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WHY IS THIS TAKING SO LONG? THE MOVE
TOWARD A NATIONAL SECURITIES
REGULATOR†

Game theoretical analysis can be useful in contexts such as securities regulation, where multiple decision makers (i.e., securities regulatory authorities or commissions) act unilaterally but can also potentially reap benefits from cooperation. We deploy several models in seeking to render more transparent the strategies and pay-offs that motivate jurisdictions to support or resist the introduction of a national securities regulator in Canada. Our analysis suggests that consensus has not been reached regarding a national regulator not only because of a lack of cooperation but also because of a lack of coordination. Indeed, it seems plausible both that provinces recognize the benefit of adopting a common standardized regulatory model and that the source of disagreement surrounds the precise regulatory content of that common standardized model. This essay explores the implications of this insight.

Keywords: Securities/regulator/cooperation/coordination/game theory

What began as an economic problem – how to define and constrain barriers to trade within the Canadian economic union – has become redefined as a political problem – how to render both levels of government more sensitive to and politically accountable for the full consequences (benefits and costs) of their policies. This in turn is ultimately a legal and institutional problem – how to design constitutional or institutional arrangements that may enhance this objective without necessarily upsetting the broad balance to which the Canadian federal system aspires ...¹

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1 Michael J. Trebilcock *et al.*, 'Summary and Implications' in M.J. Trebilcock *et al.*, eds., *Federalism and the Canadian Economic Union* (Toronto: University of Toronto Press, 1983) 560 [Trebilcock *et al.*, 'Summary'].

Canada's securities regime is a regulatory patchwork. Each provincial and territorial jurisdiction maintains its own separate securities regulatory authority and corresponding securities legislation.² Although numerous proposals have been made for a national securities regulator, they have historically gone nowhere.³ Nevertheless, more modest attempts at coordination have been successful. For example, the Canadian Securities Administrators (CSA) supports a passport system under which market participants can choose one regulator and one set of legal requirements, regardless of the market participant's province of residence. All provinces except Ontario have signed on to the passport system.⁴

A federally commissioned report issued in 2009 marks the latest push for a national securities regulator, one that spurred the federal government to allocate funds and establish a transition office toward this goal.⁵ The Expert Panel's Report proposes the creation of a Canadian Securities Commission (CSC) built on principles-based, uniform securities law (*i.e.*, with one governing statute as opposed to thirteen), along with an independent adjudicatory body. An unprecedented aspect of the report is that it provides choice to jurisdictions and market participants from non-participating jurisdictions to opt into the model, recognizing that there is no consensus among provinces with respect to a national regulator.

2 Supreme Court of Canada case law has supported the constitutionality of securities regulation as a matter of provincial jurisdiction pursuant to s. 92(13) of the *Constitution Act, 1867* (U.K.), 30 & 31 Vict., c. 3 [*Constitution Act, 1867*]. See, *e.g.*, *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161.

3 See, *e.g.*, Phillip Anisman, *Proposals for a Securities Market Law for Canada* (Ottawa: Consumer and Corporate Affairs, 1979) [Anisman, *Proposals*]; Wise Persons' Committee to Review the Structure of Securities Regulation in Canada, *It's Time: Wise Persons' Committee Final Report* (Ottawa: Department of Finance, 2003) [Wise Persons' Report].

4 See Passport System, O.S.C. MI 11-102, (2008) 31 O.S.C.B. 1009; Process for Prospectus Reviews in Multiple Jurisdictions, O.S.C. NP 11-202, (2008) 31 O.S.C.B. 1009; and Process for Exemptive Relief Applications in Multiple Jurisdictions, O.S.C. NP 11-203, (2008) 31 O.S.C.B. 1009. We use the term 'provinces' throughout this essay to mean both provincial and territorial jurisdictions.

5 Expert Panel on Securities Regulation, *Final Report and Recommendations* (Ottawa: Department of Finance, 2009) [Expert Panel's Report]. On the federal government's support for a national securities regulator, see the budget that followed the release of the Report in March 2009, online: Government of Canada <<http://www.budget.gc.ca/2009/plan/bpc3a-eng.asp>>. The Expert Panel's Report uses the terms 'national securities regulator' and (more often) 'single securities regulator' throughout the report. We use both of these terms here.

Certain provinces, including Alberta and Quebec, resist the recommendations of the Expert Panel's Report and are generally reluctant to consider a national securities regulator. In our discussion we address two central questions. First, why are these provinces opposed to a national regulator? Second, is it reasonable to believe that the recommendations of the Expert Panel's Report address the source of this resistance and that a national regulator will be achieved?

