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ARTICLE

Supreme Court Decision Clears Pathway for a Pan-Canadian Securities Regulator

Introduction

In its November 9, 2018 decision *Reference re Pan-Canadian Securities Regulation*, the Supreme Court of Canada (the Court) unanimously upheld the constitutionality of a national co-operative system for the regulation of capital markets in Canada as proposed in draft federal and model provincial legislation, overturning the Québec Court of Appeal's 2017 decision that found the proposed regime unconstitutional.[1]

Background

Since the 1930s, efforts to transform Canada's provincially regulated securities industry into a nationally harmonized one with a single capital markets regulator have encountered significant challenges, largely due to Canada's federal structure.[2]

One recent effort included the federal government's then-proposed *Securities Act* aimed at establishing a national securities regulator, which the Court found unconstitutional in its 2011 decision *Reference re Securities Act* (the *2011 Reference*). While the Court concluded that the day-to-day regulation of the securities industry remained a provincial concern,[3] it left the door open to federal legislation relating directly to the management of systemic risk and national data collection.[4] This left open the possibility for both levels of government to exercise their powers collaboratively to implement a co-operative system.

Proposed Co-operative Regulatory Regime

In response to the *2011 Reference*, in September 2014, the federal government and provincial governments of Ontario, British Columbia, Saskatchewan and New Brunswick announced that they had signed a memorandum of agreement (the MOA) formalizing the terms of a proposed co-operative regulatory regime for Canada's capital markets, the Cooperative Capital Markets Regulatory System.[5] Prince Edward Island and Yukon have since entered into the MOA. There are, however, five provinces and two territories, including Québec, Alberta and Manitoba, that have not signed the agreement

The MOA calls for a new legislative framework consisting of a single set of regulations to be administered by a national regulator — the Capital Markets Regulatory Authority (the Authority). Supervisory oversight of the Authority would be provided by an independent board of directors, in turn accountable to a Council of Ministers comprised of the Minister of Finance of Canada and a minister from each participating province or territory.

A *Provincial Capital Markets Act* (the Model Provincial Act) would be enacted by each participating province or territory and would replace the existing provincial or territorial securities legislation. Administration of the Model Provincial Act would be delegated to the Authority by each province.

The federal *Capital Markets Stability Act* (the CMSA) would address the areas ruled by the Court to be under federal jurisdiction in the *2011 Reference*, and would also be administered by the Authority. The CMSA would give the Authority national data collection powers to monitor activity in the capital markets and the requisite tools to manage systemic risk in the capital markets nationally.

Judgment of the Québec Court of Appeal

The Government of Québec took issue with the proposed regime and referred the question of its constitutionality to the Québec Court of Appeal (the Court of Appeal). In May 2017, a majority of the Court of Appeal concluded the proposed regime was unconstitutional for several reasons.[6]

First, the majority of the Court of Appeal found that the mechanism for amending the Model Provincial Act would subject provincial and territorial legislatures to the authority of an external entity (*i.e.*, the Council of Ministers), which would "fetter the parliamentary sovereignty of the participating provinces."[7]

Second, the decision-making mechanism pursuant to which the Council of Ministers would oversee the proposed regime would allow provinces to exercise a "veto" power over federal initiatives that seek to guard against systemic risks related to capital markets. The majority found this "veto right" constituted an improper delegation of legislative authority, was irreconcilable with the principle of federalism and would render the CMSA unconstitutional.[8]

In determining what head of power the CMSA fell under, the Court of Appeal found that its pith and substance was to promote the stability of the Canadian economy by managing the systemic risks that the capital markets pose. As such, the Court of Appeal found that the CMSA was *intra vires* the general branch of the trade and commerce power of Parliament pursuant to subsection 91(2) of the *Constitution Act, 1867*.[9] Due to the fact that the CMSA included the provisions relating to the Council of Ministers, which the majority found to be unconstitutional, the CMSA as a whole was rendered unconstitutional.[10]

Judgment of the Supreme Court of Canada

On appeal to the Supreme Court of Canada, two questions were before the Court:

1. Does the Constitution of Canada authorize the implementation of pan-Canadian securities regulation under the authority of a single regulator in accordance with the terms set out in the MOA?
2. Does the most recent version of the draft of the CMSA exceed the authority of the Parliament of Canada over the general branch of the trade and commerce power under subsection 91(2) of the *Constitution Act, 1867*?

The Court found that the MOA did not improperly fetter provincial legislative sovereignty, and that the CMSA was *intra vires* the jurisdiction of Parliament under subsection 91(2) of the *Constitution Act, 1867*.

