Fighting the Joint-Decision Trap : Canadian Regulation in the Securities Industry

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The globalization of finance has brought about important changes in the international, regional and national regulatory structure of finance. One of the effects of financial globalization has been to increase the centralization of legislative and regulatory authority over financial markets, especially in federal states. In the United States, legislative changes in the 1990s have facilitated cross-pillar and cross-states financial services sector activity. The US is moving towards a national marketplace in the finance industry under the watchful eyes of national regulators. Globalization has also led to a centralization of authority in the Australian federal state in the financial services sector through the creation of two revamped national regulators to ensure firms' solvency and to oversee market actors. Lütz demonstrates that the German response to the globalization of finance has been to move authority away from the Lander towards the central government (1998). Great Britain and France, although not federal states, have also rationalized their regulatory structure around the turn of the millennium. Even in Canada, where it would appear that constitutional concerns would impede centralization, Coleman argues that following the dismantling of the four pillars policy in 1987 and 1992 the central government has slowly increased its power in the regulation and supervision of financial markets (2002). That being said, Canada remains plagued by jurisdictional issue when it comes to financial services sector policy. It is the only major state in global finance without a national securities regulator.

Jurisdictional responsibilities over the financial services sector is mixed in Canada, with the federal government having authority over banks and parts of the insurance industry, and the provinces having authority over the securities and trusts

industries as well as part of the insurance industry. Provincial authority over the securities industry is more and more contested since the nationalization and internationalization of that industry increasingly lends itself to the trade and commerce clause of the constitution, thus under the auspice of the federal government. Discussions about the creation of a national securities regulator in Canada have gone on for decades, yet movement in this field has been painstakingly slow.

On the other hand, Europe since the late 1970s has taken great strides to integrate its financial services sector, through, among others, the First and Second Banking Directives, the First Investment Directive, and the recent completion of the Financial Services Action Plan (FSAP). The European Union is moving towards the harmonization and centralization of authority in the financial services sector. Even before the end of the FSAP, there were discussions in the policy network of an eventual regional securities regulator (Couppey-Soubeyran and Session 2001). Although the integration process is not yet complete, there is an increasing willingness by European decision-makers to build a single European marketplace largely regulated regionally. The purpose of this paper is to compare the debate in Canada about the possibility of creating a national securities commission to the recent successful European experience in financial services sector policymaking, especially as it concerns the securities sector, through what is commonly referred to as the comitology process.

How has Europe been able to push integration forward when Canada seems to stand still blocked by jurisdictional issues? Using the joint-decision trap as its theoretical core, this paper argues that Europe has succeeded in beating the trap by depoliticizing financial services sector regulation and hiding decision-making deeper into its

bureaucracy. In Canada, the creation of a national securities commission remains a hot political issue impeding realignment of the country's regulatory structure.

The argument of this paper is presented in four parts. First, the paper discusses the principles of the joint-decision trap. Second, the European case study is analyzed demonstrating how impediments have been overcome to pursue financial services sector integration. Third, the paper studies the Canadian predicament. The analysis section of the paper discusses the possibility of reforms in the Canadian regulatory and supervisory structure for the securities industry.

The Joint-Decision Trap

The joint-decision trap came to prominence in a seminal article by Fritz Scharpf studying policymaking in the German federal state and the European Community (1988). It argues that in a federal-type system, where all or a great majority of regional actors have a policy veto, sub-optimal policy outcomes will be obtained due to the inability to obtain consensus between all players. As such, possible national programs can be stymied if only one of the regional actors feel that the current situation is more advantageous to its interests than would be the newly proposed policy. Scharpf's model is based on two key assumptions, that of the rationality and unity of the actor.

The argument presented by Scharpf is powerful, yet it equally has some weaknesses. According to Blom-Hansen, the pessimistic view of policymaking in a federal-type state presented by the joint-decision trap can be resolved if the central government has the ability to exit the federal-regional arena and make policy through

another forum (1999). In order to do this, it is however necessary to break away from the unity assumption.

