should an electronic information and trading system be characterized as a pure public utility and controlled accordingly? Does the present system of administrative law applicable to the securities industry, which law is predicated on regulated market assumptions, actually make the securities industry function better or has it become an end in itself to prop up an artificial system? It is impossible to deal

. . . /18

exhaustively with each of these issues in a brief monograph, but it is possible to analyse succinctly the economic functions of the securities market, to examine the techniques of market regulation, to scrutinize the policy assumptions underlying that regulation and to consider alternative means to deal with the securities industry within the analytical framework suggested by Fainsod.

- TABLE 1 -

# OBJECTIVES AND TECHNIQUES OF REGULATION

| Level and nature of regulation | Objective of regulation | Technique of regulation | Selected Illustrations |
|---|---|---|---|
| Macro-level | To stablize the economy with a view to maintaining a high level of production and employment with minimum inflation. | Adjusting aggregate demand through tax, government spending and money supply and credit policies. | Government budget and central bank actions. |
| Micro-level Direct intervention | To influence directly input allocation, production and output distribution. | Subsidies | Shipbuilding |
| | | Tax incentives | Investment credits |
| | | Price supports | Agricultural product marketing cartels |
| | | Tariffs | Textiles |
| | | Foreign exchange controls | Exchange only to acquire capital goods |
| | | Export restrictions | Military technology |
| | | Foreign investment controls | Land ownership prohibitions |
| Indirect intervention | To influence indirectly input allocation, production and output distribution. | Equalizing the respective powers of market actors. | Competition laws and labor relations laws. |
| | | Institutionalizing responsibility for good market conduct in specific actors. | Corporation laws and labor union laws. |
| | | Setting up an external agency with power to adjust market structures and operations through constraints on entry, conduct and prices. | Utilities Canada<br>CRTC<br>CTC<br>NEB<br>Utilities - U.S.<br>ICC<br>FPC<br>FCC<br>CAB<br>Other - Canada<br>RTPC<br>Provincial Securities Commissions<br>Other - U.S.<br>FTC<br>SEC |

## 3. Economic Functions of Securities Markets

Because of the intrinsic difference between a command economy on the one hand and a market economy on the other, it follows that each system will employ altogether different techniques to allocate capital among government, households and business firms. Between these polar extremes there is the contemporary mixed economy such as the Canadian economy, which employs a broad mix of mechanisms to direct or, more frequently, to influence the allocation of capital.

In a command economy all savings, even those generated internally within sub-system units are taken into account and allocated in accordance with the overall economic plan. In contrast, in a mixed economy, government does not attempt to allocate savings among users of capital, but it can invoke several policy instruments to direct or to bring to bear a strong, indirect influence on the allocation process. For example, it may grant direct subsidies or tax concessions to a specific sector with a view to developing that sector generally or in a specific region. It may allocate savings obtained through the tax system or the securities markets directly to government enterprises.[22] It may indirectly allocate capital through government controlled financial intermediaries set up to influence development in certain sectors or regions or to promote small business.[23] It may sponsor the operation of the securities market by furnishing intermediate financing to strategic market actors, particularly underwriters and secondary market makers.[24] It may regulate the securities market on the assumption that it is a kind of natural monopoly, paralleling the controls over entry, conduct and prices that are applied to regulate public utilities. It may, on the other hand, regulate or even operate the securities market on the assumption that it is intrinsically an absolute monopoly.[25] Or it may employ a mix of two or more of these techniques, depending upon the prevailing economic ideology and political environment. There is no one technique that can be characterized as more or less obtrusive than the other, for the technique employed depends on assumptions about whether a market is desirable or even possible and about the prevailing concept of the acceptable role of government.

Before proceeding to determine how the securities market might be regulated it is essential to determine what functions they perform and how they fit into the overall capital market structure and to consider whether they are important enough to justify costly, detailed government surveillance. In conceptual terms, securities markets make available formal trading centres, establish guides to the value of securities, and furnish a mechanism to enhance the liquidity of government and corporate securities in the sense that they permit an investor to exchange his securities for money at low cost with a minimum reduction of market price engendered by the transaction. Indeed, it is this latter function that is the principal reason for having a securities market, that is, to bridge the manifold liquidity preferences of savers and the requirements of governments and enterprises for long-term capital. In more concrete terms, the functions of the securities markets can best be expressed by reference to five general categories of market outputs:[26]

| | Function | Description |
|---|---|---|
| (1) | Non-discretionary exchange services. | Matching buyers and sellers, clearing and settling securities ownership and cash claims. |
| (2) | Liquidity services. | Assumption of risk by an intermediary acting as an underwriter or secondary market maker both to spread the risk of loss and to satisfy immediate liquidity preferences. |
| (3) | Information services. | Disclosure of information about each market actor and about market trades that can affect price decisions. |
| (4) | Administrative services. | Investment advice, portfolio management, and record keeping. |
| (5) | Corporate finance services. | Advice to and distribution services for issuers of securities. |

. . . /22

In short, the general function of the securities market complex - which includes underwriters, stock exchanges, clearing houses, transfer agents, investment advisors, securities depositories, and, at least peripherally, the accounting profession - is to act as one more financial intermediary in the overall capital market. It is not surprising, therefore, that analogous techniques are employed to regulate the securities market and other financial intermediaries, particularly utility type controls over market entry, conduct and prices, which vary from one jurisdiction to another depending upon prevailing attitudes about the desirability of outright competition - as distinct from mere service competition - among financial intermediaries. Refracted through an analytical prism, the broad spectrum of financial intermediaries can be divided into a number of quite discrete institutions, the distinguishing characteristic of each being the degree of risk of loss borne by the owner of savings channelled through the particular intermediary. Table 2 attempts to illustrate briefly this salient characteristic of each intermediary, setting out in the columns the kinds of intermediaries in order of increasing investor risk from left to right, and setting out in the rows the kind of financial instrument employed, again in order of increasing investor risk from top to bottom.

TABLE 2

. . . /23

TABLE 2
FINANCIAL INTERMEDIARIES - DIRECT INVESTOR RISK

| Financial Instrument Employed | Financial Intermediaries | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Commercial Bank | Savings Bank | Trust Company | Insurance Company | Loan Company | Investment Company (closed-end) | Mutual Fund (open-end) | Securities Market |
| Demand deposit contract | X | | | | | | | |
| Term deposit contract | X | X | X | | | | | |
| Life insurance policy | | | | X | | | | |
| Annuity contract | | | | X | | | | |
| Variable life insurance policy | | | | X | | | | |
| Variable annuity contract | | | | X | | | | |
| Trust agreement (pension fund, etc.) | | | X | | | | | |
| Variable share of mortgage portfolio | | | | | X | | | |
| Variable share of securities portfolio | | | | | | X | X | |
| Securities trading contract | | | | | | | | X |

Table 2, because it cannot set out all the variables that relate to each intermediary, only reflects generally the trend of investor exposure to increased risk of loss. For example, at the one extreme, the first risk of any loss is borne directly by bank shareholders and not depositors; but even this security is reinforced by minimum net capital rules and deposit insurance. At the other extreme, the securities market complex, where the investor bears directly all risk of loss connected with the security, the investor who leaves cash or securities in the custody of a broker is further protected from loss caused by the insolvency of a broker - whether caused by mismanagement or fraud - by minimum net capital rules and a form of deposit insurance. In between these polar extremes there are a number of variations that relate to the instrument employed and the regulatory safeguards used to support payment by a defaulting intermediary. In any event, however, it is clear that the investor faces the greatest risk of loss when he purchases securities for his own account in the securities market, partly because he does not have the benefit of professional portfolio management, but more importantly because he cannot, as an individual, spread his risk of loss over a broadly diversified portfolio of loans or securities as can the manager of a bank, trust company, insurance company, investment company, mutual fund or pooled account.

If the amount of savings invested through the securities markets were inconsequential, extensive regulation probably would not be justified merely because of the investors exposure to risk, for although the importance of the securities market is frequently overstated by its proponents, who tend to characterize it as the hub of all business activity, it is clear that it is not overwhelmingly significant to the overall capital market of Canada. To place its role in general perspective Table 3 sets out the sources and uses of gross savings in Canada in 1974.[27]

For the purposes of this analysis, the ideal graphic presentation would show the sources of funds, the intermediaries through which they flow and the ultimate uses. Unfortunately, however, the data available tend to ignore the intermediation function and focus on sources and uses, thus only implying the financial intermediary that linked the saving institution and the user of funds. Although at best a rough estimate, after excluding government securities, Table 3 indicates that approximately only $2.7 billion of some $27 billion of funds used by the private sector in 1974 flowed through the securities markets.[28] While a relatively small percentage of the total, this $2.7 billion is still an enormous absolute amount that

. . . /24A

TABLE 3
SOURCES AND USES OF FUNDS*
CANADA, 1974

| | | | Millions |
|---|---|---|---|
| **Sources of funds** | | | |
| Contracteral savings (pension plans, insurance) | | | $ 5,682 |
| Non-bank savings institutions (credit unions, etc.) | | | 4,446 |
| Non-bank financial institutions (mutual funds, loan companies) | | | 2,356 |
| Non-financial business corporations (retained earnings) | | | 5,390 |
| Chartered banks (bank deposits) | | | 12,311 |
| Government | | | 5,320 |
| Adjustment for error | | | -415 |
| Total sources of funds | | | $35,095 |
| **Uses of funds** | | | |
| Mortgages | | | $ 7,528 |
| Corporate bonds | | $1,988 | |
| Corporate shares | | | |
| Preferred | $500 | | |
| Common | 202 | 702 | 2,690 |
| Government bonds | | | |
| Federal | | $3,234 | |
| Provincial | | 3,819 | |
| Municipal | | 739 | 7,792 |
| Government of Canada treasury bills | | | 940 |
| Short-term instruments (money market) | | | 2,145** |
| Bank loans | | | 3,625** |
| Other loans (private placements, etc.) | | | 2,303** |
| Trade accounts receivable | | | 5,828 |
| Consumer loans | | | 2,766 |
| Foreign securities | | | -12 |
| Adjustment for error | | | -510 |
| | | | $35,095 |

* Table 3 is a composite of data extracted from four sources: (1) Bank of Canada Review (April 1975); (2) Statistics Canada, System of National Accounts (Fourth Qu. 1974); (3) Statistics Canada, Canadian Statistical Review (April 1975); (4) Sun Life Ass. Co. of Canada, Canadian Capital Markets, 1975 Outlook (13 June 1975).

Because of different data definitions in each data set it is not possible to reconcile all data elements.

** Excludes individuals and unincorporated business.

is of special significance for two reasons. First, it probably tends to be used more to extend the production capacity of Canadian enterprises rather than to increase inventories or to permit greater sales on credit. And second, because of the complete objectivity of allocation by the securities market, any funds raised through that market - particularly where a corporation issues shares - tend to have a catalytic effect, qualifying the user to receive funds from other sources simply because its overall business prospects and management have been so closely scrutinized by underwriters, investment advisors and securities purchasers.

. . . /25

But to look only at the risk of investor exposure to loss and the aggregate amount of trading in corporate securities traded is to ignore what are probably - even if unquantifiable - still more important aspects of the issue, that is, the extraneous goals that are achieved by a properly functioning securities market. For example, in addition to allocating capital on a competitive basis, it permits individuals and institutions to participate in the ownership and control of business enterprises; it encourages the investment of savings in equity securities issued by productive enterprises as distinct from investments in passive assets such as land and gold; it furnishes a means to encourage Canadian ownership of domestic enterprise and so reduces our obligations to pay dividends and to repay capital to foreigners and also reduces the upward pressure on our exchange rates that is a corollary of large capital inflows; it furnishes a means to attract foreign portfolio investment instead of foreign direct investment, thus contributing further to Canadian control of domestic enterprise; and, as a result of these factors, it assures that the Canadian government can control more effectively the domestic economy. In summary, because of the exposure of the investor to risk of loss, the very large, absolute dollar amount of securities trading and the extraneous goals reached through a securities market, there is no doubt that the securities market is important to Canada as a whole and, if that market is not performing satisfactorily, that considerable government intervention is justified. But the appropriate form of intervention can only be determined by analysis of the kind of market that now exists or can be foreseen and the regulatory mechanisms available.

## 4. Development of Securities Market Regulation

Reading through the foregoing explanation of the nature of regulation, a contemporary securities regulator, unlike Molière's bourgeois gentleman, would not be too surprised to learn that he had been speaking prose for a long time, acting as an objective, external agent to impose constraints on market entry, conduct and prices with a view to making the securities market more stable, more efficient and more equitable. Like most legal institutions, however, the present securities laws did not develop deductively from preconceived, clearly understood principles but rather grew out of a consolidation of a number of separate policy initiatives designed over some three centuries to resolve specific problems.

During the seventeenth century, at the same time as the closed guilds of the feudal period were being forced to yield to a market system, more and ever larger trading corporations with transferable shares were being set up, particularly to take part in foreign trading ventures. Until the end of the century the constraints set out in the corporate charters constituted a sufficient safeguard for investors and creditors, but as the volume of share trading grew fraud became more frequent, causing the English Parliament to enact the first law to regulate the activities of stockbrokers in 1698.[29] After the passage of the Bubble Act in 1720, which was intended to curb the fraudulent promotion of speculative enterprises, until 1844, when the Joint Stock Companies Act 1844 became law, few corporations were created, although substantial trading in the shares of existing corporations did continue. The latter Act of 1844 established the foundation of modern English company law: it distinguished between partnerships and companies by introducing a companies registration system; it enabled incorporation by registration under the general law; and it required full disclosure of the company's constitution and any prospectus issued by promoters. But it did not grant limited liability, a policy that was not adopted until 1855.[30] Subsequently, the Directors Liability Act 1890 made it clear that a director was liable for mis-statements negligently set out in a prospectus, and the Companies Act 1900 introduced the modern concept of broad prospectus disclosure,[31] completing the basic policy framework of English corporations and securities law as it remains to this day. In sum, the policy expressed by the statutes and implied by the leading cases[32] was as far as possible to institutionalize responsibility in the promoters, directors and the company itself rather than to regulate the market activities of issuers, underwriters and brokers through an external government agency, the latter function having been left to the discretion of self-regulatory bodies such as the stock exchanges and the City Working Party, which drafted and enforces the City Code on Take-Overs and Mergers through the City Panel. Whether the present English system, which is administered at four levels - the courts applying the laws concerning fraud, the Department of Trade through the companies and broker registration laws, the Council of the Stock Exchange and the City Panel - should be supplanted by some form of regulatory commission is currently being considered by the United Kingdom government. Predictably, the topic generates a great deal of heated discussion.[33]

In contrast, throughout North America, apparently because markets were more open to newcomers and securities promotions more commonplace, state and provincial governments from the beginning of this century impliedly characterized the securities market as a kind of public utility and accordingly regulated it in each jurisdiction through an external state agency. Beginning with Kansas in 1911 and Manitoba in 1912, nearly all the states and all of the Canadian provinces have adopted quite comprehensive securities regulation laws, which tend generally to apply three techniques - licensing market participants such as investment advisors, brokers and salesmen, licensing specified issues of securities, and stipulating strict anti-fraud rules.[34] In economic terms these early securities acts regulated the market entry of corporate issuers and market actors and imposed stricter conduct rules with respect to primary distributions of securities. In most cases there was no direct regulation of prices charged by market actors for the services they rendered in connection with primary distributions, although some corporation laws and some securities commissions did set limits on the charges of promoters and underwriters. The salient characteristic of these state and provincial securities laws, commonly called "blue sky" laws, was the broad delegation of discretionary power to the pertinent securities commission to license salesmen and other actors and to determine what constituted full prospectus disclosure or, in other words, to determine when a prospectus was free of any fraudulent misrepresentation, whether made by way of omission or commission, and even to refuse to qualify a prospectus where, in the opinion of the commission, the proposed business is not a viable enterprise. Since 1911 both the scope and application of the state and provincial securities laws has varied considerably: for example, in most jurisdictions the scope of the laws has been extended by broadening the definition of "securities" to encompass almost any kind of scheme to raise money from the public, and, in Canada, the provincial securities laws have been extended to apply to secondary trading activity through the stock exchanges and even to certain intermediaries, particularly mutual funds.

In each case the securities laws were pragmatically adapted or expanded to resolve specific problems with a minimum of conceptual soul searching about the nature and purposes of economic regulation, the best means to regulate securities marekts, or the acceptable role of a government agency as a regulator. Thus at the state and provincial levels in North America the legislatures tacitly cast the securities commissions as public utility regulators with broad discretionary power to regulate market entry, conduct and even prices for services in respect of primary security distributions, applying broad public interest standards. In Canada these broad discretionary powers were extended with little controversy to apply to the secondary markets, particularly the stock exchanges, giving the securities commissions power to regulate all actors in the securities market complex as one integrated financial intermediary. Securities law did not develop so smoothly at the federal level in the United States, however, partly because of preconceptions that the securities market was indeed a market and not a kind of natural monopoly requiring utility-type control, partly because at the time it was introduced - 1933 and 1934 - there was considerable political ferment about the desirability of any markets, and partly because of an innate suspicion of any grant of broad discretionary powers to an independent regulatory agency.

Indeed, so strong was the feeling, notwithstanding the powers exercised by the stock exchanges, that the securities industry did operate in a market context, there was relatively little debate about regulating the securities market as a kind of public utility through a commission in accordance with broad public interest standards. Instead the final debate centered on whether the securities bill - which would apply only to primary distributions - should contain only anti-fraud rules or both anti-fraud rules and comprehensive prospectus disclosure rules as did the English Companies Act of 1929.[35] The Securities Act of 1933 as finally enacted by Congress did contain both anti-fraud and disclosure rules, adopting expressly the English model, particularly the prospectus disclosure rules and the anti-fraud rules that were buttressed by stiff civil sanctions. The disclosure rules did not make promoters, directors, officers and experts insurers of prospectus statements but did impose a positive standard of care - due diligence - on those persons, making them personally liable where they negligently permitted a false statement to be published in a prospectus.[36] Thus with respect to primary distributions the emphasis of the United States federal law, in contrast to state "blue sky" laws, was on full and fair disclosure, that is, the imposition of responsibility on an issuer and its principals, and not external government regulation based on broad public interest standards. In theory, therefore, any person could have free access to the securities market for any purpose, subject only to compliance with the disclosure rules.[37] After its passage, administration of the Securities Act of 1933 was assigned to the Federal Trade Commission while Congress considered how it should deal with the regulation of secondary trading in securities through the stock exchanges and the over-the-counter market.