Game theoretical analysis can be useful in contexts, such as securities regulation, where multiple decision makers (securities regulatory authorities or commissions) act unilaterally but can also potentially reap benefits from cooperation. We deploy several models in seeking to render more transparent the strategies and pay-offs that motivate jurisdictions to support or resist the introduction of a national securities regulator. Our analysis suggests that consensus has not been reached with respect to a national regulator not only because of a lack of cooperation but also because of a lack of coordination. Indeed, it seems plausible both that provinces recognize the benefit of adopting a common standardized regulatory model and that the source of disagreement surrounds the precise regulatory content of that common standardized model. This essay explores the implications of this insight.

Understanding securities regulation as involving coordination issues allows us to examine the attributes and motivations of the relevant actors and decision makers.⁶ First, because coordination games allow for multiple equilibria, they may involve distributional impacts such that each party prefers differing cooperative outcomes. Second, in classic cooperation games, the pay-offs tend to determine the result; in coordination games with multiple equilibria, however, limitations on side-payments and constraints arising out of history and culture can play a decisive role, such that these factors may affect the ultimate result (*i.e.*, in addition to pay-offs). For related reasons, coordination games may also implicate normative theories that support favouring certain preferences over others.

The analysis proceeds in Part II below by discussing the impasse over the desirability of a national securities regulator and why it is unlikely to be motivated by simple lack of cooperation. Part III seeks to characterize securities regulation in Canada as a 'Prisoners' Dilemma' (PD) game. In this PD game, a choice to be unsupportive of a national securities regulator is considered a decision not to cooperate with other provinces. There is a difficulty with the non-cooperative approach, however, since it requires the absence of a way to negotiate to a Pareto superior outcome credibly and collectively. The federal government can provide

6 Richard H. McAdams, 'Beyond the Prisoners' Dilemma: Coordination, Game Theory, and Law' (2009) 82 S.Cal.L.Rev. 209 at 213 [McAdams, 'Beyond the PD'].

such a mechanism. If the underlying game is a PD along these lines, the provinces should uniformly welcome a national securities regulator. This has not been the case in Canada, which suggests that something is missing from this account.

Part IV therefore extends the PD game by embedding a game involving coordination as the source of conflict. The extension involves using another classic game called 'Battle of the Sexes' (BOS). The addition of conflict over coordination allows for a focus on the distributional impacts of different modes of cooperation. Part V then uses this theory to discuss the evolution of securities regulation in Canada both before and after the introduction of the current passport system. Part VI extends the analysis to examine the recommendations in the Expert Panel's Report and to conjecture the extent to which these recommendations are likely to overcome the obstacles to cooperation and coordination in securities regulation in Canada. Part VII concludes.

Though the discussion relates specifically to Canada, our analysis is applicable to securities regulatory systems outside of Canada and, in particular, to the choices that countries or regions make in regulating their capital markets. We show that in the securities regulatory field, cooperation and coordination are possible along differing dimensions, and coordination may occur in the absence of cooperation. In a subsequent paper, we will apply this analysis in the international context.

II *Background: Decentralization vs. cooperation*

The issue of cooperation among states or provinces in a federal union is not new and has been the subject of much discussion in Canada. As Michael Trebilcock *et al.* have noted, the issue can be framed as one relating to trade barriers, which have in turn led to the balkanization of Canada.⁷ Indeed, securities regulation is but one area in which inter-provincial cooperation has historically been difficult to achieve, although efforts have been made in the past decade to secure cooperation in specific areas of regulation. The policy alternatives are stark and include a decentralized structure, as in the passport system, on the one hand, or a cooperative model relying on national securities regulation, on the other.

Canada's current decentralized structure differs from those of countries throughout the world that have recognized the need for cooperation within and outside national borders. Among the 104 members of the International Organization of Securities Regulation (IOSCO), Canada is one of only two that do not have a national securities

7 Trebilcock *et al.*, 'Summary,' *supra* note 1.

regulator.⁸ Despite their inability to agree on a national securities regulatory structure for Canada, however, provinces appear to understand the benefits of cooperation. For instance, under the Multijurisdictional Disclosure System (MJDS), eligible Canadian issuers can offer securities to the public in the United States using a prospectus that complies with Canadian regulation, and eligible US issuers wishing to complete a cross-border offering⁹ in Canada need only file a registration statement with the Securities Exchange Commission (SEC).¹⁰ Thus, under the MJDS, issuers do not need to clear their offering documents with a foreign regulator, even though they are raising capital in a foreign country.¹¹ Further examples of the cooperative approach are the mutual reliance review system (MRRS) and the passport system, both of which are discussed below.