Peters identifies other key weaknesses in the joint-decision trap model (1997). Among the problems, Peters notes that the model excludes the reality that most issues are not always part of high politics. A great many policy issues can be resolved at a bureaucratic level and are thus not subject to the trap. As well, policy issues tend now to be cross-sectoral increasing the room for negotiation. Peter also notes that the joint-decision-trap model tends to focus on a one time interaction while in reality games can be iterative. For Peters, even in situation where the joint-decision trap applies, a policy entrepreneur can ensure that an agenda is pushed forward.

The literature in public policy also tells us that federal-type arrangements can actually lead to policy innovation (McRoberts 1993). Regional governments can attempt a policy which when successful is copied by the other governments. In Canada, the most famous example is that of healthcare first adopted in Saskatchewan and than introduced across the country.

In the European context, three states clearly matter when it comes to the financial services sector: Britain, France and Germany. There are important differences in the structure of each state's financial system, in their approach to regulation, and in their understanding of European integration. Britain's model which is closer to that of the United States is clearly in opposition to that of France which still has, despite some recent innovations, strong elements of corporatism. Germany's model, still largely based on that of the universal bank, remains unique compared to the rest of Europe. Coleman and Underhill's account of the negotiation for the First Investment Directives in the early

1990s demonstrate some of the lines of division across European states regarding financial services sector integration (1996). Daphne Josselin's explanation of the same negotiation pays particular attention to the French-British conflict over the Directive (1997). The creation of the Euro pushed the EU further along towards integration and led to the creation of the FSAP in 1999. A Committee of Wise Men was created to find solution to the application of the FSAP. While it took more than three years of hardball politics for European states to come to an agreement on the First Investment Directive, the comitology process suggested by Baron Lamfalussy, chair of the Committee, saw the FSAP composed of 42 proposed Directives adopted in a period of just more than five years. Europe avoided lengthy political debate and now seems to be moving swiftly towards financial services sector integration. In other words, Europe has beaten the trap which threatened further financial services sector integration as late as the 1990s. There now is a definite political willingness among European elites to pursue integration even further.

In the Canadian securities industry, the joint-decision trap has impeded integration of markets and the creation of a single securities regulator. The regulatory fragmentation found in the Canadian system is often perceived as a sub-optimal policy outcome (WPC 2003). Change towards a national regulator is blocked by three regional governments, that of Québec, Alberta and British Columbia. These provinces are exercising a veto, which although does not exist constitutionally, certainly seems to exist politically, to limit the alternatives to the current arrangements. Québec traditionally refuses federal intervention in what it considers a provincial responsibility. Alberta and British Columbia are more concerned that a new commission would favor Ontario, would

be centrally-based, and not responsive to the needs of the local economies in these two provinces. Canada is not subject to a classic type of the joint-decision trap, in that there is still a raging debate as to the advantages and disadvantages of the current system versus the central regulator model, nonetheless substantial reform is made very difficult due to the reluctance of the three provinces mentioned above.

So, how has Europe succeeded in beating the trap while Canada is not able to move forward in the restructuring of its regulatory apparatus in the securities industry? Europe has de-politicized financial services sector policy issues granting a greater role to bureaucratic processes to avert inter-state conflict. In Canada, financial services sector policymaking remains political. The Wise Persons Committee (WPC), put together by the federal government to study reform options for the regulatory structure of the securities industry, has not proven to be a catalyst for the creation of a national regulator as was the work of the Lamfalussy committee in facilitating integration in Europe. In fact, the momentum towards creating a national regulatory is dwindling once again. In other words, the joint-decision trap in the securities industry is still paralyzing Canada.

The upcoming sections discuss in turn the European case study and than the Canadian example so as to be able to draw comparisons between the success of the latter and the troubles of the former.

Europe: Integrating Evermore

Introduction

It is generally argued that for Europe to have truly integrated economies, it must possess an integrated financial marketplace. Yet, integration in the financial services

sector is difficult and unequal. The securities industry, for instance, tends to be more integrated than banking (McKeen-Edwards, Porter and Roberge 2004). Even with the legislative completion of the FSAP, consistent implementation across states remains to be successfully completed. In fact, differences in legal and cultural traditions as well as dissimilar taxation system continue to impede complete integration.