Concurrently with its consideration of the securities market, the President and Congress were wrestling with the overall economic problems engendered by the great depression, particularly the implementation of the National Industrial Recovery Act ("NIRA"), which had become law on 16 June 1933, and which, had its full potential been realized, would have structured each sector of the economy into a cartel that would operate under government supervision, in effect substituting a command system for the market economy. Under NIRA each sector was required to develop a plan called a "code", which would include production and price controls and set out clear labour standards for the protection of employees. Each code was then submitted to the responsible agency, the National Recovery Administration and, if accepted, became the law applicable to that sector, thus displacing the competition or anti-trust laws that would otherwise be applicable to impugn such agreements as being in restraint of trade.[38] One of the early codes accepted under the NIRA was the code of fair competition for investment bankers that was approved in November 1933, encompassing the activities of underwriters, brokers and dealers.[39] Although that specific code was abrogated when the Supreme Court held the NIRA to be unconstitutional,[40] its basic concept of regulating the securities industry as a kind of cartel subject to the scrutiny of a government regulatory agency proved to be a tenacious idea.

These policies were not yet crystallized when the Securities Exchange Act of 1934 was enacted to expand the scope of regulation to include secondary trading and to create the Securities Exchange Commission as the agency to administer both the Securities Act and the Securities Exchange Act. The Securities Exchange Act, although somewhat ambiguously, did tacitly adopt a philosophy of cooperative regulation, that is, stock exchange control - or in other words, cartel control - over market entry, conduct and prices, subject to a number of express statutory conduct rules and subject to general SEC surveillance. This policy was later expressly adopted in the Maloney Act of 1938, which was clearly based on the earlier NRA Code, and which added section 15A to the Securities Exchange Act of 1934 to legitimate the cartel-like activities of national securities associations registered under the Act, giving them an even clearer cartel status than that enjoyed by the exchanges, particularly the power to discriminate against non-members without running afoul of the anti-trust laws.[41]

As a result of these developments, the policies underlying securities regulation in the United States became both obscure and complex. The federal law impliedly denied the existence of a natural or government legitimated monopoly that required utility type regulation and expressed a policy based on disclosure and self-regulation under vague SEC surveillance. But it did not displace the broadly discretionary state laws and so required compliance at all times with both federal law and the state "blue sky" laws. Moreover, the federal law expressly legitimated the fixing of brokerage commission rates and specific trade discrimination rules, which require certain transactions to be executed on the exchange and preclude an exchange member from seeking better execution elsewhere until he has determined that the transaction cannot be executed on the exchange of which he is a member. But it did not clearly give the stock exchanges immunity from the application of the anti-trust laws and so left open a major area of conflict between the securities laws and the anti-trust laws.[42] Thus from a policy point of view the federal securities laws of the United States reflect an inherent ambivalence: on the one hand they promote competitive markets by forcing broad disclosure and barring misrepresentation, market manipulation and other kinds of fraud; on the other hand they attempt to shield the actors in the securities market - albeit ambiguously - from the rigours of the competition laws with a view to strengthening securities market actors and thus increasing investor protection. It is because the SEC,[43] the Anti-trust Division of the Department of Justice,[44] the Department of the Treasury[45] and a number of private sector critics[46] tried to force a clear resolution of these issues that the proposed Securities Reform Act of 1975 elicited so much sharp controversy, particularly with respect to market entry controls, the fixing of commission rates and the trade discrimination rules, the three strategic cartel powers of the exchanges and the NASD. In the final

. . . /36

compromise among the parties in interest the stock exchanges may still require members to pay for exchange seats, the present ban on fixed commission rates is continued but may be lifted at any time by the SEC, and the present NYSE Rule 394, which requires an exchange member to try to execute a transaction on the NYSE before executing elsewhere, will continue in force.[47] In short, although these was broad agreement on the central objective of the bill - to permit a restructuring of the securities market - there is still no clear resolution of the basic problem, that is, whether the SEC is to continue to pretend that the securities industry operates within a market context and so requires only limited tinkering to remove market imperfections, or whether the SEC should consider the securities industry as a special case of monopoly, which, if not a natural monopoly, is an essential, government legitimated monopoly required to give investor protection clear priority over free market efficiency, and so regulate it like any other financial intermediary or even as public utility.

Fortunately, in Canada, we have been spared much of this conflict, not because of any superior wisdom but because the provinces tended from the outset to follow the U.S. state models, which presuppose that the securities industry is a kind of public utility and therefore that an external government regulatory body should have power to regulate market entry, conduct and commission rates,[48] subject to full consideration of industry views and subject to judicial review of the administrative process. That is not to suggest, however, that all problems have been resolved in Canada. Indeed, it is clear they have not, first because we have not yet confronted the fundamental problem of developing a central market system, which will require considerable rethinking about the competitive issues, and second because, unless we insulate the Canadian securities market from foreign influences, we must enable it to adapt to major institutional changes in the United States market, particularly fully competitive commission rates and freer access to the proposed central market. It follows therefore that there are two basic policy alternatives available to Canada. The first is to build up protective walls around the Canadian industry and permit it to develop independently of outside influences. The second and obviously preferable strategy is to attempt to coordinate industry and regulatory efforts in Canada with a view to developing a Canada-wide market that does not have to be sheltered from international competition and that will serve to attract and allocate both Canadian and foreign capital.

Irrespective of the strategy adopted to regulate Canadian securities markets, there is broad consensus about the ultimate objective: a securities market that operates fairly and efficiently. It must be fair in the sense that returns are reasonably related to risks, that the actors in the market have unquestioned financial stability and integrity, and that the individual investor is not placed at a disadvantage with respect to the institutional investor. It must be efficient in the sense that the prices of securities respond rapidly to new information, and that the trading, clearing, settlement and ownership transfer functions are effected quickly and at low cost.[50] In other words the goals are to instil confidence in the securities market in order to induce greater saving or at least greater investment of existing savings in long-term securities, to enable Canadians to acquire more securities issued by Canadian corporations, and to generate sufficient market activity so that an investor can realize his investment at its fair value at any time.

The first strategy - building protective walls around the Canadian industry to shelter it from outside influences - is, from a market economists point of view, to compound a felony, building up further entry barriers around a market that is already structured in part along cartel lines.[51] Nevertheless a number of recent Canadian reports have argued forcefully that Canada must maintain considerable governmental control over the securities market complex as well as over other financial intermediaries in order to retain political control over the domestic economy, even if that requires forgoing the stimulus of greater competition from foreign firms.[52] But even if some such constraints are essential, we should be aware of their heretical character and therefore should seek other alternatives where feasible.

The second strategy - fostering development of a Canada-wide market - implies dealing effectively with a number of topical background issues that have been forced to the front of the stage by fundamental changes in the political and technological environment, changes that require a rewrite of much of the original play by amending the plot and recasting certain roles. Indeed, the rapid acceleration of change since 1960 has compelled all jurisdictions to reconsider not only the ends and means of securities regulation but also the more basic issue whether governmental regulation is required at all. At the one pole proponents argue that the present cartel nature of the securities industry should be further fortified against competitive influences, subject to detailed government regulation.[53] At the other pole the market oriented critics argue that cartel control, to the extent it is required at all, should relate only to the central information and operational system and not at all to central market entry or commission rates.[54] The fundamental changes that gave rise to this sharp debate are both structural and technological.

The structural changes that are taking place in the securities market can be attributed to several causes: the growing complexity of financial instruments and the resulting consumer desire for comprehensive service from one firm; the rapid growth of the securities holdings of institutions such as pension funds and mutual funds that had sufficient market power to circumvent the formal market and so avoid paying the fixed brokerage commission rates;[55] the need of brokerage firms to have access to outside capital, particularly in an environment of negotiable commission rates; the doubt about the securities market as a fair means to furnish capital for highly speculative resource undertakings; the balkanization of the Canadian market by provincial regulatory policy; and finally the desire to achieve as much Canadian control as possible over brokerage firms.

The strong demand of consumers for financial department stores that offer comprehensive services has compelled financial intermediaries of all kinds to extend the services they offer, with the result that the functional distinctions among intermediaries are tending to appear arbitrary and artificial. Currently, in Canada, banks are moving into the fields of underwriting and management of trusteed plans such as the registered home ownership plans. Trust companies are offering demand deposit services. Brokers are selling mutual fund shares, managing pooled accounts and even selling insurance. Insurance companies are selling variable life insurance and variable annuities. And one department store - Eaton's - offers a wide range of financial services, from money management to liability insurance. As a result a great deal of service competition exists among intermediaries in the

. . . /42

Canadian capital markets, giving the individual investor greater choice but also luring him away from direct securities trading, which is now dominated by the institutional traders.[56]

The growing size and power of these intermediaries enabled them to seek means to circumvent the formal securities markets - or at least the exchange rules - and so obtain brokers' services at less than the fixed commission rates. To this end a large intermediary would compel a broker to give-up part of his commission to other brokers who furnished services to the intermediary or to furnish research and other ancillary services free of charge. Alternatively the intermediary would acquire membership on an exchange with a view to executing its own trades.[57] And if these tactics didn't work the intermediary could execute its transactions through the third market (over-the-counter market for listed securities) or the fourth market (direct trades among intermediaries) and so circumvent the stock exchanges altogether.[58] The result was a partial balkanization of the securities market into a number of specialized markets that could serve the intermediaries at lower cost.

This pressure on commission rates - particularly in the United States now that rates are fully negotiable - and progressive tax rates have reduced the amount of capital that brokerage firms can generate internally, compelling firms to seek outside capital, that is, capital from persons who are not active principals of the firm, thus departing from the original concept of reliance on the individual member of a brokerage firm for the financial security of the firm and its customers. Although the standards vary from one jurisdiction to another,[59] certain brokerage firms are now entitled to incorporate and, at least in the United States, even to distribute securities to the public, substituting a large capital base for the personal wealth of the firm's principals. There is, as yet, no uniform policy in the Canadian provinces with respect to this issue. Even less uniform are the policies concerning the entry of foreign owned firms into Canada, although the trend is clearly to require dominant Canadian control of all financial intermediaries.[60]

Far more serious then policy conflicts about the capitalization or degree of foreign ownership of brokerage firms is the recent tendency of provincial jurisdictions to impose rules on brokers that preclude brokers from seeking better execution on a market outside Canada, in effect building up barriers to an international market to insulate Canadian brokers from the impact of competition rates in the United States.[61] Moreover, recent Ontario and Quebec reports have recommended that certain trades initiated in a province must be executed through registrants licensed as brokers in that province, policies that would constrain not only international trading but also interprovincial trading,[62] adding a further barrier to service competition in the Canadian securities market.

A final illustration of an externally imposed structural issue is the current consideration by the provincial securities commissions of new issues of securities by speculative resource enterprises.[63] Since nearly all successful resource exploration and development in Canada is now carried on by large corporations, the commissions are questioning whether the shares of small, speculative resource firms are an appropriate investment for the small investor who must bear directly the risk of loss. And can any amount of disclosure and regulation of promoters' profits adequately protect the small investor in such cases? In short, ignoring the usual market rhetoric, is the securities market fulfilling a useful function in allocating capital to such undertakings when we know that very little of the capital is actually spent on exploration and development and, even if it is so spent, that the likelihood of establishing a new resource enterprise is very small?[64] To examine this issue is to question long established dogma, but given the rapidly increasing demands for capital it is clear that no economy can afford to dissipate its savings on highly improbable ventures or even less to legitimate a market institution that exposes individuals to demonstrably unreasonable risk. If it is more efficient to develop resources through very large private or even public sector firms because the structure of the resource industry has changed, then the securities industry must adapt accordingly to such change.

Concurrently with attempting to adapt to these structural changes, the securities industry is being compelled to adapt to the new computer-communications technology that in turn can require further structural changes, particularly because it enables creation of a single electronic market where all material information can be relayed contremporaneously to all actors. Beginning with the rapid capture, processing and dissemination of trading data, the electronic system is logically and inevitably expanding to encompass also the clearing and settlement functions, brokerage office accounting, and even ownership transfer through securities depositories. Although still only in the development stage, the ultimate electronic system is possible and, within several years, is even probable; that is, the execution of securities trades through remote, direct access terminals and the immediate capture of the trading data to generate market reports, to clear and settle inter-broker claims and to transfer ownership, thus eliminating the need for specialized markets, formal stock exchanges, market makers, clearing houses, transfer agents and even depositories, which will be redundant when electronic records instead of security certificates are relied on as proof of ownership.[65] The logical complement of this automated trading system is the integration of trading data with current data about issuers that is disclosed on a continuous basis, which will permit continuous disclosing corporations to enter the securities market at any time to increase or decrease their capital requirements, and which will, as a corollary, free such corporations from reliance on the present underwriting system with its emphasis on snapshot disclosure and immediate distribution through a large network of wholesalers and distributors.

Although the structural issues such as the growth of financial intermediaries and the concentration of the resource exploration and development industry has forced sweeping changes in the securities market, the market as presently constituted probably can adapt to these changes without serious trauma. But the new computer-communications technology is change of an altogether different order, a Copernican turn that compels reconsideration not only of all facets of securities market structure and operations but also of the nature, means and required degree of securities market regulation, for to the extent computerized systems coupled with continuous disclosure obviate the use of present primary and secondary market institutions they also render redundant many if not most of the regulatory techniques directed at limiting or removing the perceived imperfections of those market institutions.

Although there is a broad consensus about the inevitable development of a unique, nation-wide - and even international - securities market,[66] the computer-communications issue has brought into sharp focus the central regulatory issue: who will control entry, trading conduct and prices with respect to the system? Although this problem has existed since the inception of regulation, as long as there existed considerable service and even price competition among regional exchanges and specialized securities markets it caused little concern. In a unique central market, however, power to determine rights of market entry and prices becomes almost an absolute power over the securities industry, since it is unlikely that any alternative to central market membership will be feasible. A number of mechanisms have been proposed to exercise this power, and although many variations are possible the mechanisms can best be categorized with reference to three basic models.

The first model, advocated by Martin,[67] is essentially a private sector cartel that would regulate entry, conduct and prices, subject to indirect public regulation through public representatives on the board of directors governing the central market and comprehensive securities commission surveillance. Logically, the securities industry would be immune from the competition laws to the extent it was subject to external securities commission control. And since the commission control, although not clearly expressed in the Martin Report, would in theory be unlimited, the industry would be almost completely immune from the strictures of the competition laws.

The second model, proposed by Weil,[68] would continue a cartel structure but would give an external government agency rather than a private sector agency power to create a central electronic market and to regulate prices in and presumably entry into that market. Weil defines the central problem as the concentration of savings in a small number of institutions who trade through a small number of brokers, displacing both the small investor and the small retail broker to such an extent that the traditional auction market has largely disappeared. To resolve this problem he would empower the regulating agency to control, in addition to prices and entry, the activities of financial institutions with a view to maximizing service competition (as distinct from price competition) among the largest practicable number of individual and institutional investors on the one hand and the largest possible number of retail brokerage firms on the other. The effect would be to reverse the trend toward a dealer market and back to an atomized auction market dominated by brokers, where securities prices are determined principally by the supply of and demand for securities in the market.[69]

The third model, proposed by Stone,[70] would eliminate all the cartel characteristics of the securities industry by charging the securities commission to set up and administer an electronic market system, which would be open to all qualified persons upon payment of a rateable fee to cover operating costs, and by abolishing any fixed brokerage commission rates. Stone would also repeal most of the current regulatory rules relating to primary distributions by continuous disclosing corporations and relating to secondary trading, most of which - particularly prospectus qualification and market making - are responses to current market imperfections that inhere in any market regulated as a cartel

. . . /50

system. In brief, he would, like Weil, acknowledge that the central electronic market is a natural monopoly that must be operated by government or under close government surveillance; but in contrast to Weil he would abolish any artificial constraints on market entry or brokerage rates, leaving it to market forces to determine how many firms should survive[71] and what prices would be charged.

All three of the foregoing models are predicated on the assumption that an external government agency must control, directly or indirectly, the structure and operation of any central electronic market, which is by definition an unqualified monopoly. Although difficult to forecast, it is probable that the model of the future Canadian central market will be a composite of the Weil and Stone models, largely eliminating articial barriers to entry and fixed prices and thereby fostering greater competition.[72] This change in the structure and operation of the market will require a corresponding change of the philosophy and techniques of market regulation. Reflecting a truism of systems analysis that you can never change just one element of a system, the regulatory philosophy must expand from a narrow focus on specific entry, price and conduct rules to include not only an overview of the system and its function within the overall capital markets but also the design and implementation of alternative systems that render much of the traditional approach to securities regulation - entry constraints on actors, fixed rates, and anti-fraud rules - largely irrelevant.[73] As in the United States, the probable system will evolve from a Canada-wide trading disclosure system coupled with continuous disclosure by large corporations to the ultimate system of automated trading and automatic capture of the data required for clearing, settlement and ownership transfer purposes. If so, then the strategy of regulation will swing away from cartel management to continuous surveillance of the conduct of actors in the system with a view to minimizing market manipulation. In this context any conflict between self-regulation and government regulation becomes minor since both the market actors and the regulators have a common interest in identifying and disciplining any actor who attempts to beat the system and so bring discredit on the entire industry.[74] In sum, the securities industry of the near future will be far less a regulated cartel and more a free market and therefore should require less but much more sophisticated government surveillance.[75]

## Summary

Keeping in mind Fainsod's admonition that any analysis of the regulatory process should encompass the institutional matrix, the parties in interest concerned with the regulation and the policy instruments employed, I shall summarize briefly the concepts already outlined before proceeding to consider the specific mechanisms that might be employed to regulate the securities market.

(1) In a contemporary mixed economy there is an inevitable mix of the institutions of both command and market economies to achieve the three basic functions of government: to allocate resources among alternate uses, to adjust the distribution of income and wealth among individuals, and to stabilize the operation of the overall economy to achieve a high level of resource use with a minimum of inflation. To reconcile command institutions - particularly planning - with market institutions, the mixed economies have developed a hybrid institution called economic regulation to constrain the market activities of enterprises by equalizing market power, institutionalizing responsibility within the enterprise, or directing the structure and operation of a particular market through an external agency with power to control entry, conduct and prices in that market.

(2) Regulation through an external agency to plan and direct the structure and operation of a particular industry is applied in two common cases: first, where there is a natural monopoly as in the infrastructure industries - energy, transportation and communications; second, where the government has artificially created a monopoly or cartel structure with a view to achieving stability or security for specific actors in a market, for example, agricultural marketing boards to protect producers and securities commission to protect investors, long-term political goals that are consciously given priority over the goal of ideal market efficiency.[76]

(3) The regulation of capital markets to ensure investor security from fraud is a typical example of a government legitimated cartel structure, but the regulation of securities markets has one unique characteristic: much of the regulatory power is delegated to private sector agencies that exercise this power under the surveillance of the securities commissions. Within the overall capital market complex, however, the securities market complex - made up of a stock exchange, clearing house, brokers, transfer agents

and depository - is one more financial intermediary. Its distinguishing characteristic is that it permits the investor to participate directly in the ownership and control of enterprises on such conditions that the investor bears directly the risk of loss.