Question 1: Constitutionality of the Proposed Regime

First, the Court held the proposed regime would not improperly fetter provincial legislatures' sovereignty. The MOA makes clear that the Council of Ministers' role is limited to proposing amendments to the Model Provincial Act and the CMSA[11] and does not require provinces to implement amendments.[12] It is expressly subject to the approvals of participating provincial legislatures and thus lacks the force of law within a province unless and until it is enacted by that province's legislature.[13] Participating legislatures remain free to reject the proposed statutes and any amendments made to them, and to withdraw from the proposed regulatory regime entirely.[14]

Moreover, the Court of Appeal made an error in law in finding that the Model Provincial Act would improperly fetter the parliamentary sovereignty of participating provinces. This principle can only be invoked for the purpose of determining the legal effect of impugned executive action, but not its underlying validity.[15] Any executive action that purports to fetter the legislature is not inherently unconstitutional but would simply be ineffective.[16]

Second, the Court held that the proposed regime would not result in the improper delegation of law-making authority. This principle, which bars Parliament or provincial legislatures from transferring their primary legislative authority with respect to a particular matter to a legislature of the other level of government, was not applicable in this case. Neither the MOA nor the Model Provincial Act empowers the Council of Ministers to unilaterally amend the provinces' securities legislation.[17] The Council of Ministers is only authorized to approve proposals for amendments to the Model Provincial Act — a model statute that lacks any force of law — and such authority is ultimately subject to participating provinces' authority to enact, amend and repeal their respective securities laws as they see fit.[18] As such, the Court found that the Council of Ministers remains subordinate to the sovereign will of each participating province and the proposed regime therefore does not result in the participating provinces delegating their primary legislative authority.

Question 2: Constitutionality of the CMSA

The Court agreed with the Court of Appeal and characterized the pith and substance of the CMSA as controlling systemic risk having the potential to create material adverse effects on the Canadian economy.[19] The Court saw the concept of "systemic risk" invoked throughout the CMSA as a means of limiting the scope of federal regulatory powers. It held that systemic risk can be understood as having three constituent elements: (1) the risk must represent a threat to the stability of the country's financial system as a whole; (2) it must be connected to the capital markets; and (3) it must have the potential to have a material adverse effect on the Canadian economy.[20] Since the CMSA does not contain provisions that go to the day-to-day regulation of the securities industry (such as dealer registration requirements and disclosure obligations), the Court found it addresses economic objectives considered national in character.[21]

The Court classified the CMSA as addressing a matter of genuine national importance and scope going to trade as a whole, in a way that is distinct from provincial concerns.[22] The Court held that the "preservation of the integrity and stability of the Canadian economy is quite clearly a matter with a national dimension, and one which lies beyond provincial competence."[23] As such, it found that the CMSA falls within Parliament's general trade and commerce power under subsection 91(2) of the *Constitution Act, 1867*.[24]

Lastly, the Court disagreed with the Court of Appeal's finding that the CMSA provisions regarding the Council of Ministers, if enacted as drafted, would render the statute unconstitutional in its entirety. Notwithstanding the fact that the Court of Appeal erroneously characterized the Council's power as a "veto right" over federal initiatives, which not only requires the support of a majority of the Council and some level of support from the major capital markets jurisdictions (which at present, are Ontario and British Columbia) but also the federal Minister of Finance, the Court found that statutory delegation in a manner solicitous of provincial input is not incompatible with the principle of federalism.[25]

Conclusion

While the Court's decision puts the implementation of a pan-Canadian securities regime back in the political forum and removes a significant roadblock to its realization, changes in provincial governments since the project was first initiated means the securities industry will be waiting to see if there remains sufficient political will to see the project through.

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[1] *Reference re Pan-Canadian Securities Regulation*, 2018 SCC 48.

[2] *Ibid*, par. 1.

[3] *Reference re Securities Act* [2011] 3 S.C.R. 837.

[4] *Ibid*, par. 117.

[5] See our prior bulletin on the proposed regime.

[6] *Renvoi relatif à la réglementation pancanadienne des valeurs mobilières*, 2017 QCCA 756, par. 5.

[7] *Ibid*, par. 55.

[8] *Ibid*, par. 99.

[9] *Ibid*, par. 115.

[10] *Ibid*, par. 138.

[11] *Supra* note 1, par. 49.

[12] *Ibid*, paras 25 & 50.

[13] *Ibid*, paras 24 & 50.

[14] *Ibid*, paras 26 & 50.

[15] *Ibid*, par. 62.

[16] *Ibid*, par. 67.

[17] *Ibid*, par. 78.

[18] *Ibid*.

[19] *Ibid*, par. 87.

[20] *Ibid*, par. 90.

[21] *Ibid*, par. 95.

[22] *Ibid*, par. 111.

[23] *Ibid*, par. 116.

[24] *Ibid*, par. 115.

[25] *Ibid*, par. 126.

By: Breanne Lehodey, Philippe Tardif, Graham Splawski, Jacqueline Ting

Services: Capital Markets, Appellate Advocacy

Related Contacts

Graham Splawski
Partner

Toronto

GSplawski@blg.com

416.367.6206

Philippe Tardif
Partner

Toronto

PTardif@blg.com

416.367.6060