Yet, over the course of the last thirty years Europe has considerably advanced in the integration of the continent's financial services sector. The push towards ever-greater integration originates both from political and economic forces. As early as 1977, through the elaboration of the First Banking Directive, Europe demonstrated a willingness to begin integrating the financial services sector. The Directive established home-country rule, the pillar of European integration in finance (and global cooperation among financial services sector regulators). The real push towards greater integration began with the Single Market program which amongst others led to the adoption of the Second Banking Directive (1989), the First Investment Directive (1993) and the insurance service directives. These directives established across the industries the passport model which would come to characterize the European integration process. The passport system stipulates in broad terms that once a firm has established the right to operate in one of the member jurisdiction, it has the right to operate across all member states. The creation of the Euro would further increase the desire by political and market actors to deepen integration. As such, the European Commission moved forward with the FSAP as early as 1999.

The FSAP and the Comitology Process

The benefits of further European integration in the financial services sector is deemed to be threefold: improving the allocation of capital in the European economy, allowing more efficient intermediation of European savings to investment, and creating a more attractive location for inward investment (Committee of Wise Men 2000). The FSAP aimed to achieve those results through the adoption of 42 directives grouped around four strategic objectives: retail markets, wholesale, prudential rules and supervision, and wider conditions for an optimal single financial market (Committee of Wise Men 2000). The Committee of Wise Men was put together to propose ways by which the FSAP could be implemented rapidly and efficiently.

The *Initial Report of the Committee of Wise Men on the Regulation of European Securities Markets* identified the following weakness to the European policymaking procedures: the policy process is often to slow in the adoption of legislation, the legislative texts are usually ambiguous, there are delays in the transposition process, important issues are at times left out of the legislation, directives are difficult to update and the procedures for notification and communication are not sufficiently elaborated (2000). As such, the Lamfalussy committee suggested a four level approach to legislation, which quickly became known as the comitology process. At the first level, the Council and the Parliament are to come to an agreement on the directive to be adopted. The directive ought to represent broad framework principles. At the second level, the European Commission, after consultation with the European Securities Committee, is to set out the modalities for the implementation of the principles found in the Directive. At the third level, the Committee of European Securities Regulators

(CESR), called the Federation of European Securities Commission (FESCO) at the time, is to ensure the consistent interpretation, implementation and application of the directive. At the fourth level, national regulatory authorities implement the directive and it is the role of the Commission to ensure states' compliance with the legislation (Committee of Wise Men 2000).

The process was quickly agreed to by the European Commission and was put into practice almost immediately. Doubts were nonetheless initially raised about the Lamfalussy process. Would the new process really increase the speed for the adoption and implementation of directives? An initial glance at the comitology process could lead one to think the process to be complicated and leading to never ending negotiation across the four levels of decision-making. Would the Parliament be properly informed about legislative and regulatory development? In other words, does the comitology process not increase the role of the bureaucracy to the detriment of democracy? Would dispute about technical details originating from member states impede CESR from playing its role as defined by the Committee of Wise Men? Although the comitology process may not have been infallible, the process is now generally understood to have facilitated European policymaking in the financial services sector. John Tiner, at a conference organized by the Financial Services Authority (FSA), the British regulator, looking at the future of the comitology process states: "I have every confidence that this model will be able to deliver an effective cross-EU regulatory supervisory structure and I feel that this is the most cost-effective way to manage the implementation of the FSAP and what lies beyond it" (2004).

CESR, especially, is given a great deal of credit for the success of the new legislative approach and the completion of the FSAP. In a short time, CESR has been able to establish itself as a credible source of European authority and as a locale for discussion about ways to further increase continental integration. In an April 2004 document revising its role, CESR states that it has acted so far in three directions: coordinated implementation of EU law, regulatory convergence, and supervisory convergence (2004). In each of these three categories, CESR even proposes to increase its role. For instance, CESR is looking to the Commission to give increased authority to its guidelines, recommendations and standards. Howard Davies, the Chairman of the FSA, for his part, states: "I am not sure that the directives, in practice, have been as spare as Lamfalussy envisaged. But what has certainly worked is the new regulatory network. CESR, as it is modestly known, has begun to be an effective deliverer of what we might call secondary legislation" (2003).