(4) A securities market is a valuable institution because of the absolute value of the transactions executed in that market, but probably even more important are the extraneous goals: to induce investment in productive enterprise, to empower investors to participate in the ownership and control of firms, and to decrease the need for and so reduce the undesirable effects of extensive foreign direct investment.

(5) Securities market regulation did not develop from preconceived premises but grew out of a number of separate policy initiatives set out in corporation laws and securities laws. Although the rhetoric to justify securities market regulation varies from one jurisdiction to another, depending upon the prevalent political doctrine and economic dogma,

. . . /55

there is an implied consensus that a securities market should be cartelized - at least in part - to ensure investor confidence and, as a corollary, should be subjected to close government surveillance, employing techniques analogous to those applied to regulate the public utilities or, in other words, the natural monopolies.

(6) Recent developments in the securities market, particularly the immense growth of the financial intermediaries such as banks, pension funds and mutual funds and the implementation of computer-communications technology, have compelled reconsideration of the cartel-like structure and operations of the market and of the institutions designed to regulate that market. Current proposals - all of which assume a central information system - can be distinguished as three models: (1) a continuation of the present quasi-cartel structure with only service competition, managed by a private sector agency under the close surveillance of a securities commission; (2) a straightforward cartel system with only service competition, regulated as a public utility by a securities commission having full powers over entry,

conduct and prices; and (3) management of the central information system by government as a public utility but with no constraints on market entry or prices and only those conduct constraints required to ensure full and fair disclosure and to prohibit fraud with a view to achieving full price and service competition.

5. Regulatory Mechanisms

Even assuming the development of an electronic market over the next several years, there remains the obvious need to regulate the existing system and to participate in the development of the new system during the transition period and also to develop new regulatory techniques to maintain surveillance over the electronic market. As at present, future securities market regulators must exploit all three regulatory techniques - balancing power to preclude monopoly control, institutionalizing responsibility within firms, and regulating the market through an external agency. But the first technique - balancing power - will continue to concern mainly the distribution of capital market functions among competing intermediaries and reconciliation of securities law with competition law, and the second technique - institutionalizing responsibility - will largely concern the reconciliation of securities law with corporation law, including the particularly thorny problem of imposing personal responsibility on directors and officers of securities firms. The emphasis, therefore, will continue to be on the third technique, that is, the regulation of entry, structure, conduct and prices in the securities market through an external government agency or a self-regulatory agency subject to close government surveillance. Accordingly, this analysis will focus exclusively on this third technique. Indeed, the institution of the so-called independent regulatory commission is so established as the means to regulate a securities market that the only practical way to analyse this issue is to outline briefly the background, structure, functions, constraints on and the criticisms of the independent regulatory commission and then proceed to consider the relative advantages of the independent commission as compared with administration through a department or an integrated department-commission.

Beginning with the Massachasetts' banking commission created in 1838,[77] governments in North America have continually exploited the concept of the independent regulatory commission to deal with economic problems that appeared too intractable to be resolved through the existing government agencies applying conventional legal institutions. That the institution has been frequently invoked for 150 years, however, does not mean that it has been uncritically accepted. Indeed, political scientists have castigated it as a "headless fourth branch" of government,[78] lawyers have commonly condemned it as a usurpation of judicial powers to deal with property, contract and unfair competition issues,[79] and economists never tire of demonstrating that it is a poor substitute for the market to allocate resources.[80]

While there is some merit in all three criticisms, they are largely predicated on false assumptions about the separation of government powers,[81] the role of the commissions as essentially regulation making or adjudicative bodies created to achieve specific objectives as distinct from political bodies set up in part to determine objectives,[82] and the ability of policy makers to satisfy public demands by achieving presumed market efficiency, relying on nineteenth century laissez-faire mythology.[83] Although frequently reiterated by leading authors,[84] because of their ideological preconceptions critics will not readily acknowledge that a regulatory commission is a complete anomaly in a market economy: it is a mechanism to substitute planning in large part for market forces, for example, to minimize the wasteful allocation of resources in natural monopoly sectors, to stabilize the income of agricultural producers, or to ensure greater security for investors. Whether or not one likes this characterization of the nature of the regulatory commission, if he accepts it as being generally true, then the arguments both for and against the commission concept can be seen in clearer perspective.

Like all generalizations this statement of the nature of a regulatory commission is only partly true, for the regulatory commissions developed at different times for different reasons

. . . /60

to exercise different functions and to achieve different goals. There is therefore no homogeneous mass of agencies that can be subsumed under the category of regulatory commission, although there are some characteristics common to all commissions. For example, where the purpose of the regulatory law was to equalize bargaining power in markets as under the competition laws and the labor laws, a commission was set up not to plan markets but to make the markets work more effectively. In theory this power could have been left to the common law and the courts, but when these laws were enacted there was a widely-felt distrust that the judiciary was incapable of achieving such broad goals: first, because the judiciary had no powers of investigation and economic analysis and therefore could not initiate action but must rely on actions begun by private persons and on the evidence furnished by them; second, because the judiciary could not maintain the required continuous surveillance over the operation to determine whether the policies were working or whether they needed adjustment; and finally, because the judicial process was too cumbersome a means, with its lengthy appeal processes, to achieve reasonable uniformity of policy. On the other hand, where the purpose of the regulatory law was to displace a market with a view to directing the structure and operations of an industry, the commission was set up to exercise a broad spectrum of powers to enable it to achieve its planned goals.[85] This kind of regulation tends to develop by accretion. At first regulation is restricted to specific, concrete goals that can be achieved merely by proscriptions that are enforced in accordance with clear standards. Gradually power is extended to a typical commission to deal with the structure and quality of conduct in an industry. And finally this power is further extended, usually under the pressure of an economic crisis, to plan the overall system, that is, to set objectives within the overall framework of a public interest standard, to establish priorities, and to control the details of entry, structure, conduct and prices. As Landis has pointed out, the development of the institution of the regulatory commission reflected an understanding that where the state undertakes to direct a sector of the economy it must give the planning agency broad powers to plan, promote and police that sector, powers that had been traditionally characterized as exclusively legislative, administrative or judicial.[86]

Thus the regulatory agency gradually came to be constituted as a mini-government in itself, created to exercise legislative powers to resolve detailed problems with which a legislature could not cope, to exercise judicial powers based on its own investigations and expert analyses to acquire information to which a court would not ordinarily have access, and to exercise executive powers to plan and to measure performance. In essence, the independent regulatory commission at its final stage of development is a compromise among the executive, the legislature, and the judiciary, which is probably not wholly satisfactory to any one branch of government, but which fulfils an essential planning function without requiring that any one branch abdicate its powers altogether, for although "independent" to a degree a regulatory commission is constantly subject to legislative control over its enabling legislation and annual budgetary appropriations, subject to executive power over the appointment of commission members, and subject to judicial power over the interpretation of its enabling statute and the review of its regulation making powers and adjudication procedures. Although the regulatory commission has elicited tremendous controversy, even one of its severest critics concedes that there is a very broad consensus that it is a useful institution, although different critics like it for very different reasons.[87] As a result, with a few notable exceptions,[88] most of the criticism of the regulatory commission concept has been directed not at its existence but at its performance, not at alternative institutions but at means to make the regulatory commission function more effectively within the context of overall national policy by better defining its legislative goals through more refined statutory standards, subjecting it to more - or less - judicial review, tinkering with its structure and functions, or requiring it to permit more competition, particularly service competition, whenever feasible in a regulated industry.

. . . /63

The ubiquitous problem of standards relating to the delegation by the legislature of broad policy or regulation making, investigative, adjudicative and administrative powers takes on particular significance in an enabling act setting up a regulatory commission because of its relative independence of the normal political processes. To compound the problem, like any government program it is exceedingly difficult to specify precisely the objective that a regulatory agency is expected to achieve in exercising those powers. For example, if a securities commission is given broad powers to regulate the securities industry in the public interest without further qualification, the commission, even if only to give its own staff a sense of purpose, must specify its own objectives and particularize as far as possible how and when it will exercise its powers to achieve those objectives. In effect, where there is such broad delegation, the legislature is consciously assigning to the commission the task of identifying the specific problems in the industry and working out solutions.[89] That is not to say, however, that the legislature is abdicating its responsibility but rather that it is temporarily empowering an expert body to deal with the problem until such time as further legislation is required to define better the commissions purposes and powers, to expand or restrict those powers, or even to dissolve the commission altogether.

This basic problem of expressing statutory standards was clearly recognized by Landis, who, although he advocated very broad delegations of power to commissions, stated that each case presented a paradox of "... applying Prosrustean standards to a world that breeds both pygmies and giants."[90] If the standards are too broad the commission may fail to define its objective or be too timid to exercise its powers, or, conversely, may exercise its discretion arbitrarily. If the standards are too narrow the commission may quickly lapse into the kind of bureaucratic routine that precludes it from developing imaginative means to regulate a dynamic industry.

The broad delegation model urged by Landis became the focal point of two criticisms of ineffective agencies: first, an agency with no clear legislative mandate appears unable either to define or achieve its objectives and therefore tends to become the captive of the regulated industry and to characterize the public interest as congruent with the industry's interest; and second, such an agency appears to exercise its discretion arbitrarily in the sense that a person appearing before the agency never knows what case he has to make in order to qualify for the privilege he seeks.[91] The only answer to the first criticism is that the legislature must express the purposes and powers of the commission more clearly. The second criticism may be answered in two ways: by clarifying the standards of delegation or by bringing pressure to bear on the commission to compel it to exercise its regulation making powers to define the standards it applies when making a decision, so that like cases will be dealt with in the same manner, an affected person can predict with reasonable certainty future agency action, and the agency can circumscribe the cases it will consider.[92] Jaffe, taking a position between Landis on the one hand and Friendly and Davis on the other, argues that regulation making, while undoubtedly beneficial is not a universal panacea.[93] As usual in dealing with an administrative law problem, one must look at the overall spectrum of administrative agencies and then develop the best mix of remedies to resolve the specific problem. In theory the refinement of statutory standards is always desirable; but some agencies have difficulty even developing regulations within a broad statutory delegation because of the dynamic nature of the industry regulated, whereas other agencies with narrowly specified goals in a more static environment can make and thrive on detailed regulations. It is important therefore that the delegation of power be broad enough to enable an agency to act effectively, that pressures to induce regulation making be built into the statutory system, and that the exercise by a commission of broad powers be subject to continued scrutiny by the legislature. Legislative scrutiny is especially important because no broad delegation of power to regulate an industry can be exercised without applying value judgments, which may be based on beliefs ranging between laissez-faire liberalism and cartelism, and which may therefore - consciously or unconsciously - subvert the original policy goal of the enabling act.

Concurrently with bringing pressure on the legislature and the commissions better to define statutory standards or to refine those standards through detailed regulations, the critics, particularly the lawyers, pressed forcefully for greater procedural safeguards - characterized as due process or natural justice rules - in order to preclude administrators from exercising arbitrarily the wide discretion implied by broad public interest standards. This movement for law reform led to the enactment of the Administrative Procedure Act of 1946 in the United States,[94] the Tribunals and Inquiries Act of 1958 in the United Kingdom,[95] and, more recently, the Federal Court Act in Canada[96] and the Statutory Powers Procedure Act and the Judicial Review Procedure Act in Ontario.[97] The United Kingdom legislation, because of the absence of the regulatory commission as an institution,[98] effected a largely non-controversial reform of administrative procedures. The United States law and its Canadian counterparts[99] have, however, elicited a long and heated debate that has until recently focused mainly on the regulatory commissions, partly because the commissions are the most visible administrative bodies, partly because the reforms were largely directed at such bodies.

While the procedural safeguards implemented by these laws were generally acknowledged to be desirable, particularly where the administrative action was essentially adjudicative in the sense of applying a statutory rule or standard to a factual situation, administrative law scholars questioned whether such laws, which were frankly modeled after the adverse party trial system, were appropriate to govern the conduct of the regulatory commissions.[100] The American literature on the subject is very extensive, but most of the criticisms can be distilled down to the following basic themes. In general, the adverse party process is ill-suited to the functioning of the regulatory commissions, which were set up to enable administrators to achieve broad policy goals through the application of expertise to analyse difficult technical fact situations and to make complex judgments affecting many parties and even the general public, functions that the courts were not qualified to deal with. Moreover, in an adverse party context the parties tend to control the proceedings by defining the issues, investigating the facts and furnishing the evidence, thus tending to displace expert analysis by objective commission staff. And as a corollary the parties became preoccupied with building a record for the purposes of judicial review instead of concentrating on analysis of the issues. In sum, by

. . . /68

emphasizing the judicial approach, the administrative procedure laws fragment the process of policy development by over-emphasizing case by case analysis, pre-empt the time of the commissions to hear specific cases, and so divert the commissions from their basic task of developing, advocating and evaluating policy or, in other words, prevent them from planning.[101]

The recent enactment of administrative procedure laws in Canada, which are clearly predicated on the assumption that more judicial review is inherently desirable, has evoked similar comments as well as criticism that the legislature should not attempt to apply one set of rules to straightforward adjudication cases such as entitlement to unemployment insurance and also to complex market regulation cases such as energy pipelines. Among other things, critics urge that the courts use restraint in reviewing the substance of administrative decisions to uphold decisions that do not conflict with the law or with values fundamental to the legal system,[102] or alternatively that judicial review be completely abolished - or at least expressly limited to jurisdiction and procedural issues - and that the enabling acts be reviewed one by one to permit an express right of appeal where an appeal from an adjudicative decision appears appropriate.[103] Whether these broader review powers in the Canadian laws will engender practical problems or whether the courts will show the same kind of restraint shown by the United States courts in applying the Administrative Procedure Act remains to be seen.[104]

In any case, there is a clear even if largely tacit consensus that there are certain functions, particularly the exercise of broad policy-making powers by commissions responsible for the regulation of markets, that are not appropriate matters for judicial review. Assuming the issues are clearly defined and the court has access to all relevant evidence, a court probably could decide even these issues as well as a regulatory commission. But this hypothetical case begs the entire question by assuming resolution of the judicial shortcomings that constituted the basic reasons for setting up commissions in the first place, that is, the need for expertise to define issues, to do in-depth analyses, and to maintain continuous surveillance over the regulated industry to forecast the emergence of new issues and to adjust policies accordingly. Thus although judicial review is useful - even necessary - to constrain a commission to act within its statutory jurisdiction, to preclude it from acting arbitrarily, and to ensure that it adheres to fair procedures, it is not a useful institution to reconsider the substance of commission decisions, for above all a commission is not a subordinate court conducting an adverse party trial but rather a political body developing, evaluating and applying alternative policies. In short, a reviewing court should only look at the legality of a decision, not the correctness of the policy decision made. The underlying reason is clear. There can no more be value-free adjudication within the context of broad standards than there can be value-free administration, therefore any decision rendered under such broad standards is a choice of a policy alternative, a choice that is better left to the legislature or, if the policy choices are too nebulous for statutory expression, to a commission that will have the expert resources and the means - adjudication of specific cases and regulation making powers - to develop, enunciate and evaluate alternative policies.[105]

Acknowledging that market regulation through a commission required the exercise of broad policy making powers to achieve political objectives, many critics have eschewed reform through the better definition of statutory standards or judicial review and have recommended, instead, changes in government machinery that will make the regulatory commissions function better or render them more directly accountable to the executive and the legislature. These changes fall generally into two classes: changes directed at the internal structure and functions of the commissions, and changes directed at overall government restructuring, particularly by what has come to be called departmentalization, that is, the absorption of commission functions into executive departments or at least the clear subordination of commission policy making power to executive direction.

The internal changes range from relatively minor matters such as the substitution of a single chief executive officer for the present collegiate commissions,[106] the improvement of commission personnel,[107] and the improvement of internal operations procedures[108] to basic organic changes such as complete separation of the investigation and prosecution functions from the adjudication function[109] and the de-emphasis of adjudication, particularly the excessive judicial formalities that have rendered regulation unduly cumbersome, so that a commission may apply more of its time, expertise and experience to policy formulation.[110] Although they have generated some controversy, these recommendations concerning internal change reflect more a desire to tinker with structures, functions and organizations than to resolve fundamental problems. In contrast, the recommendations concerning basic changes of government machinery by merging commissions into executive departments[111] (or, what is the same thing, reducing their independence[112]) or at least better coordinating their activities with executive department policies[113] are changes of an altogether different order, requiring reconsideration of the reasons for setting up independent regulatory commissions in the first place. Fortunately, in Canada, these problems generate far less heat,[114] partly because we have always assumed that the regulatory commissions must be subject to the oversight of executive departments,[115] at least in respect of strategic policy issues,[116] and partly because, until recently, the operations of the regulatory agencies were largely confined to technical problems and therefore not too visible. But recent crises in the energy, communications and transportation sectors have forced these agencies to the front of the stage, compelling Canadian governments to confront and to resolve these problems.[117]

While these recommendations to change commission structures and relationships are useful, preoccupation with them has undoubtedly built up unrealistic expectations about what can be achieved by restructuring organizations and has diverted attention from the basic problem, which is how to make the regulated industries perform better. Whether the task of regulation is assigned to a department or an independent commission, as English experience establishes, is not of central importance. What is essential is to recognize that all regulation problems are polycentric in the sense that they may involve several conflicting interests in a changing environment and that they may be subject to numerous alternative regulatory mechanisms. Therefore each regulatory issue - assuming regulation is the best solution - requires careful analysis of all these factors and not just of government machinery.

Indeed, the topical criticism[118] of the regulatory process largely ignores the questions of delegation, judicial review and administrative mechanisms and launches a frontal attack on the regulatory citadel, questioning how much regulation is really essential or even whether regulation is required at all, and advocating more empirical analysis to permit a more rational approach to answering these problems. The critics of this school acknowledge that governments deliberately structure certain industries as monopolies or cartels in order to limit destructive competition,[119] but they argue that the onus should be on an industry to prove the existence of any destructive competition in an open policy debate in order to justify new regulatory initiatives and even the continuance of existing, well-established regulatory systems.[120] If there is some destructive competition but only of a temporary or minor nature, then instead of overall regulation a program of adjustment assistance or insurance can be instituted to permit equitable treatment of any hardship cases, a solution that obviates continuous government surveillance. If, on the other hand, the industry is in fact a natural monopoly or must be cartelized for stability or public security reasons, then the regulatory system should be openly characterized as a planning mechanism that displaces the market and should be designed accordingly, keeping in mind the criticisms outlined above, particularly the point that behind each criticism is

. . . /74

a political conviction for or against planning as a process or an ingenuous belief that politicians can actually sacrifice equitable treatment in a large number of cases in order to achieve overall economic efficiency for all.