The literature in the securities law area on decentralization versus cooperation is not voluminous.¹² The main relevant study for our purposes is one by Amir Licht, who also applies game theory to securities regulation.¹³ Licht argues that PD is a powerful heuristic model with real-life application but that other 2×2 models (such as BOS) also depict the conflict that countries face with respect to cooperation in the securities field.¹⁴ Licht assumes that states seek to maximize national social welfare (*e.g.*, by increasing liquidity and trading volumes), as well as relative gains (rank), and applies his analysis to three areas of securities

8 See Letter from David Brown, Chair of the Ontario Securities Commission, to Michael Phelps, Chair of the Wise Person's Committee (8 July 2003), online: Ontario Securities Commission <http://www.osc.gov.on.ca/Media/Speeches/2003/sp_20030708_brown-re-wpc.jsp>.

9 The system is not confined to securities offerings. It also facilitates cross-border takeover bids, issuer bids, and other business combinations.

10 The Canadian law is stated in *Multijurisdictional Disclosure System*, O.S.C. NI 71-101 (1998), 21 O.S.C.B. 5104. See also O.S.C. Companion Policy 71-101 (1998), 21 O.S.C.B. 5089 and O.S.C. Rule 71-801 (1998), 21 O.S.C.B. 6919. The US law appears in 56 Fed. Reg. 30036 (1991) and is reproduced in Rule 71-801.

11 The vast majority of MJDS transactions involve Canadian issuers seeking to raise capital in the United States.

12 By contrast, we note that the corresponding literature in the corporate law sphere is relatively prolific. See, *e.g.*, William Cary, 'Federalism and Corporate Law: Reflections upon Delaware' (1974) 83 Yale L.J. 663; Ralph K. Winter, 'State Law, Shareholder Protection, and the Theory of the Corporation' (1977) 6 J.Legal Stud. 251; Roberta Romano, 'Competition for Corporate Charters and the Lesson of Takeover Statutes' (1993) 61 Fordham L.Rev. 843; Michael Klausner, 'Corporations, Corporate Law, and Networks of Contracts' (1995) 81 Va.L.Rev. 757; and, in Canada, Ronald J. Daniels, 'Should Provinces Compete? The Case for a Competitive Corporate Law Market' (1991) 36 McGill L.J. 130; Douglas J. Cumming & Jeffrey G. MacIntosh, 'The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law' (2000) 20 Int'l Rev.L.& Econ. 141.

13 Amir N. Licht, 'Games Commissions Play: 2×2 Games of International Securities Regulation' (1999) 24 Yale J.Int'l L. 61 [Licht, 'Games'].

14 Ibid. at 65.

regulation (disclosure, fraud, and insider trading). Like Licht, we posit the explanatory power of coordination games in addition to cooperation games. We then use these games to examine securities regulation within a specific country (Canada) in order to probe the prospects for cooperation and/or coordination along certain dimensions.

Two points before proceeding to this analysis. First, some may argue that the debate about decentralization versus cooperation is moot, since much of Canadian securities law is harmonized (*e.g.*, rules relating to disclosure, insider trading, and prospectus offerings). However, there are areas in which securities regulation is not harmonized, such as derivatives and enforcement actions. Furthermore, there are institutional differences across provinces, including the ways in which they interpret and apply ostensibly uniform law.¹⁵ On a purely descriptive level, we seek to understand the respective pay-offs of the provinces in agreeing or refusing to join a national securities regulator. The analysis is worthwhile because securities regulation is not completely harmonized and because differences in pay-offs – and in particular costs that arise for certain jurisdictions if they choose to cooperate on certain dimensions – are perhaps at the root of Canada's inability to achieve a national securities regulator to date.¹⁶

Second, as suggested by the quote from Trebilcock *et al.* that appears as the epigraph to this essay, the Canadian securities regulatory structure must be viewed in the broader context of federal/provincial relations.¹⁷ *The Constitution Act, 1867*,¹⁸ enumerates various heads of federal and provincial jurisdiction. Historically, securities regulation has been interpreted to fall under the provincial property and civil rights power,¹⁹ but this interpretation does not preclude the argument that the federal government has constitutional jurisdiction under its 'trade and commerce' power.²⁰ The constitutional tension over securities regulation exists

15 Licht, *ibid.* at 104, explains that monitoring and enforcement capabilities differ across countries. We believe that the same is true across Canadian provinces.

16 Thus, for example, cooperation on disclosure or prospectus offering rules may differ from cooperation in the anti-fraud context.

17 Trebilcock *et al.*, 'Summary,' *supra* note 1.

18 *Supra* note 2.

19 *Ibid.* at s. 92(13).