One of the areas where CESR has had particular success is in consultation. David Green also of the FSA recognizes the increased consultation done by the European Commission through CESR (2003). The willingness of CESR to talk openly with national governments, regulators, and market actors has increased its credibility. Whereas before the European bureaucracy could be seen as distant to market reality, CESR makes a constant effort towards consultation and openness. The increased consultation has not slowed down the legislative and regulatory process rather it has facilitated communication and increased coordination among national regulators and between regulators and market players.

The surest sign that the comitology process as put together has achieved success is that the FSAP has been implemented within a five year time-frame. In an article in *Euromoney* in 1999, Shirreff reported: "After nearly a decade of fanfare, the single European market for financial services is a ghost of what it should be" (1999). Although the article questions the coherency of the FSAP, it is forced to acknowledge, that finally Europe seemed to have a real plan for integration in the financial services sector. The negotiation for the First Investment Directive approved in 1993 were long and bitter, yet the Markets in Financial Instruments Directive (the revamped ISD) approved in 2004 was negotiated much more quickly with much less political grandstanding. In just a few years, all of the key directives of the FSAP have been adopted and industry insiders were looking at the next steps in the integration process. The tenth report on the progress of the FSAP by the Internal Market division of the Commission is titled *Good Progress but Real Impact Depends on Good Implementation* (European Commission 2004). As such, prior to moving to further legislative efforts, the EU and member states are to concentrate on consistent implementation across the Union of the policy adopted over recent years.

No policy process is as smooth as is always desired, European directives in the financial services sector are still at times overtly precise, nonetheless, the comitology process has vastly facilitated the European policymaking exercise in the financial services sector.

Conclusion

European financial services sector integration is thirty years in the making and while it is not complete, the FSAP has certainly accelerated the rate of integration. From

the mid-1980s to the mid-1990s, integration centered around the initiatives of the Single Market program. Although important progress was made, it was slow, highly political and prone to inter-state conflict. The policymaking process based on the Lamfalussy process has rendered European decision-making in the financial services sector much more effective and efficient. The policy arena has changed from interstate negotiation to the European bureaucracy, which has elaborated an extensive consultation process. Policymaking in this policy field is now much less political and CESR, at the heart of the process, is quite amicable to discussion with both national regulators and market actors. The success of the comitology process is also demonstrated by the fact that the model has been copied both to the banking and insurance sectors.

Europe's policy process in the financial services sector was slow and ineffective. The EU has now largely beaten the trap, it has moved away from paralysis to ever-increasing and deepening integration. The creation of the Euro, the political will, and the pressure from market actors all contribute to the new enthusiasm for integration. Born out of this enthusiasm is a policy process that is proving to be a cure to inertia.

Canada: The Struggle

Introduction

The Canadian financial services sector went through a process of reform from 1996 through 2001. At the beginning of this period, the federal government studied the possibility of creating a national securities commission, yet nothing came out of those efforts (Koch 1997). The federal government then created the Commission on the Future of the Financial Services Sector in Canada chaired by Harold McKay. The Commission,

demarcating its role immediately and the space for the subsequent debate, said that it would not deal with federal-provincial issues, whether that be duplication and overlap, taxation, over-regulation or securities regulation (Taskforce on the Future of the Canadian Financial Services Sector 1998). The government's 1999 White Paper similarly did not address these issues. The federal policy process mostly focused on the banking sector. Admittedly, the 2001 legislation, Bill C8, acknowledges the process of demutualization in the insurance industry, and the alignment of ownership rules for life and health insurance firms with that of the banking sector. Nonetheless, financial services sector policy federally was and is still largely banking policy. The possibility of the creation of a national securities commission was thus quickly discarded not to be discussed again throughout the rest of the reform process.

The Debate

Following the adoption of Bill C8 in 2001, Paul Martin, still Minister of Finance, named Harold McKay to study the possibility of bringing about changes in the securities industry. In a 2002 letter to the Minister, a position now occupied by John Manley, Mr. McKay suggested that it was time for the federal government to study the creation of a national securities commission and that to do so, it might be appropriate to name a Commission similar to the one he chaired in the build up to Bill C8. The advice was followed and John Manley appointed the WPC to study options to improve the regulatory structure in the securities industry. The WPC was chaired by Michael Phelps an established industry insider. After focused consultation, the WPC presented its final report in early December 2003.