For as Wilson has pointed out,[121] all of these criticisms of the regulatory process involve a trade-off between equity and efficiency. Those who advocate greater equity press for fairer procedures and wider scope for judicial review over jurisdiction, procedures and even substance. Those who advocate greater regulatory efficiency press for better policy coordination with the executive - particularly to specify objectives - through departmentalization or other organic change or better definition of regulatory standards. Finally, the new critics press for overall industrial efficiency on the ground that even the most sophisticated regulatory system cannot achieve what a market does well, that is, evaluate the performance of a firm or an industry through the price mechanism in order to determine whether resources should be allocated to it.[121]

In any event, however, it is highly probable that legislatures, for valid political reasons, will continue frequently to invoke the institution of the independent regulatory commission, that is, a commission set up outside of the conventional government departments, in order to resolve problems that are too complex to be resolved through ordinary bureaucratic administrators who apply relatively static statutory rules and standards. I shall therefore summarize the above arguments and then outline briefly the advantages frequently attributed to the independent commission.

(1) The independent regulatory commission is a mini-government, which is empowered to exercise legislative, judicial and administrative powers with a view to planning the structure and operations of an industry or a market.

(2) As a general rule, to operate effectively, a commission must have a relatively broad delegation of power under its enabling act if it is to be able to regulate imaginatively and effectively. Delegation under broad "public interest" standards is in effect authority to develop and enunciate policy as distinct from applying value-free rules and standards to specific cases. It is in this sense that each regulatory commission is in politics.

. . . /76

(3) For the same reason - the absence of value-free rules and standards - judicial review of the decisions of a regulatory commission is not a satisfactory means to control commission decisions, except to constrain a commission from acting outside the limits of its jurisdiction, acting arbitrarily, or following unfair procedures.[123] A court should adjudge only the legality of a commission's decision, not the correctness of the policy decision made.

(4) Rather than focus on delegation standards or judicial review, therefore, it is more appropriate, particularly in the Canadian context where scant attention is accorded separation of powers mythology, to structure a commission in a way that achieves a workable balance between the commission's relative independence on the one hand and its responsiveness to the executive as well as its responsibility, through a minister, to the legislature on the other.

(5) Assuming regulation is politically necessary, when undertaking to regulate an industry or a market, the legislators and the regulators should be constantly aware that to displace market competition - and particularly price competition - is to

. . . /77

bureaucratize the industry or market, that is, to abandon the price mechanism as a means to determine value and to measure performance and substitute other performance measures. Wherever possible, therefore, regulation should be limited to conduct rules and standards and should only be extended to govern entry and prices - the strategic elements of a competitive market - when no other solution is politically acceptable.

(6) In summary, in addition to the general economic criticism that regulation is a poor substitute for a competitive market, regulation through a regulatory commission is frequently attacked on three fronts. First, the exercise of very broad discretion within the context of a public interest standard may empower a commission to dilute the force or even subvert the original policy of the law, unless the standard is further refined or the agency subjected to continual policy oversight by the executive. Second, again because of the broad discretion exercised by a typical commission, it may act unlawfully, unfairly or arbitrarily unless it is subjected to judicial review. And third, because of its relative independence, a commission may become ineffective or even become

a captive of the regulated industry, unless its planning is closely coordinated with the executive to ensure that the commissions goals and priorities are consistent with the government's overall goals and priorities.[124]

(7) Nevertheless the regulatory commission is widely acknowledged to have a number of specific advantages over the conventional department structures that outweigh its disadvantages.[125]

- It permits flexible and expert administration where bureaucratic administration of rules and standards as interpreted by the courts would not work. A commission can take on a novel and complex task, explore and analyse an industry, apply its expertise to refine very broad statutory policy through adjudication and regulation making, and maintain continuous over- sight of the regulated market or industry to determine the effectiveness of that policy.
- It permits the resolution of conflicts among rival interest groups, if not free from politics, at least free from the immediate pressure of short-term, partisan politics, permitting it to avoid expedients and so develop policies that

. . . /79

will have considerable continuity. A commission can, particularly when adjudicating a specific case, retain enough independence from the executive to decide the case impartially.

- It presumably can, as a collegiate body, render better judgments and permit broader representation in the regulation making process[126] then can an agency with a single head.
- It enables interested persons better to aim their criticisms and to recommend policy changes to government because the establishment of a commission tends to focus program responsibility.
- A commission can also serve to balance conflicting interests by considering the interests of groups that are not well represented because the benefits of regulation are widely diffused among the public whereas the costs are concentrated and borne, for example, by a small group of producers.[127]
- It can offer a number of administrative advantages, particularly freedom from the constraint of the bureaucratic rigidities of government personnel and financial management rules and from the requirement of queuing up to receive general

services such as legal, data processing and public relations services. A commission can achieve better program performance through term employees or contracts, which also precludes the growth of tenured employees and so facilitates winding-up when a limited program goal has been achieved.

- It permits government to assume a quasi-commercial activity, for example the administration of a computer-communications system, with less hostility from the business community.[128]
- It facilitates regional representation and also the coordination of programs that cut across the traditional jurisdiction of several departments.
- And finally, it is a versatile institution to coordinate intergovernmental programs, which is an especially important characteristic of a commission in a federal system.

6. Institutions of Federal-Provincial Cooperation

Although the regulatory commission is widely acknowledged to be an especially versatile instrument to coordinate intergovernmental programs, it is only an alternative means to achieve an objective and not in any sense a solution of the underlying problem, which is to render overlapping, federal-provincial programs more effective. For as Derthick points out, "Organizations are instruments of purpose, and they ought not to be judged apart from the objectives they purport to serve".[129] In other words, one should not have exaggerated expectations about what can be achieved by organizational change, for absent at least broad consensus among the federal and provincial government about joint program objectives, not even an ideal form of organization can administer the joint program effectively.

It is, however, a reasonably safe assumption, if we ignore peripheral issues and bargaining rhetoric, that all Canadian governments share a common objective with respect to securities market regulation:[130] to develop and maintain a Canada-wide securities market that is effective in the sense that it tends to allocate capital to enterprises that can make optimum use of it, and efficient in the sense that it enables capital to flow from savers to users with a

. . . /82

minimum of unnecessary cost. The central problem therefore is to determine what institutions of federal-provincial cooperation will best enable the governments of Canada to achieve this objective, which involves consideration of the existing framework of federal-provincial relations and the alternative coordinating mechanisms that can realistically be employed within that framework.

The present framework of federal-provincial relations can best be explained by a brief explanation of its evolution. The original concept of federalism, both in the United States and Canada, was "dual federalism", which was based on the assumption that federal and provincial powers could be separated into watertight compartments and that any program conflicts could be resolved through the arbitral powers of the supreme court, or, if that did not result in a solution satisfactory to the parties, then through the process of formal constitutional amendment.[131] As government intervention in the social and economic life of the federal states grew, it became obvious that with respect to complex systems all matters become interdependent, and the larger the resource commitment to any one program the greater the impact on all other programs. The response to this new state of affairs was the concept of "cooperative federalism", which is based on a negotiating process to define common program goals and to determine the amount of resources to be allocated to each common or shared program by each government involved.[132] This approach, although only a qualified success, has if nothing else highlighted the importance of defining program objectives, particularly where there can be substantial overlap or even conflict among federal and provincial programs.

As already pointed out, there is probably little conflict between federal and provincial objectives with respect to securities market regulation, but experience with shared programs has clearly underlined the importance of looking at a whole system and not just its constituent parts. For example, when considering the securities market one must look both at the overall capital market in which the securities market is only a sub-system unit and also at other programs such as taxation and resource development that have direct impact on capital market and securities market policies. Since, however, there is at present in Canada no permanent intergovernmental machinery to deal on a continuous basis with capital market or securities market policies,[133] before the federal government can consider becoming involved in securities market regulation it must consider the alternative coordinating mechanisms that will best enable it to achieve its program goals and at the same time reconcile those goals with provincial policies. Although other, extraneous coordinating mechanisms such as intergovernmental policy committees are possible, assuming the federal government does decide to enter the securities field, then within the context of the securities laws there exist only two probable strategies. The first is a dual system, which implies superimposing a federal law and a federal regulating system on the existing provincial systems. The second is an integrated system, which implies vesting in one commission authority to exercise powers under discrete federal and provincial securities acts.[134]

These two conceptual approaches to federal-provincial program coordination can best be illustrated by reference to actual experience with attempts to coordinate corporation and securities laws in three federal jurisdictions that share a common legal tradition - the United States, Australia and Canada. In all three jurisdictions little thought has been given to the kinds of policy goals sought to be achieved by the corporation laws on the one hand and the securities laws on the other, therefore there is considerable confusion about which policy goal should be pursued under one statute or the other. In an ideal world the corporation law would be limited to the institutionalization of responsibility in corporate managers, majority shareholders and the corporation itself with

. . . /85

a view to protecting shareholders, creditors and the public generally, whereas the securities law would be limited to regulating, directly or indirectly through self-regulatory agencies, the entry, structure, conduct and price aspects of the securities market. These reasonably clear distinctions did not develop in any one of these jurisdictions, however, because of the different distribution of powers under the constitution of each and because of confusion about certain institutions such as insider trading, take-over bid and financial disclosure rules that are required to be set out in both the corporation laws and the securities laws to make them apply to closely held corporations as well as publicly distributing corporations. Moreover, in the United States the securities laws have had to reach out to include such topics as proxies, insider trading, cash take-over bids, and financial disclosure because there is no federal corporation law that can be used to impose standards that apply generally to all corporations set up under the notoriously lax state laws.[135] In Australia, constitutional powers to enact corporation laws, (except in respect of federal territories) and securities laws were until recently assumed to be exclusively state powers. And in Canada, to add to the confusion, the federal and provincial corporation laws are essentially co-equal, whereas the securities laws exist only at the provincial level because the provinces first entered the field and because there is some uncertainty about federal powers to enact a securities law. But notwithstanding these constitutional differences, the concepts employed in each jurisdiction to coordinate these different laws can be applied in any federal framework.

As already pointed out, when it enacted the Securities Act of 1933 the U.S. Congress deliberately maintained a two-tier regulatory system based on disclosure and self-regulation at the federal level and broad administrative discretion at the state level, thus assuring a broad, minimum national standard and at the same time permitting more stringent state standards.[136] It follows, therefore, that in connection with each public distribution of securities a prospectus must be qualified at the federal level and in each state where the securities are to be distributed, a policy that is continued in the proposed Federal Securities Code on the grounds that the dual system is required to empower the states to enact laws that better reflect local capital market conditions and that give regulators broader, more subjective discretion to deal with local market actors.[137] Starting from this premise, law reform in the United States has therefore been directed not at federal preemption or federal-state uniformity but instead at federal-state coordination and state law uniformity. In the federal Securities Act of 1933 coordination is achieved largely through the intrastate exemption, which in effect excepts from the application of the federal law any securities distribution that is confined to a state or a state and certain defined contiguous areas.[138] At the state level coordination is commonly achieved by automatic qualification of a prospectus that has already been cleared at the federal level, obviating repeated scrutiny in several jurisdictions.[139] And both federal and state administrators collaborate to minimize duplication of effort, for example, to reduce the paperwork burden of firms required to file information returns with both federal and state securities commissions.[140]

Although cumbersome because based on two contrasting policy views at the federal and state levels, the United States system has worked with a minimum of federal-state conflict. In contrast, in Australia, where the states have long exercised sole jurisdiction over corporate and securities matters, the federal government, basing its policy on a recent constitutional case that extended widely the federal commerce power,[141] moved quickly to occupy much of the traditional corporation and securities law field, apparently without any extensive discussions with the state governments. On learning that the federal government had set up a committee to determine what role it should play with respect to securities market regulation, three of the state governments - New South Wales, Victoria and Queensland - made a pre-emptive strike on 18 Febraury 1974, setting up an Interstate Corporate Affairs Commission by a multilateral agreement to achieve most of the goals projected to be resolved by federal law.[142] Undeterred, the federal Senate Select Committee continued its work and on 18 July 1974 issued a report entitled "Australian Securities Markets and Their Regulation" (Rae Report), which recommended that the Commonwealth - that is, federal - government should enact a statute to occupy much of the corporate and securities law field now occupied by the states. Several months later, on 26 February 1975, the Commonwealth Lower House passed the Corporations and Securities Industry Act to achieve this purpose. The Senate, not satisfied with the House Bill, on 9 April 1975 again set up a select committee to review the statute enacted by the Lower House. Concurrently, the state governments are urging the federal government to reconsider the statute, particularly to consider restructuring the proposed federal commission as a joint federal-state commission.[143] Although the final result of this match remains uncertain, it appears probable that, unlike the United States, Australia will adopt a comprehensive law that will pre-empt the field within its scope, that is, a unitary rather then a dual system of laws. It appears probable that the coordinating mechanism will be a federal commission structured to maintain close, continuous liaison with the state agencies.

Because there is no federal securities law in Canada, this problem of coordinating federal and provincial laws has not yet been faced, although serious efforts have been made for more then forty years to achieve a reasonable degree of uniformity of policy. By 1929 several of the provinces had adopted the Ontario model, but because of differences in local securities markets and policy differences among provincial governments, the uniform base was rather quickly eroded, resulting in a number of similar but still different securities acts across Canada.[144] Following enactment of the Ontario Securities Act of 1966, there was once again a strong uniformity movement that produced relatively uniform laws in Ontario and the Western Provinces. In addition, spurred on by a renewed federal interest in the securities field, the provincial securities administrators have set up a quite formal organization - the Provincial Securities Administrators - to coordinate their policies and procedures with a view to simplifying compliance with the several provincial acts. The Securities Administrators have together produced a set of relatively uniform policy statements [145] and have collaborated closely to develop the current version of the Ontario Securities Bill,[146] which was tabled in the Ontario

. . . /90

legislature on 30 May 1975, and which is intended to be the model statute for all the provinces. In short, the provinces, following the strategy employed by the Australian states, are attempting to develop a system of securities laws that will in effect have Canada-wide application and will therefore render unnecessary any federal occupation of the securities regulation field.

Like their Australian counterparts the provinces have as part of their in-depth defence strategy another position that can be invoked as an alternative to exclusive federal occupation of the field, that is, a joint federal-provincial commission to administer the securities laws at both the federal and provincial levels. First suggested by the Ontario Securities Commission in 1968 in its published CANSEC Proposal, the topic was recently referred to again by the Ontario Securities Commission as a possible means to coordinate federal and provincial activities relating to securities.[147] This alternative approach has the advantage that it can lead to one uniform law and one set of policies and procedures, whereas the dual system of the United States, based as it is on two different philosophies, institutionalizes a multiple statute system.

Where a dual system obtains, because it is probable that the federal and provincial securities laws will differ in material respects, in order to minimize conflict of law problems and duplication of administrative effort, it is essential to distinguish clearly the cases to which either federal law or provincial law applies exclusively and so limit the cases where a person is required to comply with two substantially different legal systems. Although this is true with respect to all aspects of regulatory control over entry and conduct in both the new issues market and the secondary trading market, it is especially significant with respect to documents such as prospectuses, applications for licences and financial statements, which, if they are not essentially uniform in all jurisdictions, engender both unnecessary frustration and excessive costs.

In the United States, where Congress clearly had power to pre-empt the entire securities field, it elected instead for a system of concurrent jurisdiction that permits a state to impose more stringent rules in any case or less stringent rules where an issue is confined exclusively to that state.[148] For example, in the case of prospectus qualification the federal standard is limited to full and fair disclosure, whereas many state statutes superimpose a more stringent, highly subjective - and therefore broadly discretionary - standard based on the administrator's opinion as to

. . . /92

whether the enterprise is viable or whether the transaction is fair, just and equitable to the prospective shareholders[149]. On the other hand, a state may in fact establish lower prospectus qualification standards on intrastate issues with a view, for example, to promoting local resource development[150]. Concluding that the dual system of federal and state securities regulation was too deeply entrenched in the United States to make federal pre-emption practicable there, the most prominent U.S. scholar in this field has concluded that " ... the only hope for simplification lies in uniformity and federal-state coordination"[151], that is, uniformity of statutory provisions and coordination of statutory systems, administrative forms and administrative procedures.

The major attempt at uniformity of state statutes in the United States is the Uniform Securities Act sponsored by the National Conference of Commissioners on Uniform State Laws[152]. Although very influential this model uniform act has not been able to overcome the predilection of local legislature to attempt to improve policy through subtle drafting changes to substantive provisions and of administrators to develop different procedures. Fortunately the coordination of statutory systems through the intrastate exemption technique has proved to be a more fruitful approach because it permits a state to express local idiosyncracies in its laws and at the same time subordinate those laws to give priority to interstate distributions that comply substantially with the local laws.

The key provision in the United States federal law that was designed to accommodate different state laws is the intrastate exemption set out in section 3(a)(11) of the Securities Act of 1933. This exemption was so narrowly interpreted by the courts, however, that it became a trap for the unwary and therefore was seldom relied on as a means to avoid qualification under federal law[153]. In order to clarify the exemption so that counsel can render an unqualified opinion that an intrastate issue is exempt from the federal securities laws, the SEC recently adopted a new Rule 147, which does not render the exemption more flexible but does make clear that an issuer is in a safe haven if it was incorporated in the state, has its principal office in the state, earns 80% of its gross revenue in the state, has 80% of its assets in the state, will employ 80% of the capital raised by the issue in the state, and will bar transfers of the issued securities to persons outside of the state for at least nine months[154]. The proposed Federal Securities Code essentially continues this policy but underlines that its purpose is to encourage rather than to constrain exempt intrastate distributions[155].

This attempt to induce greater use of the intrastate exemptions is not just window dressing, for the Code also expressly continues the dual system of the present law by empowering a state to superimpose its standards on the

. . . /94

federal standards, particularly in respect of substantive market entry standards that apply to prospectuses or licence application forms[156]. But the proposed Code does not forgo altogether federal pre-emption power, which is invoked in a subtle manner to motivate each state to harmonize its law with the federal law, employing the concepts of registration by coordination and notification that had been developed under the Uniform Securities Act as alternatives to the usual registration by qualification procedure. Briefly, registration by qualification means compliance with the statutory standards, for example, to render an issuer eligible to distribute specified securities to the public. Registration by notification means that a "blue chip" issuer is automatically entitled to distribute its securities to the public upon filing the required disclosure documents unless the securities administrator takes affirmative action to stop the distribution. Registration by coordination, as the name implies, means coordination with federal law, which is effected through two techniques: first, the federal forms are accepted but supplemented by further local documents where required to comply with additional local criteria; and second, qualification is concurrent with federal qualification unless the local administrator takes affirmative action to delay or stop the distribution and so advises the issuer when it seeks last minute clearance for the distribution[157].