The title of the report of the WPC, *Its Time*, is a good representation of the attitude of the Committee. According to the WPC, there is a consensus in the securities industry about the necessity to create a national regulator:

> This is not the first time that Canadians and their governments have considered whether to reform Canada's securities regulatory structure. Unlike prior efforts, however, there is now an unprecedented opportunity - and a necessity - for change. Issuers, investors and financial intermediaries across Canada are united in their call for change. Markets around the world and their regulatory structures are rapidly changing. Other countries are finding ways to achieve competitive advantage through their securities regulatory structure. Canada should do no less" (2003: 13).

The WPC does a good job of highlighting both the advantages and disadvantages of the current system in Canada. In support of the current system are the arguments that having provincial regulation favors local approaches fostering regional economic growth; that the current structure allows the establishment of personal contacts between industry players and regulators; and, that distinct regulatory regimes favor regulatory innovation. The passport system favored by some of the provinces continues to build on these advantages.

The WPC, however, challenges those supposed advantages. The argument regarding local markets fostering local economic growth is discarded on the basis that Canada now has a national economy and that regional economic differences could be accommodated through a national system. With the creation of local offices, personal contact could also be kept between industry players and regulators despite operating under the umbrella of a national securities commission. Although the current system may have led to regulatory innovation, such innovation renders the current arrangement more complex, confusing, slow to adapt to change, and costly. For instance, the WPC

estimates savings of up to $46 million dollars a year with the creation of a national securities commission (2003).

The problems with the fragmented regulatory approach in Canada are many:

> The Committee heard a litany of complaints about Canada's securities regulatory system: Canada suffers from weak and inconsistent enforcement and investor protection. Wrongdoers too frequently go unpunished, and adjudication is unduly delayed. Policy development is slow and inflexible. The need for consensus often results in a lack of uniformity, over-regulation or policy paralysis. The system is too costly, duplicative and inefficient. The regulatory burden impedes capital formation. Canada's international competitiveness is undermined by regulatory complexity. Canada lacks a single securities regulator charged with representing the national interest (WPC 2003: 25).

In their submission to the WPC, the TSX Group presented the issue in a succinct and direct manner: "In sum, this is no longer an issue confined to specialists. There is a broad constituency for modernizing what is essentially a 19th century system that is increasingly perceived to be weighed down by 20th century burdens and inappropriate to the needs of the 21st" (WPC: 2003a).

The WPC thus proposed the creation of a national securities commission. The Committee proposes a structure that would see the creation of a national regulator with regional offices across the country. The WPC rejects the passport system favored (and subsequently adopted by the provinces) as being insufficient to resolve the burden and costs faced by the Canadian securities industry due to the current regulatory structure.

Opening the policy window even more at this time was concurrent movement at the provincial level. Beginning in 2001 the Ontario government was reviewing the Act governing the Ontario Securities Commission. The Committee that it set up to do so spent the first chapter of its interim report arguing in favor of a national securities commission. It stated: "We add our voice to countless others raised in support of the

urgent need for a single Canadian securities regulator. This is the most pressing securities regulation issue in Ontario and across Canada." (Crawford 2002: 29). Ontario has sought to be a catalyst in recent years pushing for the creation of a national regulator. One of the most ardent proponents of such a commission has traditionally been the TSX. Barbara Stymiest than President of the exchange stated

> Australia has a history every bit as fractious as ours. But they got on with the job and got it done. The Nordic countries possess all the same fears that haunt our history, that the small will be dominated by the strong, the west by the east, one language by another. But they're getting on with the job, and getting it done. And Europe's momentum toward a single market comes little more than half a century after the selfsame countries were locked in a terrible war. Now they're meeting on what Sir Wilfrid Laurier called the grand assizes of commerce, and they are getting the job done. It's time that our governments pick up the challenge and get the job done, too. Then, we can all get on with building capital markets that will truly be the 21st century nation-building equivalent of our 19th century railroads (2002).

Yet, Ontario's strong position in favour of a national securities commission is also somewhat problematic as others around the country perceive such a proposal as a central Canadian initiative. A large segment of industry actors, as can be seen by studying the submissions made to the WPC, advocate the creation of a national securities commission. But the position of Ontario and that of business has not so far been able to force the creation of a single regulator.

There is a long list of arguments opposing the creation of a national securities commission, some of which we already have outlined above. The CIRANO report of 2003 highlights the position of Québec and those opposed to the creation of a national regulator (Suret and Carpentier 2003). Beyond the already stated arguments, the report argues for instance that the Canadian market is already highly concentrated and that the creation of a national securities commission risks further alienating small players in the

industry, a problem since the Canadian marketplace is composed mostly of small emitters and investors. The Canadian securities industry is still regional (unlike what the WPC argued) and firms outside of Ontario will be disadvantaged with the creation of a national regulator. The CIRANO report also argued that it was not clear that Canada was not a competitive market and in fact the report seeks to show that the Canadian market is in a favorable position compared to other OECD states. In fact, Desjardins Ducharme Stein Monast in its submission to the WPC stated : " … avant de conclure qu'il est opportun d'adopter le scenario de la commission unique, compte tenu que les initiatives d'amélioration en marche donnent déjà de bons résultats, il faudrait d'abord conclure que le régime actuel malgré l'impact présent et les bénéfices futurs de ces initiatives, ne sera pas efficace. Or, selon notre expérience, ce n'est pas le cas" (2003a). The CIRANO report also noted that it was not necessarily more expensive to be an emitter in Canada than it was in the United States. If Canadian firms seek to raise capital in the United States, it is not because of Canada's regulatory structure but rather because of competition between exchanges. The CIRANO report argues that the TSX is a regional exchange and is not in a position to be competitive with the NYSE. One of the strongest arguments presented by the CIRANO report is that regulatory competition is an advantage to Canada encouraging flexibility and innovation. The Canadian situation, the report pointed out, is not different than the situation for corporate law in the United States.

By February 2004, Québec had reformed its regulatory arrangement in the securities industry. The province moved to a single regulator called *l'Autorité des marches financiers* (AMF) to oversee all provincially regulated financial services sector

activities. The structure is similar to recent changes that have taken place in Europe, including in Great Britain. One of the arguments used by the Québec government at the time it brought forth the AMF is that if Canada was to move to a national regulator, the Québec regulator could serve as a counterweight to a Canadian counterpart. If, in fact, Canada was to move to a national regulator in the securities sector and Québec retained the AMF, the situation would not be that different than in the blood industry where operations across the country are managed by *Canadian Blood Services*, except in Québec where such services are offered by *Héma-Québec*. Such a discussion seems to indicate that the real impediment to the creation of a national securities commission may not be Québec, it may be the other recalcitrant provinces, that is Alberta and British Columbia.

An argument opposing the creation of a single national regulator is that philosophy of regulation also differs across provinces. At a time when Ontario has chosen to move towards the American model, now founded on the Sarbanes-Oxley legislation of 2002, a model that is highly codified, British Columbia adopted in 2004 legislation moving to a principles-based model. The difference in philosophy is striking and denotes a completely different understanding of the responses needed to answer the crisis in confidence in financial markets since the Enron collapse. The recent adoption of new corporate governance rules by the Canadian Securities Administrators, composed of the provincial securities regulators, will not be applied universally across Canada. Québec and British Columbia both oppose elements of the new approach. At the time of writing, the British Columbia law has not come into force, yet even the intention of BC to

move towards principles-based regulation indicates some hidden debates on regulatory philosophy in the Canadian securities industry.

Opponents of the single regulator model argue that regulatory competition is beneficial, yet they are also quick to point out that great strides have been taken towards harmonization of legislation and regulation. Most notably, the CSA has worked since 2001 on the elaboration of a Uniform Securities Act to be possibly concluded by 2006. The thinking is that when such an Act is agreed to, provinces could move towards implementation independently in each of their jurisdiction. The implementation of harmonized legislation across provinces aims to reduce the current regulatory complexity for market actors. In fact, harmonization has already taken place for a variety of practices and regulations (Suret and Carpentier 2003). The harmonization process allows Canada to currently move towards adoption and implementation of the passport model.