. . . /95

Thus the Uniform Securities Act reflects a carrot approach to the problem, suggesting techniques of administration that are more efficient but still do not detract from local autonomy, since the state administrator retains residual power to issue stop orders on an exceptions basis. The Federal Securities Code, however, employs a stick approach, continuing state residual control over substantive standards but displacing the state laws with respect to disclosure requirements where the state law requires different disclosure or additional disclosure that is not essential to the application of a unique state substantive standard. As a result, although it preserves state power to apply substantive policy differences, the Code clearly displaces state law and substitutes federal law with respect to prospectus disclosure and broker and investment advisor disclosure. Even more important the Code displaces unqualifiedly any state law relating to secondary trades and "blue chip" securities distributions that can now be qualified by notification only under state laws that contain the notification procedures of the Uniform Securities Act[158].

In summary, the proposed Federal Securities Code suggests three ways to deal with overlapping federal-state laws in the United States[159]: first, pre-empt the field and abrogate the state laws; second, continue the present dual system of substantive laws but encourage the states to develop uniform laws and procedures and to adopt notification and qualification procedures that minimize duplication of disclosure; or third, continue the dual system with respect to the substantive standards that apply to the new issues market but impose uniform disclosure standards and regulate the secondary trading market exclusively under federal law, a technique the Code characterizes as harmonization of federal and state laws. Although the constitutional jargon varies slightly[160], and although federal power to legislate in the field of securities regulation is less clear in Canada, the basic problems identified and the alternative solutions suggested in the Code to coordinate federal and state securities laws apply equally to the coordination of any federal and provincial securities laws. But the Code does not discuss another alternative that has been frequently invoked and therefore is of special significance in Canada, that is, integration of regulation through a commission exercising both federal and provincial powers, either exclusively or concurrently with regulation through provincial commissions.

Until recently in Canada there was considerable doubt about integrated federal-provincial regulatory schemes because it was clear under the constitution that one legislature could not delegate any part of its authority to another legislature in order to empower the second legislature to deal with both interprovincial and intraprovincial aspects of the regulatory problem[161]. The legislatures succeeded, however, to break out of this impasse through the patently legalistic device of setting up a regulatory agency under either federal or provincial law to which both federal and provincial legislatures may delegate regulation making authority. As a result, although the federal government cannot, for example, delegate to a provincial legislature power to legislate with respect to interprovincial highway transport, the federal government can delegate that legislative power to a regulatory agency that has been set up under provincial law to regulate highway transport under broad public interest standards[162]. But even if lacking logical symmetry this constitutional doctrine has given to the Canadian legislatures an extraordinarily flexible mechanism to deal with regulatory problems that are not clearly within the jurisdiction of either the federal or a provincial legislature. Although infrequently used, this mechanism has been invoked in at least three statutes by the federal Parliament to legitimate regulation of three sectors - highway transport, agriculture and energy supplies - that are of strategic importance to the Canadian economy[163].

The first of these provisions, s. 3 of the Motor Vehicle Transport Act, which was enacted specifically to empower provincial transport commissions to make regulations concerning interprovincial transport[164], directly authorizes a provincial commission to issue an interprovincial licence in accordance with the same standards and subject to the same conditions as it issues an intraprovincial licence. The

Energy Supplies Emergency Act sets up a federal board and, under s. 9, authorizes that board to sub-delegate any or all of its powers to any other person or agency. Even more versatile, the Farm Products Marketing Agencies Act contemplates the creation by the Governor in Council of federal-provincial marketing agencies that are expressly authorized under s. 23 to exercise federal powers relating to interprovincial trade, to accept a delegation of provincial powers relating to intraprovincial trade, and also, with the consent of the Governor in Council, to sub-delegate federal powers to a local marketing board set up under provincial law. In the securities regulation context, therefore, it would be possible to set up a federal commission, staff it with outsiders, federal departmental officers, provincial departmental officers, provincial securities commissioners or any combination of these persons[165], authorize it to exercise federal powers and to accept delegations of provincial powers, and even authorize it to sub-delegate any of these powers to a provincial securities commission or to a self-regulatory body[166]. Thus in Canada, in addition to coordinating federal and provincial regulatory functions through complementary statutory provisions (e.g., with respect to primary or secondary markets and disclosure or substantive standards), there exists another coordinating mechanism - delegation of legislative authority to a regulatory commission - that can be employed with or even as a substitute for complementary statutes. But the creation of any commission exercising both federal and provincial powers poses

. . . /99

a paradox: if there are material policy differences between the federal government and a provincial government, how can the commission be given clear policy direction? In other words, what minister is ultimately responsible for the development and enunciation of statutory policy and for the implementation of that policy by the commission? Although it did not clearly resolve this problem, the CANSEC proposal set out in a research paper published by the Ontario Securities Commission in 1967[166] defines the basic issues and recommends an imaginative solution that merits detailed analysis.

In its discussion paper on CANSEC the Ontario Securities Commission pointed out that with respect to securities market regulation in Canada the ideal system would embody uniform laws, uniform administration, a common database and an expert staff to do policy analyses and research specific problems, to investigate problem cases and to administer the overall system[168], but the discussion paper goes on to point out that the present Canadian system did not develop with ideal goals in mind but rather in response to different problems in different jurisdictions. Consequently the present problem is not to develop an altogether new system but to coordinate existing systems in order to increase administrative efficiency and to develop a mechanism that will enable policy makers and administrators realistically to seek to achieve those ideal goals and so overcome the present paradox of balkanized provincial regulation: on the one hand, if a province puts few resources into securities regulation either the law or its administration must be substandard; on the other hand, only the larger provinces have the volume of securities business to justify both a sound act and the expenditure of substantial resources on effective administration. As a result the larger provinces - through sheer competence - necessarily attract the major business and thus tend to dominate the field. The major problem therefore in designing a Canada-wide securities regulation system is to reconcile centralized policy making with decentralized administration in a way that does not relegate any jurisdiction, federal or provincial, to an ineffective status.

To resolve this problem the Cansec Proposal recommended creation of a crown corporation with a three tier administrative structure: (1) a council of ministers made up of the interested ministers from each participating jurisdiction (participation would be optional); (2) a commission made up essentially of the members of the provincial securities commissions[169]; and (3) a director at the central office, associate directors at each regional office and at certain local offices. The residual decision making powers would be vested in the council of ministers, the federal minister to exercise some 33% of the votes and each province to exercise votes in accordance with its relative gross personal and corporate income tax collections, giving Ontario roughly 29%, Quebec 17%, British

Columbia 7%, and the other provinces the balance of the votes. A decision of the council of ministers would require the approval of a majority of the participating governments that exercise at least 2/3 of the votes[170].

The second tier, the commission, would be a decentralized structure, having its head office in Ontario, a regional office in Quebec and British Columbia, and a local office in each other province[171]. The commission chairman would be selected from among the regional office commissioners. Each of the commissioners would have tenure of office for a ten-year period, but only five commissioners would be employed full-time, three in Ontario and two at each other regional office. A quorum for a commission decision would be two commissioners to ensure that each regional office would be empowered to act for the full commission on a continuous basis. One or more commissioners would go, as required, to a local office to deal with any local issues. The third tier, the director level, would be made up of a director at the regional office where the chairman is located and an associate director at each regional office.

The functions of each administrative tier would be designed to characterize the council of ministers as essentially an overall policy evaluation body, the commission as a policy development and administrative review body, and the director as the chief administrative officer. More specifically, the council of ministers' functions would be to appoint commissioners and senior officers, review budgets, and review policies and procedures with a view to recommending legislative changes. The key functions of the commission, continuing the policy of the uniform securities acts, would be to review decisions of a director based on the application of standards and rules set out in the statute, to grant administrative remedies such as orders to freeze assets and stop trading, and to make recommendations to the council of ministers concerning policy changes[172]. The director, subject to the direction of the chairman, would be the chief administrative officer, responsible in the first instance for application of the law and policies to specific cases, for enforcement[173], and for the overall administration of personnel, finances, and capital assets[174].

The Cansec Proposal has clearly been thought through in detail and with great care, and even if it does not satisfy all Canadian governments, it may serve ultimately as the only acceptable means to rationalize securities regulation in Canada. In any event it furnishes a useful benchmark, identifying the substantive, structural and procedural problems and also underlining, at least by implication, the advantages and disadvantages of such a cooperative scheme.

Certainly the great advantage of the Cansec Proposal is that it furnishes a coordinating mechanism that preserves substantial provincial autonomy, enables the efficient use of experienced commission staffs, and therefore should lead to better and more efficient securities regulation in Canada. More particularly, the Cansec Proposal would result in more uniform laws and procedures, elimination of much duplication of effort by applicants and administrators, and greater insulation from local, short-term political pressures. In addition, the Cansec Proposal would make possible centralized policy research and information processing that in turn would better enable decision makers to develop, refine and apply policies, looking at the Canadian securities market as an articulated, Canada-wide system. But most important of all the Cansec Proposal would not require any province to yield powers it presently exercises with respect to securities market regulation.

But from the federal perspective some of these strengths of the Cansec Proposal are also its greatest weaknesses. It does not commit any province to join or to remain in Cansec. It sets up a very rigid constitutional framework that makes amendment difficult except under threat of withdrawal. It virtually requires withdrawal where there is a sharp policy conflict between one minister - acting under instructions from his government - and the council. It tends to perpetuate a system of eleven separate securities laws. It renders the commission extremely independent of and therefore unresponsive

. . . /104

to the political process. And most seriously, it diffuses responsibility in such a way that no minister has clear responsibility to answer to any legislature for program performance. In sum, even if it acknowledges that the Cansec Proposal is incisive, imaginative and constructive, for two reasons it would be difficult for any federal government to accede to the proposal as originally presented. First, because it refuses to acknowledge any federal jurisdiction over the interprovincial aspects of the securities markets, it leaves the federal government in a perpetual minority position with no assurance that it will have any effective influence over securities market policies. And second, it might set a bad precedent, substituting for clear political responsibility in one legislature a complicated structure that diffuses responsibility among three internal organs of Cansec and among eleven ministers, extending the concept of cooperative federalism to the point where no one is clearly responsible for the good governance of the securities markets.

The specific goal of the Cansec Proposal therefore is to seek uniform *administration* of the different provincial securities laws and of a limited federal law that would legitimate the integrated commission concept and delegate to it authority to deal with international and criminal matters that are not clearly within provincial jurisdiction. As a result it implies a division of jurisdiction that leaves nearly all substantive issues in the several provinces - or undetermined[175] - and so narrowly limits federal bargaining power. Since jurisdiction, or in other words, decision making power, is the core of the problem, a brief tabulation of some of the possible models is essential to place this problem in overall perspective.

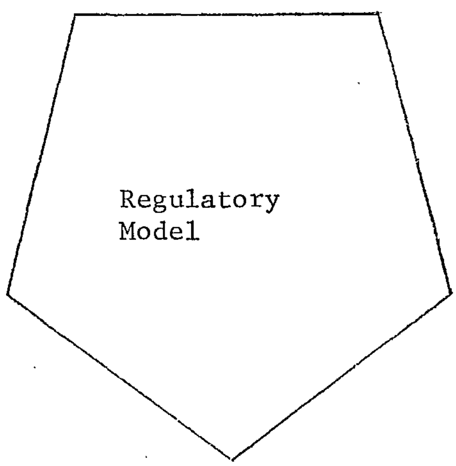
Hundreds of permutations are possible because each alternative model has five dimensions, each of which contains several variables as indicated in Table 4.

Table 4

Dimensions of Securities Market Regulation

System of regulation:
- separate commissions
- integrated commissions
- delegation of federal powers to provincial commission

Division of Jurisdiction:
- federal issuers
- foreign issuers
- interprovincial issues
- intraprovincial issues




System of Administration:
- federal
- joint federal-provincial
- provincial

Division of Jurisdiction:
- disclosure rules
- substantive standards

Division of Jurisdiction:
- primary market
- secondary market

Set out in Table 5 therefore are only the more probable combinations of these elements, which are not exhaustive but which illustrate clearly the broad range of possible systems, moving from a strongly centralized system in the top left to a completely decentralized system at the bottom right. In between are the many models that might be invoked to resolve the basic problem of any federal system, that is, to reconcile centralized policy making with decentralized administration through a mechanism that is sufficiently flexible to be responsive to local needs and yet effective to achieve broad national goals.

Table 5

. . . /107

Table 5

Models of Securities Market Regulation

Federal

| Model | Federal Law: Primary | Federal Law: Secondary | Joint Federal and Provincial Laws: Primary | Joint Federal and Provincial Laws: Secondary | Provincial Law: Primary | Provincial Law: Secondary |
|---|---|---|---|---|---|---|
| 1. | All except intra-provincial issues | All | | | | |
| 2. | All except intra-provincial issues but subject to added provincial substantive standards *(proposed U.S. Federal Securities Code)* | All | | | | |
| 3. | All except intra-provincial issues but subject to added provincial substantive standards and disclosure rules *(present U.S.)* | All | | | | |
| 4. | | | Federal Law - federal issuers - foreign issuers - interprovincial issues<br>Provincial law - intraprovincial issues | Federal law-all | | |
| 5. | | | Federal law - federal issuers - foreign issuers<br>Provincial law - interprovincial issues - intraprovincial issues | Federal law-all | | |
| 6. | | | Same as 4 but federal law administered by provinces | Federal law-all | | |
| 7. | | | Same as 5 but federal law administered by provinces | Federal law-all | | |
| 8. | | | Either Model 4, 5,6 or 7 | Provincial law-all | | |
| 9. | | | Federal law - federal issuers - foreign issuers<br>Federal *and* provincial law (province of incorporation or head office) - interprovincial issues<br>Provincial law - intraprovincial issues | Federal law-all | | |
| 10. | | | Federal law *and* provincial law (province of incorporation or head office) - federal issuers - foreign issuers - interprovincial issues<br>Provincial law - intraprovincial issues (even of federal or foreign corporations) | Federal law-all | | |
| 11. | | | Either Model 9 or 10 | Provincial law-all | | |
| 12. | | All | | | All | |
| 13. | | | Joint commission that acknowledges federal jurisdiction over interprovincial trades | | | |
| 14. | | | Joint commission that does not so acknowledge (Cansec) | | | |
| 15. | | | | | All | All *(present Canada)* |

Provincial

Table 5 brings into sharp focus the fundamental - although largely tacit - conflict between the OSC and the federal government over the Cansec Proposal. What the federal government insisted upon was characterizing the Canada-wide securities market as a national system that clearly falls within federal jurisdiction. Probably, therefore, assuming separate federal and provincial commissions, Models 4 to 10 probably would have been negotiable. On the other hand, assuming an integrated commission as advocated by the OSC, although more difficult for the federal government to accept, Model 13 would have been a possibility. The specific problem, therefore, is to select one of these models or to develop a synthesis of two or more of these models that might be politically acceptable to both the federal and provincial governments.

## 7. Alternative Models - Securities Regulation

Although any of the models described in Table 5 is possible, the models that best illustrate the three alternative types of systems that have the greatest probability of political success are Models 6, 10 and 13. These three models as set out in Table 5 assume federal jurisdiction over inter-provincial transactions in both the primary and secondary market, but this assumption is not essential to this discussion about these three models, for the issue need not be forced until there is an open conflict over the creation of the system,

. . . /109

the withdrawal of a party from an integrated system, or the application of non-uniform provisions in the federal law and a provincial law[176]. These three models have been selected to underline the differences among unitary, dual and integrated regulatory systems. In effect, Model 6 gives the federal government a voice in policy but leaves administration to the provinces; Model 10 involves the federal government both in policy and administration through a federal commission that coexists with the provincial commissions; and Model 13 gives the federal government a voice in policy and administration through a joint federal-provincial commission. Table 6 attempts to compare graphically these three models, relating the regulators to regulatory functions and assigning primary and secondary roles to each regulatory body involved in the overall process.

Table 6

. . . /110

# TABLE 6
## REGULATORS

**Model 6**

(P means primary responsibility, * means influence)

| Function | Prov. Leg. | Prov. Min. (Cab.) | Council of Min. (Fed.-Prov.) | Courts | Prov. Comm. | Integ. Fed.-Prov. Comm. | Fed. Comm. | Director (each comm. or region) | Fed. Min. (Cab.) | Fed. Parl. |
|---|---|---|---|---|---|---|---|---|---|---|
| Policy-legislative change (overall system) | P (prov law) | * | | | * | | | | * | P (fed. law) |
| Policy-regulations (major operations) | | P | | | * | | | | P | |
| Policy-adjudication of cases | | | | | P | | | | | |
| Budget review and appropriations | P | * | | | | | | | * | P |
| Articulated information system | | | | | P | | | | | |
| Appointment of commissioners | | P | | | | | | | | |
| Appointment of senior staff | | P | | | | | | | | |
| Regulation of market entry (issuers, actors) | | | | | P | | | | | |
| Regulation of business conduct (disclosure, etc.) | | | | | P | | | | | |
| Oversight of conduct of self regulatory bodies | | | | | P | | | | | |
| Regulation of rates | | | | | P | | | | | |
| Investigations | | | | | P | | | | | |
| Enforcement-administrative proceedings | | | | | P | | | | | |
| Enforcement-civil actions | | | | | P | | | | | |
| Enforcement-referring criminal prosecutions | | | | | P | | | | | |
| Review of Director's regulatory decisions | | | | | P | | | | | |
| Administration (personnel, finances, capital) | | * | | | * | | | P | | |
| Review of administrative action (jurisdiction, procedures, arbitrariness) | | | | P | | | | | | |

**Model 10**

(P means primary responsibility, * means influence)

| Function | Prov. Leg. | Prov. Min. (Cab.) | Council of Min. (Fed.-Prov.) | Courts | Prov. Comm. | Integ. Fed.-Prov. Comm. | Fed. Comm. | Director (each comm. or region) | Fed. Min. (Cab.) | Fed. Parl. |
|---|---|---|---|---|---|---|---|---|---|---|
| Policy-legislative change (overall system) | P | * | | | * | | | | * | P |
| Policy-regulations (major operations) | | P | | | * | | * | | P | |
| Policy-adjudication of cases | | | | | P | | P | | | |
| Budget review and appropriations | P | * | | | | | | | * | P |
| Articulated information system | | | | | * | | * | | | |
| Appointment of commissioners | | P | | | | | | | P | |
| Appointment of senior staff | | P | | | | | | | P | |
| Regulation of market entry (issuers, actors) | | | | | P | | P | | | |
| Regulation of business conduct (disclosure, etc.) | | | | | P | | P | | | |
| Oversight of conduct of self regulatory bodies | | | | | P | | P | | | |
| Regulation of rates | | | | | P | | P | | | |
| Investigations | | | | | P | | P | | | |
| Enforcement-administrative proceedings | | | | | P | | P | | | |
| Enforcement-civil actions | | | | | P | | P | | | |
| Enforcement-referring criminal prosecutions | | | | | P | | P | | | |
| Review of Director's regulatory decisions | | | | | P | | P | | | |
| Administration (personnel, finances, capital) | | | | | * | | * | P | | |
| Review of administrative action (jurisdiction, procedures, arbitrariness) | | | | P | | | | | | |