Actors opposing the creation of a single national regulator usually support the use of the passport model. The Inter-Ministerial Committee of Provincial Finance Ministers presented its own report in 2004 which called for the adoption of the passport system. Québec, Alberta, British Columbia, New Brunswick, Manitoba, Saskatchewan, Yukon and Nunavut have signed on to the agreement. As seen from the list of participating provinces, Ontario withheld its support still clinging to the arguments in favour of a national regulator.

Drawn from the European Union experience, the passport system would require emitting firm to register with only one of the provinces instead of all of them for a national emission. In such a system, each province remains independent with its own regulatory structure. For some, this option is more logical than that of the national

securities commission because it is politically feasible, while the creation of a national regulator is not negotiable politically. It may also be easier from a technical point of view if, as some experts argue, minimal norms indeed do exist across the country.

In regards to both the Uniform Securities Act and the passport system, it is important to note that the place of the federal government in regulating the securities industry is not recognized. It should also be noted that the passport model does not solve all of the issues identified as being problematic in the Canadian arrangement such as discipline and international representation. Recent accusations of preferential treatment and incompetence against the Alberta Securities Commission raise further doubts about the quality of supervisory work done by the provinces (Tedesco 2005). Finally, although Europe uses the passport model, level of integration across finance industries still differ. The integration of markets has certainly advanced since the early 1990s, but the success of the passport model itself can be debated. European integration is successful because of political will, not because of the passport model. It would also not be surprising for CESR to eventually become the continent's securities regulator. As such, the passport model in Europe is not seen as an end in itself, but rather as a tool to facilitate integration possibly leading eventually, if enough harmonization is achieved, to a single regulator system. As such, it is possible to ask why Canada should opt for a model that in many ways is meant to be temporary and transitory. As a state, it could be argued that Canada should skip that step and head directly to the creation of a national securities commission.

Conclusion

Despite the adoption of the passport model by a majority of the provinces, Canada is still caught up in the joint decision-trap. The federal government and Ontario still prefer the creation of a national securities commission. Other key provinces are installing the passport model across the country. Without the support of Ontario, it is unclear how far the passport system will take Canada in terms of regulatory reform. Resolution to this conflict does not necessarily appear to be near. In this political conflict, it is somewhat unclear how well Canadian markets are doing. Are the Canadian markets competitive regionally and globally? Is the current system really discouraging possible emitters and investors? Agreements on such questions would go a long way in determining the extent to which the Canadian regulatory apparatus in the securities sector needs reforming.

Analysis

The Canadian financial services sector is mired in the politics of federalism. A classic joint-decision trap has emerged with what many would argue is a sub-optimal policy outcome in the securities industry as key provinces block the creation of national securities commission. In Europe, the trap was overcome through the depolitization of the issue. By creating CESR, Europe has a deeply technical body committed to harmonization and the European integration process as a whole. CESR is out of the limelight and operates far from controversial political issues. In Canada, discussions surrounding the creation of a national securities commission are still highly political and any kind of reform is made difficult because of the entrenched position of key actors.

The Canadian situation may not represent a classic example of the trap since there is such a fierce debate as to whether or not the current arrangement and adoption of the passport model really represent sub-optimal policies. Assuming that the creation of a national securities commission is the desirable outcome, how is it possible for Canada to 'beat' the trap? What can Canada learn from Europe in restructuring its regulatory apparatus? The rest of the analysis section attempts to answer such questions.

One of the elements of European integration in general is that over recent years, institutions of the EU have become increasingly intrusive. EU institutions are involved in almost all policy areas. These institutions represent a force for integration. In the financial services sector, the FSAP was ambitious. After years of inertia, the Commission sought the implementation of 42 directives in a five years period. Yet, the Plan was achieved. In Canada, the federal government has not played the role of catalyst. The WPC report was well-received in Ottawa and over the last four decades, since the Porter Commission in 1964, the federal government has claimed to be interested in the creation of a national securities commission. Constitutional experts advised the WPC that the federal government disposed of sufficient power to impose a solution (2003). Because the securities sector can be said to fall under the trade and commerce clause of the constitution, the central government could legally act in this policy area. To create the national regulator, the WPC suggested that Ottawa passed standard legislation. Provinces would than pass a law of their own copying the federal legislation. The national regulator would have regional offices around the country to retain interaction at a local level as well as to promote innovation. The federal government, because it does

not want to enter into an open conflict with the provinces, has not taken steps to create a single national regulator.