**Model 13**

(P means primary responsibility, * means influence)

| Function | Prov. Leg. | Prov. Min. (Cab.) | Council of Min. (Fed.-Prov.) | Courts | Prov. Comm. | Integ. Fed.-Prov. Comm. | Fed. Comm. | Director (each comm. or region) | Fed. Min. (Cab.) | Fed. Parl. |
|---|---|---|---|---|---|---|---|---|---|---|
| Policy-legislative change (overall system) | P | * | P | | | * | | | * | P |
| Policy-regulations (major operations) | | * | P | | | * | | | * | |
| Policy-adjudication of cases | | | | | | P | | | | |
| Budget review and appropriations | P | * | P | | | | | | * | P |
| Articulated information system | | | | | | P | | | | |
| Appointment of commissioners | | * | P | | | | | | * | |
| Appointment of senior staff | | * | P | | | | | | * | |
| Regulation of market entry (issuers, actors) | | | | | | P | | | | |
| Regulation of business conduct (disclosure, etc.) | | | | | | P | | | | |
| Oversight of conduct of self regulatory bodies | | | | | | P | | | | |
| Regulation of rates | | | | | | P | | | | |
| Investigations | | | | | | P | | | | |
| Enforcement-administrative proceedings | | | | | | P | | | | |
| Enforcement-civil actions | | | | | | P | | | | |
| Enforcement-referring criminal prosecutions | | | | | | P | | | | |
| Review of Director's regulatory decisions | | | | | | P | | | | |
| Administration (personnel, finances, capital) | | * | * | | | * | | P | * | |
| Review of administrative action (jurisdiction, procedures, arbitrariness) | | | P | | | | | | | |

The unitary system, Model 6, is unitary only in the sense that administration is vested in one level of government, for the several provincial commissions would continue to exist, therefore requiring a delegation of federal powers to each commission. But this model has several clear advantages: it gives the federal government considerable influence over Canada-wide securities market policies with a minimum of administrative difficulty and preserves much provincial autonomy, and it obviates duplication of regulation, makes maximum use of experienced personnel, and is flexible in the sense that it assumes decentralized decision making in a manner that is sensitive to local conditions and also in the sense that it permits reasonably efficient personnel and financial administration through provincial offices. The signal disadvantages of such a system are that federal influence may be rather tenuous, particularly where federal law is not uniform with provincial law, that uniformity of statutes and procedures is not likely to develop, and that centralized information processing is improbable.

Model 10 has the advantage that it preserves both provincial and federal autonomy within their respective jurisdictions, but because it requires a separate federal commission, inherent in this model are two clear disadvantages. First it institutionalizes a dual system and therefore does not create any clear incentives for statutory and procedural

. . . /111

uniformity; second, and even more important, assuming a decentralized federal commission administered through regional offices, it does not make most efficient use of experienced regulators, in effect superimposing one level of regulation on the existing system, except to the extent duplication of work can be avoided through qualification by notification and qualification by coordination techniques and the use of common disclosure standards.

The third alternative, Model 13, places the federal government in an awkward minority position from which it can extricate itself only with great difficulty, that is, by withdrawing from the integrated system and setting up an independent federal system, which it could do realistically only if the courts had decided that Parliament has jurisdiction over interprovincial transactions, particularly automated trading systems. Nevertheless Model 13, which is very similar to the Cansec Proposal, has a number of desirable characteristics: it continues considerable federal and provincial autonomy, it tends more strongly to statutory and procedural uniformity, it necessarily leads to common information processing, it renders duplication of facilities unnecessary, it permits more efficient use of experienced personnel, and it permits flexible, decentralized administration at little added cost. But as already pointed out, it is unlikely that this model would be acceptable to the federal government unless the provinces agreed to enter into an integrated system

. . . /112

that is based on the premise that until the Supreme Court of Canada decides to the contrary the federal government has jurisdiction over interprovincial transactions - particularly over computerized trading, clearing, settlement and ownership transfer systems - and that the federal law should be cast as a comprehensive law encompassing all aspects of the securities market system. Indeed, it is this condition that distinguishes Model 13 from Cansec. The Cansec Proposal is directed at *uniform administration* of different laws, whereas Model 13 is directed at *uniform administration* of a *uniform law* with a substratum of provincial laws that preserves provincial autonomy with respect to intraprovincial transactions. Model 13 resembles Cansec in that it would commit the federal government to an institutional arrangement where it has no control over the regulatory system but only the rather ambiguous power to withdraw from the integrated system and set up a clearly less desirable dual system.[177]

The respective advantages and disadvantages of Models 6, 10 and 13 are briefly summarized in Table 7.

Table 7

Table 7

Comparison of Models

| Characteristics | Model 6 | | Model 10 | | Model 13 | |
|---|---|---|---|---|---|---|
| | Advantages | Disadvantages | Advantages | Disadvantages | Advantages | Disadvantages |
| Federal autonomy | Yes but constrained | No administrative control except to withhold resources | Yes | Dual system | Yes but constrained | Minority position |
| Provincial autonomy | Yes but constrained | Federal law superimposed at least re disclosure | Yes | Dual system | Yes but constrained | Threat of federal withdrawal |
| Uniform laws and procedures | No | Tends to a dual system | No | Dual system | No but tends to uniformity | Less local experimentation |
| Obviates duplication of regulation | Yes | Tenuous federal control | No | Dual system except as co-ordinated by statute | Yes | Complicated system to approve change |
| Makes use of experienced regulators | Yes | Ontario and Quebec dominate | Yes at provincial level | No, particularly at regional offices | Yes | |
| Makes possible central information processing and overall systems analysis | No | Requires co-ordination of discrete provincial files | Yes | Except intra-provincial operations | Yes | |
| Flexible - decentralized decision making and responsive to local conditions | Yes | Lack of uniformity of standards and procedures | No | Dual system of regional offices | Yes | |
| Flexible - efficient use of personnel, finances, capital assets | Yes | Ontario and Quebec dominate | No | Almost certain duplication | Yes | |

## 8. Conclusions

Although recent data tend to the inference that the securities market is declining in importance as a financial intermediary, there is nevertheless a broad consensus that the securities market is a very desirable institution to allocate capital, to direct savings to productive enterprise, to induce investors to invest in equity securities, and to ensure greater Canadian ownership of Canadian enterprise. But recent developments in the securities markets, particularly the growth of intermediaries such as pension funds, insurance companies and mutual funds and the rapid development of computer-communications technology, have compelled a re-examination not only of regulatory techniques but also of the basic assumptions that underlie securities regulation to determine whether the securities market should continue to be regulated as a quasi-cartel, as an outright cartel, or as an essentially competitive market subject only to close public controls over the computer-communications system as a public utility.

Irrespective of the nature of the regulatory goals, there will continue to be available three basic means to regulate markets. The first is to balance power among potential competitors - for example, among banks, underwriters and brokers - to maximize interindustry competition under the aegis of the competition laws. The second is to institutionalize responsibility in market actors, for example, by establishing public councils to advise government, adding public members to stock exchange boards, and imposing personal liability on the principals of securities firms and on individuals connected with a securities issue. The third - and still by far the most important - is to regulate through an external regulatory commission that acts under relatively broad public interest standards, exercising legislative, administrative, adjudicative and investigative powers over the main levers of market control - entry, conduct and prices - to control the behaviour of actors in the market.

Although the regulatory commission concept has recently come under heavy fire - particularly in respect of the regulation of infrastructure utilities - as being two independent of the political process, too arbitrary, too much under the influence of the regulated industry, and even as being ineffective, for several reasons the regulatory commission offers advantages that more than outweigh its disadvantages. For example, it permits expert policy development and expert administration within a context of broad statutory standards, relative independence from the immediate pressures of partisan politics, freedom from many

. . . /115

of the bureaucratic constraints imposed on government departments, and, above all, a very flexible means to coordinate interdepartmental and even intergovernmental programs. Before acceding to criticisms of the regulatory commission, it is therefore essential that the means and ends of each regulatory scheme be closely scrutinized to determine whether the criticisms have any bearing on that scheme.

Indeed, because of the Canadian constitutional law relating to the delegation of powers from the federal and provincial legislatures to a regulatory commission, a commission is an ideal vehicle to coordinate the exercise of federal and provincial powers that relate to a common program objective such as securities market regulation. The present law permits the use of three coordinating techniques: (1) the federal government may delegate authority to administer a federal law to provincial commissions; (2) the federal government may set up a federal commission and invoke statutory coordinating mechanisms to minimize the overlap of functions carried out by the federal and provincial commissions; or (3) the federal and provincial governments may agree to set up a joint federal-provincial commission to which legislatures at both levels delegate quite broad regulatory authority.

Although not free from political and technical difficulties, particularly the reluctance of the provinces to acknowledge even tacitly that the federal Parliament has any jurisdiction over interprovincial securities transactions, the third alternative - an integrated federal-provincial commission - is clearly preferable. It tends strongly to the development of uniform laws and procedures without requiring any legislature expressly to yield jurisdiction. It permits continued use of the most experienced securities administrators in a context that permits consideration of local as well as national conditions. And above all, it furnishes a mechanism that can be adapted to the probable future regulatory environment, which will focus less on detailed market structures and functions and more on the overall design and regulation of a Canada-wide securities transactions system based on computer-communications technology.

<u>FOOTNOTES</u>

1. Staff of Subcomm. on Comm. and Fin. of Comm. on Interstate and For. Comm., 92d Cong., 1st Sess., Securities Industry Study (1972).

2. *General*: OECD Capital Markets Study, General Report (1967);

   *United States*: SEC, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963); SEC, Institutional Investor Study Report, H.R. Doc. No. 92-64, 92d Cong., 1st Sess. (1971); Staff on H.R. Subcomm. on Comm. and Fin. of Comm. on Interstate and For. Comm., 92d Cong., 1st Sess., Securities Industry Study (Subcomm. Print, 1972); Staff of Sen. Subcomm. on Securities, Comm. on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess., Securities Industry Study (Comm. Print, 1973); Lorie, Public Policy for American Capital Markets, U.S. Dept. of the Treasury (1974);

   *Canada*: Conway, The Supply of and Demand for Canadian Equities (1970); Shaw and Archibald, The Management of Change in the Canadian Securities Industry (7 of 8 vols., 1972-75);

   *United Kingdom*: Department of Trade (U.K.), Inquiry concerning Supervision of the Securities Market (July 1974);

   *Australia*: Australian Securities Markets and Their Regulation, Report of Sen. Select Comm. on Securities and Exchange (18 July 1974);

   *France*: Le Marché des actions (Rapport Baumgartner, June 1971).

3. Securities Reform Act of 1975, H.R. Report No. 94-123, 94th Cong., 1st Sess. (1975).

4. Grossman, Economic Systems 18-20 (1974). See also Jacoby, The Bureaucratization of the World (1973).

5. The obvious example of the centrally planned economy is the system in the Soviet Union, which is described in detail in Campbell, Soviet Economic Power (2d ed., 1966). There are many versions of attempts at decentralized planning through cartels under varying degrees of government supervision. The U.S. experience during the New Deal era is summarized in Fainsod, Gordon and Palamountain, Government and the American Economy 525-569 (3d ed., 1959), and in Wilcox, Public Policies toward Business 762-766 (4th ed., 1971). Vestiges of these cartels continue to exist in certain sectors such as the agricultural industry, e.g., through milk or egg marketing boards.

. . . /2

6. Musgrave, The Theory of Public Finance 5-27 (1959). See Friedmann, The State and Rule of Law in a Mixed Economy 3 (1971), where the author uses four similar but different functional categories - provider, regulator, entrepreneur and umpire. See also Lowi, Four Systems of Policy, Politics and Choice, Pub. Admin. Rev. 299 (1972), where the author speaks of four categories of policies that determine the form of government action - distributive, constituent, regulatory and redistributive policies: cited in Doern, The Concept of Regulation and Regulatory Reform, in Doern and Wilson (eds.), Canadian Public Policy 8 (1974).

7. Kaysen, The Corporation: How Much Power? What Scope? in Mason (ed.), The Corporation in Modern Society 85, 103 (Atheneum paperback ed., 1966).

8. See Schultze, National Income Analysis 11 (3d ed., 1971).

9. Price and wage controls - or to use the economist's euphemism, incomes policy - are not considered here on the ground that they displace the price mechanism rather than influence input allocation and output distribution. Although selective controls may not completely displace the price mechanism, as used in this paper they constitute controls, a form of ad hoc planning.

10. Wilson, The Politics of Regulation, in McKie (ed.), Social Responsibility and the Business Predicament 135, 136 (1974).

11. The performance measure used is the litmus test to distinguish between a price system and a command system, between competitive management and bureaucratic management. See Downs, Inside Bureaucracy 25 (1967).

12. See Leftwich, Price System and Resource Allocation 25 (1963), cited in Berczi, The Stock Exchange - A Total System Approach, p. vi, an unpublish paper of Faculty of Commerce and Administration, Sir George Williams University (July 1971). See also Shaw and Archibald, Canada's Capital Market iv, Study One of TSE Study (June 1972); Demsetz, Perfect Competition, Regulation and the Stock Market in Maune (ed.), Economic Policy and the Regulation of Corporate Securities 1-11 (1969).

13. Wilson, n. 10 above at 141-146 demonstrates that the distribution of costs and benefits of a regulatory policy will determine the means of regulation.

14. See Bain, Industrial Organization 515-517 (2d ed., 1968); Caves, American Industry: Structure, Conduct, Performance 93-94 (3d ed., 1972).

15. See generally Wilcox, Public Policies toward Business 14 and 718-720 (4th ed., 1971); Fainsod, Gordon and Palamountain 187-195 (3d ed., 1959); Mund, Government and Business (4th ed., 1965).

16. This was the principal policy goal of the Canada Business Corporations Act, S.C. 1975 c. 33, which received Royal Assent on 24 March 1975.

17. The best illustration is the Labor-Management Reporting and Disclosure Act of 1959, Public Law 86-257 (Landrum-Griffin Act, 1959), which is referred to in Freeman, Labor Economics 125 (1972) and analysed in detail in McAdams, Power and Politics in Labor Legislation (1964).

    The Quebec Government recently enacted a similar but more stringent law in response to the sensational disclosures made to and the recommendations of the Cliche Commission. See an Act respecting the placing of certain labour unions under trusteeship (Bill 29), National Assembly of Québec, 30th Leg., 3d Sess., 1975.

18. See, for example, the Proposed Statute for the European Company, art. 137, Supp. to Bull. 8 of EEC (1970). Since this institution is limited to one corporation there is no implication of cartelization of an industry as was attempted through the NRA Codes during the New Deal era in the United States. See Shonfield, Modern Capitalism 309-318 (1965); Fainsod, Gordon and Palamountain, Government and the American Economy 525-543 (ed ed., 1959).

    Another interesting variation is the Kelso Plan, designed to induce employee share purchases, which is discussed in the Interim Report of the Select Comm. of Ont. Leg. on Economic and Cultural Nationalism, Capital Markets, Foreign Ownership and Economic Development 92-99 (1974).

. . . /4

19. Note that these regulatory techniques can be characterized in many ways. Wilcox, n. 11 above, categorizes regulatory techniques as aspects of competition: (1) controlling monopoly by maintaining competition; (2) controlling monopoly ("natural monopoly") by regulation; (3) controlling monopoly by public enterprise; (4) setting the plane of competition (consumer, investor, resource protection); and (5) moderating competition to achieve a higher priority policy goal (labor law, agricultural cartels, etc.). Fainsod et al, n. 18 above, employ different categories.

    See also Feller, Public Policy of Industrial Control, in Friedrich and Mason (eds.), Public Policy 130 (1940).

20. Schwarz and Wade, Legal Control of Government 29 (1972).

21. Fainsod, Some Reflections on the Nature of the Regulatory Process in Friedrich and Mason, Public Policy 297 at 299, 323 (1940). See also M.H. Bernstein, Independent Regulatory Agencies: A Perspective on Their Reform, The Annals of Am. Acad. of Pol. and Soc. Science 14 (1972); Doern, Hunter, Swartz and Wilson, Approaches to the Study of Federal Administrative and Regulatory Agencies, Boards, Commissions and Tribunals, Report Prepared for the Canada Law Reform Commission 47-60 (April 1974).

22. See, e.g., the Petro-Canada Act, S.C. 1975, c.61.

23. See, e.g., the Canada Development Corporation Act, S.C. 1970-71-72, c. 49, s. 2, which states that the purpose of the Act is "... to establish a corporation that will help develop and maintain strong Canadian controlled and managed corporations in the private sector of the economy and will give Canadians greater opportunities to invest and participate in the economic development of Canada".

    See also the Federal Business Development Bank Act, S.C. 1974-75, c. 14, s. 4, which was created "... to promote and assist in the establishment and development of business enterprises in Canada ...".

24. Arguing that the pervasive influence of development banks has prevented the development of a securities market in developing countries, Kleinman advocates that governments sponsor a liquidity fund to finance the interim holdings of securities by underwriters and market makers: see Hearings on Capital Markets and Economic Development: The Kleinman Plan, Subcomm. of Inter-Am. Affairs of House Comm. on Foreign Aff., 92d Cong., 2d Sess. 2-17 (1972).

25. See Stone, An Economic Study of the Securities Industry 137 (1973), where the author argues that economic analysis requires government ownership or full regulation. For a similar argument see Weil, The Securities Industry: Myth v. Reality - And a Proposal, paper published by Paine, Webber, Jackson & Curtis, N.Y. (June 1975), reprinted in Securities Amendments Act of 1975, Hearings on S. 249 before Subcomm. on Sec. of Sen. Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess., 268 (Feb. 1975).

    One author underlines, however, that at least in the U.S., government has a strong bias toward regulation and away from public ownership or management: Wilson, The Politics of Regulation, In McKie (ed.) Social Responsibility and the Business Predicament 135 (1974).

26. Stone, n. 25 above, at 127. See also Friend, The SEC and the Economic Performance of Securities Markets, in Maune (ed.), Economic Policy and the Regulation of Corporate Securities (1969).

27. As shown on Table 3 the basic data sources are:

    (1) Bank of Canada Review (April 1975);
    (2) Statistics Canada, System of National Accounts (Fourth Qu. 1974);
    (3) Statistics Canada, Canadian Statistical Review (April 1975); and
    (4) Sun Life Ass. Co. of Canada, Canadian Capital Markets, 1975 Outlook (13 June 1975).