The largest critique to be made against the WPC is that its focus was relatively narrow. It studied the current structure to compare it with that of the passport system, and that of a national securities regulator. Key topics in the field were ignored by the Committee. The WPC did not address, for instance, the issue of regulatory philosophy. When the Financial Services Authority was created in Britain, regulatory philosophy was an important issue. In particular, the new regulatory body said it would be much more risk-focused. When France recently reformed its regulator in the securities industry, an important issue was that of the relationship of the new authority with market actors. The conflict between Ontario and British Columbia regarding responses to the confidence crisis in financial markets demonstrate regulatory philosophy and approach to be important issues and points of divergence in Canada. Discussions in Canada have always focused on the structure of the regulatory apparatus, on whether or not the country should establish a national securities regulator. Even the adoption of the passport model should inspire debate on regulatory philosophy, especially as regulators must learn to trust one another. That debate has not yet taken place to its full extent.

In Europe, there is a general consensus on the issues that further integration efforts must address. Currently, the focus is on implementing the directives that came out of the FSAP. Canadian reforms have been plagued as debate invariably return to attempts at conversion for recalcitrant provinces to accept the idea of a national regulator model. One way by which to move discussions forward may be to propose a new regulatory model altogether. For instance, the Canadian regulatory structure in the whole

of the financial services sector could be transformed to a functional regulation approach. In such a system, regulation and supervision operate according to firms' activities rather than the pillar in which they belong. There would thus be two national regulators, a solvency regulator (a revamped Office of the Superintendent of Financial Institutions, which already carries out most of these responsibilities but would gain that responsibility for all financial services sector firms in Canada whatever the pillar) and a regulator for market behavior. Functional regulation is gaining worldwide credence due to the desegmentation of finance industries at the global level. Further analysis would obviously be required to determine the details of such a proposal and whether or not functional regulation would really be the best way by which to govern Canada's financial services sector. Nonetheless, if diverse regulatory structures were presented, with rooms for negotiations, it is hard to imagine that a formula could not be put together that would take into account regional interest and please emitters, investors, provincial and federal governments.

As mentioned above, in Europe regional institutions have played a key role in pushing forth integration. In Canada, the federal government does not have to impose a solution, yet if the federal government were to actively become involve and propose credible solutions, it is possible that many of the provinces may be willing to sit down, listen and negotiate. If the federal government chooses to remain inactive, Ontario could seek along with other willing provinces to create a national regulator. In principle, the creation of a national securities commission does not require the intervention of the federal government. Such a regulator could be the creation of the provinces which delegate powers to the inter-provincial body. It is even possible to imagine the CSA

playing such a role. Recalcitrant provinces could eventually opt in to the national regulator model.

One possible effect of the present arrangement is that the OSC become the *de facto* national securities regulator. After all, Toronto is now without a doubt the financial centre of Canada. The TSX is Canada's premiere exchange and recent indications that it will enter the derivatives market in direct competition with Montreal, as soon as the current agreement preventing it as a result of the restructuring of the exchanges in 1999 ends, suggest that Ontario is completely overtaking markets around the rest of the country. Although many see the creation of a national securities commission as a power-grab by Ontario, such a regulator could be seen as a way by which to curb Ontario power. Maybe the real surprise is that Ontario argues strongly in favour of the creation of a national single regulator. To retain influence in the decisions-making process, some of the recalcitrant provinces should maybe review their traditional position.

There has been a global trend towards regulatory reform. At a time of volatility in financial markets, reforms seem particularly important for national markets to remain competitive, efficient, and secure. Europe in particular is looking to remain competitive with both the United States and Asia. It is moving ever further ahead in the integration of its financial services sector. Yet, the Canadian regulatory structure remains largely unchanged. Canada's inability to bring about substantial changes, whatever the content of proposed modifications, may be costly as its securities markets may be left in the dust of more competitive, enticing and confidence-enhancing regulatory jurisdictions. The question therefore remains: Can Canada beat 'the trap'?

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