28. Because the different source documents differently define each captioned data element, it is impossible to reconcile these statistical tabulations, therefore I have arbitrarily adjusted Table 3 for error, therefore that table is at best only an approximation of the flow of funds from sources and impliedly through various financial intermediaries to end uses.

29. Act of 8 & 9 Wm. 3, c. 32, cited in Gower, The Principles of Modern Company Law 38, n. 82 (3d ed., 1969). The modern English Statute is the Prevention of Fraud (Investments) Act, 1958, 6 & 7 Eliz. 2, c. 45 as amend. Gower, at p. 35, n. 58 points out that Parliament made several rather ineffective attempts during the eighteenth century to preclude stock market abuses.

30. Id. at 28-48. See also Williamson, Securities Regulation in Canada 4-6 (1960, Supp. 1966).

31. Williamson, Id. at 5-6.

32. *Ashbury Carriage Co.* v. *Riche* (1875) L.R. 7 H.L. 653 introduced the notion of ultra vires to constrain adventurous management; *Trevor* v. *Whitworth* (1887) 12 App. Cos. 409, H.L. barred a corporation from acquiring its own shares; *Erlanger* v. *New Sombrero Phosphate Co.* (1878) 3 App. Cos. 1218, H.L. made clear that promoters, directors and officers were fiduciaries and, as such, had a duty to act in good faith even if not a duty of care.

33. See the several responses to the Inquiry of the Department of Trade of June 1974 published by the Capital Markets Committee (Dec. 1974), the Panel on Take-overs and Mergers (Jan. 1975), and the Law Society (Jan. 1975).

34. See generally 1 Loss, Securities Regulation 23-35 (1961, Supp. 1969); Loss & Cowett, Blue Sky Law 1-10 (1958); Williamson, Securities Regulation in Canada 3-46 (1960, Supp. 1966); Baillie, The Protection of the Investor in Ontario, 8 Can. J. of Pub. Admin. 172 and 325 (1965).

35. See Loss, *supra* n. 34, at 121-128. The major exception was the Thompson Bill, discussed in Landis, The Legislative History of the Securities Act of 1933, 28 Geo. Wash. L. Rev. 29, 31 (1959); Parrish, Securities Regulation and the New Deal 42-72 (1970); De Bedts, The New Deal's SEC 35-38 (1964).

36. Landis, *supra* n. 35, at 34-35.

37. But Congress deliberately did not pre-empt the field and therefore left to the state the power to impose any higher public interest standards at the local level: see Loss & Cowett, Blue Sky Law 237 (1958).

38. See Fainsod, Gordon & Palamountain, Government and the American Economy 529-543 (3d ed., 1959). See also the other works cited in n. 5, above.

39. 2 Loss, Securities Regulation 1362 (1961, Supp. 1969); Robbins, The Securities Markets 83-123 (1966).

40. *Schechter* v. *U.S.*, 295 U.S. 495 (1935).

41. The SEC surveillance powers are set out in s. 19 of the Securities Exchange Act of 1934.

    Only one association, the National Association of Securities Dealers (NASD), a Delaware non-profit corporation, has ever been registered. See generally Robbins, *supra*, n. 39 at 112; 2 Loss, Securities Regulation 1365 (1961, Supp. 1969).

    Its Canadian counterpart, the Investment Dealers Association (IDA) is an unincorporated association that has never had statutory legitimacy. As a result it has been successfully sued for damages for intimidation on the grounds it wrongly refused to qualify a securities salesman to be employed by IDA members: *Reynolds* v. *Eckman et al* representing all members of the IDA (1975).

42. This subject is discussed generally in 5 Loss, Securities Regulation 3153-86 (1961, Supp. 1969). See also Pozen, Competition and Regulation in the Stock Markets, 73 Mich. L. Rev. 317 (1974); and Statement of U.S. Dept. of Justice at SEC Hearings on the Structure, Operation and Regulation of the Securities Markets, in Part 6 of Study of Sec. Ind. by H.R. Subcomm. on Comm. and Fin., *supra* n. 2, at 3135.

43. See studies cited *supra*, n. 2, and see also SEC Statement on the Future Structure of the Securities Markets (2 Feb. 1972); SEC Policy Statement on the Structure of a Central Market System (29 March 1973).

44. Hearings before the Subcomm. on Securities of Sen. Comm. on Banking Housing and Urban Affairs, 93d Cong., 1st Sess. on S. 2519, at p. 194 (12-14 Nov. 1973).

45. Dept. of the Treasury, Public Policy for American Capital Markets (Lorie Report, 7 Feb. 1974).

46. Studies, *supra*, n. 43, and Hearings, *supra*, n. 44.

47. Securities Acts Amendments of 1975, §§6(b)(5), 15A (b)(6), 19(c), discussed in Report of the Senate-House Conference Committee, H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 99 (1975).

48. See, e.g., the reference to the industry as a kind of "combine" in the report on the proposed national brokerage commission rates, OSC Bull. 107, 108 (Aug. 1973).

49. Details of alternative coordinating mechanisms are discussed below in Part 7 under the heading "Institutions of Federal-Provincial Cooperation".

50. Lorie Report, *supra* n. 45, at 3-6.

51. This extends beyond the secondary market where there is detailed regulation of entry and commission rates and includes the underwriting function in the primary market, which tends strongly to monopoly because of the inherent need for underwriters to work closely together in order to spread the risk of any underwriting loss. See the Report on Foreign Direct Investment in Canada 101-102 (Gray Report, 1972), where it is argued that barriers to competition should be lowered and the need to collaborate lessened by creation of a special insurance fund. Compare the Kleinman Plan, *supra*, n. 24.

52. See especially the Report of the Committee to Study the Requirements of Capital and the Implications of Non-resident Capital for the Canadian Securities Industry (Moore Report, May 1970); Study of the Securities Industry in Quebec (Banchard Report, June 1972); OSC Report of the Securities Industry Ownership Study (April 1972).

53. See Martin, The Securities Markets (Martin Report, 5 Aug. 1971), reprinted in Study of Sec. Ind., Hearings (Part 6) before H.R. Subcomm. on Comm. and Fin. of H.R. Comm. on Interstate and For. Comm., 92d Cong., 2d Sess. 3189 (1972); Weil, *supra* n. 25.

54. See Stone, An Economic Study of the Securities Industry 278-290 (1973).

55. The SEC required all U.S. stock exchanges to eliminate fixed commission rates on 1 May 1975, a move that has already had deep impact upon the market: see Securities Week, pp. 1-3 (26 May 1975).

56. In the U.S. individuals have been net sellers of securities consistently since 1959: see Chase Manhattan Bank, Business in Brief No. 115 (April 1974). Institutions now account for some 70% of NYSE trading. The amount was 59.7% in the U.S. in 1971: NYSE Fact Book 53 (1972). The dominance of institutions is probably the same or even greater in Canada. Meyer alleges 75% in normal times and as high as 90% during the current recession: Meyer, Where Lies the New Jerusalem ..., Executive 13 (July 1974).

57. These practices have been adduced as evidence that fixed commission rates did tend to excessive monopoly rents: Mann, The New York Stock Exchange: A Cartel at the End of Its Reign, in Phillips (ed.), Promoting Competition in Regulated Markets 301, 314 (1975).

    The latest refinement, introduced after fixed commission rates were abolished in the U.S., is a co-operative that remits to a customer a patronage dividend based on the volume of the customer's business, in effect returning to the customer the brokerage commission less a management surcharge. See Elia, Broker Firm ... Structured like a Co-op", Wall St. Jo., p. 33, col. 3 (27 May 1975).

58. See Robbins, The Securities Markets 252-261 (1966); Securities Industry Study, *supra* n. 2, at 77; SEC Institutional Investor Study Report, H.R. Doc. No. 92-64, Part 4, 92d Cong., 1st Sess. 2311-22 (1971).

59. This topic is discussed at length in the Moore Report, *supra* n. 52, at 70-78; the Bouchard Report, *supra* n. 52, at 130 ; and the OSC Report of the Securities Industry Ownership Study, *supra* n. 52, at 95 and 120.

60. See the reports cited *supra* n. 52.

61. See article "Must deal Canadian", Fin. Post, p. 16, col. 1 (24 May 1975) concerning alleged QSC pressure on institutions to execute in Canada.

62. See OSC Report of the Securities Industry Ownership Study, *supra* n. 52, at 122; Bouchard Report, *supra* n. 52, at 146.

63. See QSC Statement further to Repeal of its Policy No. 8 imposing higher standards on new issues by mining, oil and natural gas corporations (21 Oct. 1974). And see OSC Enquiry discussed in article by Zehr, OSC Gets Noticeably Tougher, Northern Miner (14 April 1975); OSC Bull. .

64. This issue was also raised in the Report of the Royal Comm. on Banking and Finance 341 (Porter Report, 1964).

65. These ideas are discussed in detail in Mendelson, From Automated Quotes to Automated Trading: Restructuring the Stock Market in the U.S. (1972); Berczi, The Stock Exchange - A Total System Approach, *supra*, n. 11; Parts 5-6 of the Study of the Securities Industry, Hearings of Subcomm. on Comm. and Fin. of H.R. Comm. on Interstate and For. Comm., 92d Cong., 2d Sess. (1972); of Subcomm. on Sec. of Sen. Comm. on Banking, Housing and Urban Aff., 92d Cong., 2d Sess. (1972); National Securities Market System Act of 1973, Hearings of Subcomm. on Sec. of Sen. Comm. on Banking, Housing and Urban Affairs on S. 2519, 93d Cong., 1st Sess. (1973).

The first major step in this direction was implementation of the "Consolidated Tape" on 16 June 1975 to report concurrently all trades of NYSE listed securities on several markets. See Autotransaction Industry Report of International Data Corporation, vol. 3, no. 5 (11 June 1975).

66. See the reports cited, *supra*, n. 43. Even the Martin Report, *supra*, n. 53, which has a strong bias toward cartel control of the market, concedes this point.

    With respect to Canada see the MSE report by Honeywell, Canada Wide Securities Market System - Preliminary Proposal (March 1973).

67. *Supra*, n. 53. See also the commentaries on the Martin Report reprinted in Part 6 of the Study of the Securities Industry, Hearings of the Subcomm. on Comm. and Fin. of the H.R. Comm. on Interstate and Foreign Comm., 92d Cong., 2d Sess. (1972).

68. Weil, The Securities Industry: Myth v. Reality - and a Proposal, paper published by Paine, Webber, Jackson and Curtis, N.Y. (June 1975), reprinted in Securities Acts Amendments of 1975, Hearings on S. 249 before Subcomm. on Sec. of Sen. Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. (1975).

    For a similar Canadian view see paper by Lafferty, A New Design for Capital Markets in Canada, presented to Invest. Sec. of the Can. Life Ins. Ass. (12 May 1970).

    Davant, chairman of Paine, Webber has recently disagreed with Weil, arguing that the SEC has done enough by removing fixed commission rates and that the industry should be empowered to develop any required new structure: BNA Sec. Reg. Law Rep., No. 303, p. A-17 (21 May 1975).

69. In this context an auction market is a market that determines prices through the matching of buyers' bids and sellers' offers, whereas in a dealer market a dealer holds large inventories, giving the dealers some control over supply and probable power to influence price.

    One analyst argues that trading on the NYSE is now made up of only 6% auction trading and 94% dealer trading: see Brown, Small Orders and Auction Markey Myths, Comm. & Fin. Chronicle, p. 8, cols. 3-4 (13 Jan. 1975).

70. Stone, An Economic Study of the Securities Industry, esp. 125-139, 169-175, 278-290 (1973).

71. Stone impliedly assumes the existence of an insurance system to protect investors from losses caused by securities firm failures.

72. This is the practical result of the U.S. Securities Reform Act of 1975 that became law on 14 June 1975. See discussion above, at nn. 43-47.

73. This development from reacting to block abuses to design of an overall system - i.e., from policing to planning - is not a new phenomenon. See Fainsod, Gordon and Palamountain, Government and the American Economy 267-270 (1959). See also Wilson, The Politics of Regulation, in McKie (ed.), Social Responsibility and the Business Predicament 135, 152 (1974); Lowi, The End of Liberalism 141 (1969).

74. See Staff of Subcomm. on Securities Industry Study, Report of Subcomm. on Sec. of Sen. Comm. on Banking, Housing and Urban Affairs 2, 158 (Comm. Print 1973).

Contrast the fuzzy platitudes about cooperative regulation in Staff of Subcomm. on Securities Industry Study, Report of Subcomm. on Comm. and Fin. of H.R. Comm. or Interstate and For. Comm., pp. viii - xvii (Subcomm. Print 1972).

75. The economic case is cogently urged by Mann, The New York Stock Exchange: A Cartel at the End of its Reign, in Phillips (ed.), Promoting Competition in Regulated Markets (1975).

76. For an excellent discussion of this phenomenon, see Wilson, The Politics of Regulation, in McKie (ed.), Social Responsibility and the Business Predicament 135-136 (1974).

77. Fainsod, Gordon and Palamountain, Government and the American Economy 243 (3d ed., 1959).

Canadian authors frequently admonish us to be wary of drawing conclusions from comparisons between U.S. and Canadian regulatory commissions: see Baillie, Securities Regulation in the Seventies, in Ziegel (ed.), Canadian Company Law 343, at 350 (1973); Doern, The Concept of Regulation and Regulatory Reform, in Doern & Wilson (eds.), Issues in Canadian Public Policy 8, 29 (1974). Close study shows, however, that the problems defined and the solutions proposed are close analogues. Similar problems in the U.K. are commonly resolved by departmentalization or state ownership rather than by regulatory agencies: see Schwarz and Wade, Legal Control of Government 26 (1972). And see, *infra* n. 99.

Ironically, U.K. experience was heavily relied upon to justify setting up the first U.S. federal commission. See Bernstein, Regulating Business by Independent Commission 25 (1955).

78. Report of the President's Committee on Administrative Management (Brownlow Comm., 1937), cited in Bernstein, Independent Regulatory Agencies: A Perspective on their Reform, Annals of Am. Acad. of Ec. and Pol. Sc. 14 (1972).

79. See, e.g., Zimmerman, The Legal Framework of Competition Policies toward Regulated Industries, in Phillips (ed.), Promoting Competition in Regulated Markets 367 (1975); Schwarz, Legal Restriction of Competition in the Regulated Industries: An Abdication of Judicial Responsibility, 67 Harv. L. Rev. 436 (1954).

80. See, e.g., Wilson, The Dead Hand of Regulation, 25 Pub. Interest 39 (1971); Phillips (ed.), Promoting Competition in Regulated Markets (1975).

81. See Bernstein, Regulating Business by Independent Commission 291-293 (1955).

82. See Cary, Politics and the Regulatory Agencies 139 (1967); Jaffe, The Illusion of the Ideal Administration, 86 Harv. L. Rev. 1183, 1197 (1973); Wilcox, Public Policies toward Business 467 (4th ed., 1971).

83. See Bernstein, *supra* n. 81, at 126, where the author discusses the political effects of this doctrine.

84. Landis, The Administrative Process 11-15 (1938); Jaffe, The Effective Limits of the Administrative Process: A Re-evaluation, 67 Harv. L. Rev. 1105, 1129 (1954); Lowi, The End of Liberalism 101, 141 (1969).

85. Landis, *supra* n. 84, at 1-46 (1938).

86. Lowi, The End of Liberalism 130-143 (1969); Landis, *supra* n. 84, at 15-16, 46.

87. Bernstein, *supra* n. 81, at 71; and see the Ont. Comm. on Govt. Productivity 3, 38 (Report No. 9, 1973).

88. The Sherman Act of 1890 was originally administered by the Bureau of Corporations in the original Department of Commerce and Labor: see Lowi, The End of Liberalism 119 (1969). The report of the President's Committee on Administrative Management (Brownlow Report, 1937) recommended that all programs, including those administered by regulatory agencies be integrated in a department under the authority of a cabinet member: see Bernstein, *supra* n. 78, at 15. This thesis was reiterated in the report

. . . /13

by Redford, The President and the Regulatory Commissions (17 Nov. 1960), submitted to the President's Comm. on Govt. Org. See also Hector, Problems of the CAB and the Independent Regulatory Commissions, 69 Yale L. Jo. 931, 960 (1960).

This parallels the ministry concept recommended in the report of the Ont. Comm. on Govt. Productivity 19-28 (Report No. 9, 1973).

89. Jaffe, The Illusion of the Ideal Administration, 86 Harv. L. Rev. 1183, 1190 and 1197 (1973).

90. Landis, The Administrative Process 72 (1938). See also the discussion at pp. 51 and 66. To the same effect see Friendly, The Federal Administrative Agencies 13 (1962).

Landis, without recasting his earlier views completely, underlined in a later report that the legislature must, to fulfil its planning responsibilities, define each agency's objectives and powers more clearly. See Landis, Report on the Regulatory Agencies to the President-Elect (1960), discussed in McFarland, Landis Report: The Voice of One Crying in the Wilderness, 47 Va. L. Rev. 373, esp. 425-427, 433-438 (1961).

91. See Bernstein, Regulating Business by Independent Commission 155, 294-95 (1955).

92. The leading advocates of expressing clearer, detailed standards are Friendly, The Federal Administrative Agencies 19, 142-146 (1962), and Davis, Discretionary Justice 56-65 (1969). See also the critique of Davis by Anisman, 47 Can. Bar Rev. 670 (1969); and Jowell, The Legal Control of Administrative Discretion, Public Law 178, 203-206 (1973).

93. Jaffe, *supra* n. 89, at 1188-1190.

94. Davis, Administrative Law Text §1.04 (1972).

95. See discussion in Schwarz and Wade, Legal Control of Government 152 (1972).

96. S.C. 1970-71-72, c.1, esp. ss. 18, 28, discussed in detail in Mullan, The Federal Court Act: A Misguided Attempt at Administrative Law Reform?, 23 U. of T. Law Jo. 14 (1973).

97. S.O. 1971, c. 47 and S.O. 1971, c. 48 respectively. Complementary provisions were enacted by the Public Enquiries Act. S.O. 1971, c.49, and the Civil Rights Statute Law Amendments Act, S.O. 1971, c.50, all of which are discussed in Baillie, *supra* n. 77, at 16-17.

98. Schwarz and Wade, *supra* n. 95, at 26-31.

Amendments to the B.C. Securities Act in 1974 have reconstituted that Commission more on an English model, vesting all policy making and administrative powers in a departmental officer, the Superintendent of Brokers, and relegating the Commission to the status of a purely adjudicative agency. See B.C. Sec. Act. S.B.C. 1967, c. 45, as amended, ss. 3-6; and she Getz, Appellate Functions Planned, Van. Stock Ex. Rev. (Oct. 1974).

99. Professor Willis points out that it is "... from the United States that we have borrowed most of our regulatory legislation together with our preference to the American board, as opposed to the English civil service, method of implementing it". Willis, Canadian Administrative Law in Retrospect, 24 U. of T. Law Jo. 225, 235 (1974).

100. Bernstein, Regulating Business by Independent Commission 192-209 (1955).

101. See, in particular, Bernstein, *supra* n. 100, at 179-182; Jaffe, The Illusion of Ideal Administration, 86 Harv. L. Rev. 1183 (1973); Massel, The Regulatory Process, 26 Law and Contemp. Problems 181 (1961); Jowell, The Legal Control of Administrative Discretion, Public Law 178, 213 (1973).

Schwarz and Wade, *supra* n. 95, at 111 concluded that the U.S. Administrative Procedure Act "... has elevated the procedural level without crippling the administrative process."

102. Hogg, Judicial Review: How Much Do We Need?, 20 McGill Law Jo. 157, 175 (1974).

103. Willis, *supra* n. 99, at 244; Willis, The McRuer Report: Lawyers' Values and Civil Servants Values, 18 U. of T. Law Jo. 351, 359 (1968); Mullan, *supra* n. 96, at 50-53.

Note that the U.S. Securities Reform Act of 1975 has substantially amended s. 25 of the Securities Exchange Act of 1934 to extend express judicial review powers, particularly to encompass rule making as well as adjudicative orders. See H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 100 (1975).

104. A comparison of trends in the U.K. and the U.S. is made in Schwarz and Wade, *supra* n. 95, at 26-27, 117-120.

105. See Massel, The Regulatory Process, 26 Law and Contemp. Problems 181, 195-197 (1961); Jaffe, Basic Issues: An Analysis, 30 N.Y.U. Law Rev. 1273, 1285 (1955).

106. These issues are all summarized with respect to the U.S. commissions in Bernstein, Independent Regulatory Agencies: A Perspective on Their Reform, Annals of Am. Acad. of Pol. and Soc. Science 14 (1972).

107. Landis Report (1960), cited in Bernstein, *supra* n. 106, at 18.

108. Second Hoover Comm. (1955), cited in Bernstein, *supra* n. 106, at 17.

109. Second Hoover Comm. (1955), cited in Bernstein, *supra* n. 106, at 17. One of the difficult problems relates to ex parte communications, i.e., facts considered by an adjudicative commission that are not on the record and not fully disclosed to the affected parties. See Davis, Administrative Law Text, c.13, esp. §13.07 (1972).

See Cary, Why I Oppose the Divorce of the Judicial Function from Federal Regulatory Agencies, 51 ABA Jo. 33, where the author argues strongly against separation on the ground that case by case adjudication is often the best means to "prick out" an effective policy.

110. Bernstein, *supra* n. 106, at 24. Schwarz and Wade, *supra* n. 95, repeatedly points out, too, that the U.S. formalities cannot be reconciled with resolving conflicts that arise in connection with comprehensive social welfare programs.

111. Brownlow Comm. (1937), cited in Bernstein, *supra* n. 106, at 15. See also n. 88, *supra*.

112. Bernstein, Regulating Business by Independent Commission 145-150 (1955). The author points out that independence may be desired by industry to ensure control over the regulators.

One proposed change of U.S. securities laws would have institutionalized industry influence over the SEC. This proposal was rejected at the Conference Committee stage. See H.R. Report No. 94-229, 94th Cong., 1st Sess. 96 (1975).

. . . /16

113. First Hoover Comm. (1949), Landis Report (1960), and Ash Report (1971), cited in Bernstein, *supra* n. 106 at 16, 18, 19.

The most recent U.S. federal commission, the Commodity Futures Trading Commission created by Public Law 93-463 of 23 Oct. 1974, involved a transfer of regulatory authority from the Dept. of Agriculture to an independent commission; but the commission is structured to ensure close, continuous liaison with the Secretary of Agriculture. See Staff of Sen. Comm. on Agriculture and Forestry, The Commodity Futures Trading Commission Act of 1974, p. 21 (Comm. Print, 1974); and Dept. of Agric., Report to Cong. on the Commodity Exchange Auth. and on Commodity Futures Trading 12-13 (3 May 1974).

114. Bernstein characterizes the concept of "independence" from the executive as a "curious American concept": Bernstein, *supra* n. 112, at 150. See also Massel, *supra* n. 105, at 186.

115. See, e.g., the Ont. Comm. on Govt. Productivity, Rep. No. 9, p. 45.

But Baillie, *supra* n. 77, at 353, points out that Canadian securities commissions are in practice substantially independent of both the legislature and the executive.

116. This theme is frequently reiterated but it defies any kind of clear definition. See, e.g., Jaffe, The Effective Limits of the Administrative Process: A Reevaluation, 67 Harv. L. Rev. 1105, 1135 (1954); Cary, Politics and the Regulatory Agencies 25 (1967).

117. The federal government has recently taken steps to clarify departmental control over strategic policy decisions with respect to transportation and communications. With respect to the latter see Communications: Some Federal Proposals, Information Canada (1975), discussed in Toronto Globe & Mail, p. 10, col. 1 (26 April 1975), and also the Canadian Radio-television and Telecommunication Commission Act (Bill C-5) as enacted by H.C. on 21 April 1975.

118. See esp. Wilson, The Dead Hand of Regulation, 25 The Public Interest 39 (1971); Phillips (ed.) Promoting Competition in Regulated Markets (1975).

119. See Jaffe, *supra* n, 116, at 1114, 1127 where the author criticizes a too simplistic free market approach.

120. For an excellent illustration of this kind of analysis, see Mann, The New York Stock Exchange: A Cartel at the End of its Reign, in Phillips (ed.), *supra* n. 118, at 301.

This approach is not altogether new. In 1954 Schwarz advocated that the courts be empowered to quash agency decisions that reduce competition except where the agency establishes that it cannot otherwise achieve its statutory objectives: see Jaffe, *supra* n. 116, at 1134. Schwarz's idea is now reflected in s. 23 of the Securities Exchange Act of 1934 as amended by the Securities Acts Amendments Act of 1975.

121. Wilson, *supra* n. 118, at 40-42.

122. These critics are currently having great impact. Several U.S. bills have recently been tabled in Congress recommending a study of the functions of the regulatory commissions. See, e.g., S. 4145 and S. 4167, 93d Cong., 2d Sess., discussed in BNA Antitrust Reg. Rep., p. A-17 (26 Nov. 1974).

Since then the President and a bipartisan congressional delegation have met to discuss the issues raised by the bills and have concluded that deregulation should be effected wherever practicable, particularly in respect of the price-fixing powers of the commissions regulating infrastructure industries. See Wall St. Jo., p. 2, col. 3 (26 June 1975).

123. Note especially the judicial review provisions set out in s. 25 of the U.S. Securities Reform Act of 1975, cited *supra* n. 103.

124. See generally Massel, *supra* n. 105, at 183; Bernstein, *supra* n. 112, at 24, 100; McFarland, *supra* n. 90, at 423.

125. See Bernstein, *supra* n. 112, at 24, 70; Ont. Comm. on Govt. Productivity, Rep. No. 9, *supra* n. 115, at 37; Fainsod, Some Reflections on the Nature of the Regulatory Process, in Friedrich and Mason (eds.), Public Policy 297, 312, n. 6 (1940).

126. This is an important consideration in Canada, where most - but not all - regulation making power is vested in the Cabinet to ensure regional representation in the policy making process. See Mallory, Parliamentary Scrutiny of Delegated Legislation in Canada: A Large Step Forward and a Small Step Back, Public Law 30 (1972).

127. See Wilson, The Politics of Regulation, in McKie (ed.), Social Responsibility and the Business Predicament 135, 143-146 (1974).

128. Weil argues that the U.S. Government should set up a state corporation to administer a computerized securities market as a public utility on a cost recovery basis. See Weil, The Securities Industry: Myth v. Reality, *supra* n. 25.

129. Derthick, Between State and Nation 224 (1974).

130. Since 1937 a number of royal commissions have discussed the desirability of securities regulation without any detailed analysis of alternative means. See Report of the Royal Commission on Price Spreads 44 (1937); Report of the Royal Commission on Dominion-Provincial Relations, Bk. II, p. 57 (Rowell-Sirois Report, 1940); Report of the Royal Commission on Banking and Finance 348 (Porter Commission, 1964).

131. See Van Loon & Whittington, The Canadian Political System: Environment, Structure & Process 165-228, esp. 206-228 (1971); Sundquist and Davis, Making Federalism Work 6-13 (1969); Mallory, The Five Faces of Federalism, in Meekison (ed.), Canadian Federalism: Myth or Reality, 55 (2d ed., 1971).

132. A further refinement on this in Canada is "consultative federalism", which is based on the idea of inter-governmental consultation, particularly among first ministers, before a proposed new program is introduced with a view to identifying and minimizing program conflicts. See Smiley, Constitutional Adaptation and Canadian Federalism since 1945, Study No. 4 of Royal Comm. on Bilingualism and Biculturalism 90-94 (1971).

Where consultation does not lead to a satisfactory solution a province may opt out of a shared program and instead accept a lump sum of income tax revenues finance its own program. This alternative has been raised most recently by the Ontario government with respect to health care programs: see speech of Ontario Treasurer on Ontario revised budget of 7 July 1975, Ont. Leg. Debates.

The U.S. variation is called "creative federalism", which is based on the idea of national leadership to establish goals and priorities and to furnish resources to local governments for program execution, a system that sounds good but that fails to resolve the paradox of program execution by local governments that have different or even hostile policies. See Sundquist and Davis, *supra* n. 131, at 12-13.

133. See Smiley, *supra* n. 132, at 89-90, where the author outlines a number of alternative institutions of federal-provincial coordination.

134. This paper presumes there is no constitutional restriction on the delegation of powers from both Parliament and one or more legislatures to a joint commission. See Laskin, Canadian Constitutional Law 39-41 (3d ed., 1969); Lederman, The Limitations of Co-operative Federalism, in Vaughan et al (eds.), Contemporary Issues in Canadian Politics 22, 28 (1970).

135. See Cary, Federalism and Corporate Law: Reflections upon Delaware, 83 Yale Law Jo. 663, 663-668 (1974); Staff of Sen. Comm. on Interior and Insular Affairs, 93d Cong., 2d Sess., Federal Charters for Energy Problems - Selected Materials (Comm. Print 1974).

136. *Supra* n. 37, at 237-238.

137. ALI Federal Securities Code, Tentative Draft No. 4, sec. 513 (1 April 1975). See also Loss, The ALI Federal Securities Code Project, 25 Bus. Law. 27, 35 (1969); Loss, The Current Status of SEC Codification, 26 Bus. Law. 555, 557 (1970).

138. Securities Act of 1933, §3(a)(ii); Sec. Act Rule 147. See 1 Loss, Securities Regulation 591 (1961, Supp. 1969).

139. Loss & Cowett, Blue Sky Law 241-42 (1958).

Similarly some states automatically exempt private offerings that have qualified as exempt offerings under federal law: see Del. and Maryland joint release of 24 Oct. 1974 in CCH Blue Sky L. Rep., ¶11, 653.

140. A recent example is the new broker-dealer reporting form adopted by Exchange Act Release No. 11424 of 16 May 1975, CCH Fed. Sec. L. Rep., ¶80, 176. Moreover, a nation-wide system to register U.S. broker-dealers has been developed in the U.S. and approved by N.Y., making possible the development of uniform databases: see N.Y. Times, TSE Press Clipping Service, Access. No. D90-484 (3 July 1975).

141. *Strickland* v. *Rocla Concrete Pipes Ltd.* (1971) 45 A.L.J.R. 485, High Ct. of Aust., discussed in CCH Aust. Corp. Aff. Rep., ¶120.

142. CCH Aust. Corp. Affairs Rep., ¶502.

143. See generally the CCH Aust. Sec. Law Rep., ¶70-127 - ¶70-128 and CCH Aust. Corp. Aff. Bull. No. 72 (11 April 1975).

144. See Williamson, Securities Regulation in Canada 24-28 (1960, Supp. 1966).

145. These policy statements fall into three classes: (1) National Policy Statements that apply in all provinces except Newfoundland and Nova Scotia; (2) Uniform Act Policies that apply in Ontario and the Western Provinces; and (3) Provincial Policies that apply only in the one province. See CCH Can. Sec. L. Rep. ¶54-838 to ¶54-956.

146. Ontario Securities Act 1975 (Bill 98).

147. The 1968 CANSEC Proposal is discussed in Banwell, 1 Queens Intramural L. Jo. 3 (1969). The recent reference to CANSEC arose during OSC hearings concerning the proposed "national commission schedule" of brokerage commission rates: O.S.C. Bull. 108 (Aug. 1973).

148. Securities Act of 1933, s. 18; Loss and Cowett, Blue Sky Law 237-238 (1958); 1 Loss, Securities Regulation 30-31, 156, 591 (1961, Supp. 1969); and see Engdahl, Presumptive Capability of Federal Power, 45 U. of Col. L. Rev. 51 (1973); Laskin, Canadian Constitutional Law 104-111 (3d ed., 1966, rev.'d 1969).

149. See, e.g., Cal. Corporations Code §25140. The Quebec Securities Act, , like the California law, grants very broad discretionary powers to the administrators.

The divergent U.S. state standards are discussed in Loss and Cowett, *supra* n. 148, at 34-42 (1958).

150. Quebec experimented with lower standards for resource companies between 1967 and 1974 but reimposed the general standards applied to industrial companies by repealing its Policy No. 8: see QSC Release on Financing Mining Companies (21 Oct. 1974). See also the article by Zehr, Financing Speculative Mines, Northern Miner ( 14 April 1975), where the author alleges the QSC policy effectively prohibits use of the securities markets to raise capital for speculative resource exploration ventures.

151. Loss and Cowett, *supra* n. 148, at 238; ALI Federal Securities Code, Tent. Draft No. 3, §1603 (1 April 1974).

152. The Uniform Act is set out in Loss and Cowett, *supra* n. 148, at 245.

153. 1 Loss, Securities Regulation 591-605 (1961, Supp. 1969); ALI Federal Securities Code, Tent. Draft No. 3, p. 150 (1 April 1974).

154. Sec. Act Release 5450 (7 Jan. 1974), discussed in Kant, SEC Rule 147 - a Further Narrowing of the Interstate Offering Exemption, 30 Bus. Law 73 (1974).

155. ALI Federal Securities Code, Tent. Draft No. 3, pp. 150-154 (1 April 1974).

Although they can render local distributions more practicable, the private placement and small issue exemptions are ignored here because they are not essentially coordination mechanisms.

156. ALI Federal Securities Code, Tent. Draft No. 3, §1603 (1 April 1974).

157. See Loss and Cowett, *supra* n. 148, at 241-242, 290-299.

. . . /22

158. ALI Federal Securities Code, Tent. Draft No. 3, §1603. §1603(b)(3) also makes Canadian blue chip issuers eligible for the qualification by notification procedure.

159. ALI Federal Securities Code, Tent. Draft No. 3, pp. 137 (1 April 1974).

160. Laskin, *supra* n. 148, at 104-111.

161. *A.G.N.S.* v. *A.G. Can. (Nova Scotia Interdelegation Case)*, [1951] S.C.R. 31; [1950] 4 D.L.R. 369, discussed in Laskin, *supra* n. 160, at 39-41.

162. See Laskin, *supra* n. 148, at 43-66.

163. Motor Vehicle Transport Act, RSC 1970, c. M-14, s. 3; Farm Products Marketing Agencies Act, S.C. 1970-71-72, c. 65, s. 23; Energy Supplies Emergency Act, S.C. 1973-74, c. 52, ss. 9(2).

164. In *A.G. Ont.* v. *Winner* [1954] A.C. 541, [1954] D.L.R. 657, 13 W.W.R. (N.S.) 657, the Privy Council had decided that Parliament had exclusive jurisdiction over interprovincial highway transport. See Laskin, *supra* n. 148, at 522-524.

165. The executive presumably would have broad staffing discretion as under other federal regulatory statutes.

166. The Farm Products Marketing Agencies Act creates a federal agency called the National Farm Products Marketing Council, which has as its purposes, among others, to advise the federal minister of agriculture with respect to the agriculture industry, to recommend the creation of marketing agencies, and to review agency performance. It is thus more a policy advisory council than a regulatory agency, although it regulates indirectly through the agencies.

167. The CANSEC research paper is published in the OSC Bulletin (Dec. 1967). It is discussed in Langford and Johnston, The Case for a National Securities Commission, U. of T. Commerce Jo. (1968); Banwell, Proposals for a National Securities Commission, 1 Queen's U. Intramural Law Jo. 3 (1969).

During the hearings on the national brokerage commission rates the OSC stated that the Ontario government had given approval in principle to the CANSEC scheme: see OSC Bull. 108-109 (Aug. 1973)

168. OSC paper on Cansec, ¶ 22 (8 June 1967), referred to in this paper as the "Cansec Proposal".

169. A province would have the option to maintain its provincial commission or merge that commission into Cansec. In any event it would be subordinated to Cansec and therefore would not require an independent staff.

170. This is a variation of the proposed Fulton-Favreau formula to amend the constitution where all provinces are affected, which formula required the approval of 2/3 of the provinces representing at least 50% of the population: see Laskin, Canadian Constitutional Law 1076 (3d ed., 1966).

171. This model assumes that all provinces would opt to join Cansec.

172. The Cansec Proposal sets out a random list of ends and means of a commission: (1) to regulate the entry of issuers and other actors; (2) to regulate the conduct of actors through rules concerning proxies, take-over bids, insider trading, financial disclosure, and stock exchange trading; and (3), as means to achieve these objectives - financial audits, investigations, issuing administrative remedies, and seeking court appointments of receivers.

173. The Director could initiate administrative proceedings but only recommend criminal prosecution to the provincial attorney-general who would retain prosecutorial discretion.

174. The foregoing discussion sets out only the more material elements of Cansec, which is elaborated in greater detail in the source document.

175. The key issue is jurisdiction over interprovincial transactions in both new issue and secondary markets. The unsettled constitutional question is whether the securities regulation system should be equated with a nationwide commodities market system (federal) or viewed as an aggregate of discrete contracts like insurance contracts (provincial).

176. This discussion assumes that where they were not uniform the federal and provincial laws will complement rather than conflict with one another. Should a sharp conflict arise, it can be settled by ordinary litigation or a special reference under s. 55 of the Supreme Court Act, R.S.C. 1970, c. S-19 as amended.

. . . /24

177. This assumes a financing scheme similar to that suggested in the Cansec Proposal, which is discussed, *supra*, at n. 169.