20 See three constitutional opinions contained in A. Douglas Harris, ed., *WPC – Committee to Review the Structure of Securities Regulation in Canada: Research Studies* (Ottawa: Department of Finance, 2003) at 1, online: Wise Persons' Committee <http://www.wise-averties.ca/report_en.html>, which all argue that the federal government has the constitutional jurisdiction to enact securities laws. It should be noted that the issue of paramountcy is important, as it is unclear whether federal legislation in this field would suspend the operation of pre-existing provincial legislation such that only one scheme of securities regulation exists. The federal government is seeking a reference from the Supreme Court of Canada regarding the constitutionality of a

against the background of federal/provincial disputes in other areas, giving rise to the view that political barriers, and not simply institutional or legal impediments, prevent consensus on a securities regulatory structure for Canada. We address this possibility in Part VII below.

III *Securities regulation and cooperation*

Numerous reports and academic studies have pointed to the benefits of cooperation in the administration and enforcement of securities regulation in Canada.²¹ The most recent is the Expert Panel's Report, which identifies a range of concerns with continuing to allow thirteen different bodies to regulate capital markets in Canada. These concerns include increased transaction costs and inefficiencies from multiple regulators; reduced ability to react to changing circumstances in financial markets; and the inability to address increasingly national and international developments in capital markets. To address these concerns, the Expert Panel's Report recommends a single national securities regulator for Canada.²²

The absence of a national securities regulator in Canada could be seen as the result of a Prisoners' Dilemma. In the classic PD game, if neither of two prisoners confesses, each receives the minimal sentence. This non-action, which is a form of cooperation, leads to a Pareto optimal result from the perspective of the prisoners; neither can be made better off without making the other worse off. However, by assumption the two prisoners are unable to communicate, and as a result they will tend not to choose a cooperative strategy, given their expected set of pay-offs. Rather, each prisoner will rationally believe that she will do better by defecting (*i.e.*, confessing) and thus go free, regardless of what the other prisoner decides to do. The result is Pareto sub-optimal: each could fare better if she could credibly commit to cooperate and not confess, but neither is able to do so.

federal scheme of securities regulation. At the time of writing, the precise questions at the heart of this reference were not publicly available. See David Akin, 'Feds seek court ruling on regulator' *The National Post* (16 October 2009), online: *The National Post* <<http://www.nationalpost.com/m/story.html?id=2112135>> [Akin, 'Feds seek']; and see discussion at note 52 *infra*.

21 See, *e.g.*, Anisman, *Proposals*, *supra* note 3; Wise Persons' Report, *supra* note 3; Expert Panel's Report, *supra* note 5; and Ontario, Crawford Panel on a Single Canadian Securities Regulator, *Blueprint for a Canadian Securities Commission: Final Report* (Ottawa, 2006), online: Crawford Panel <http://www.crawfordpanel.ca/Crawford_Panel_final_paper.pdf>.

22 Expert Panel's Report, *supra* note 5 at 39–42. This recommendation follows the conclusions of the Wise Persons' Report, *supra* note 3.

In the PD, the defection through confession of each player is the symmetrically dominant strategy. This yields an equilibrium of 'defect-defect,' which is a unique Nash equilibrium. Generally speaking, a Nash equilibrium is achieved if (a) each player has chosen a strategy and (b) none of the players can benefit by altering her adopted strategy given what the other players have chosen. Thus, there is a relative aspect to the Nash equilibrium: each player's strategy must be the best possible response to the strategies that the others choose.²³

How does this relate to securities regulation in Canada? To begin the analysis, we will assume that there are only two provinces in Canada: Alberta and Ontario. We take these provinces to be single, independent, and rational decision makers – that is, it is the provincial government's views or preferences that count. In reality, we know that the decisions by these provinces as to whether to join in a national securities system depend on the preferences of a number of parties (including arm's-length provincial securities commissions, issuers, dealers, and investors) and the institutions by which these preferences are combined in the particular province. We discuss some of the implications of intra-provincial differences in preferences below. For now, however, we propose a basic model of a single decision maker with fixed preferences and focus on the resulting inter-provincial dynamic.

Broadly conceived, the players each have two strategies available to them with respect to securities regulation. They can choose to regulate the securities market in their respective provinces using their own rules (as has historically been the case); we call this non-cooperative strategy 'defect.' Alternatively, the two provinces can agree on some form of national securities regulation, which we call 'cooperate.'²⁴ Of course, this 2×2 matrix is a simplification of securities regulation, but it illuminates the basic conflict between provinces on this issue.

The interaction of these strategies results in a 2×2 pay-off matrix. We use hypothetical pay-offs for the provinces' preferences with respect to the possible outcomes, since they allow us to discuss whether a province prefers one outcome to another. To begin, we assume that these pay-offs relate to an aggregate measure of provincial welfare; in other words, each province chooses its strategy based on the pay-off for the

23 Douglas Baird, 'Game Theory and the Law' in Peter Newman, ed., *The New Palgrave Dictionary of Economics and the Law*, vol. 2 (New York: Stockton Press, 1998) at 192.

24 We recognize the highly stylized character of this model and address alternative scenarios, including one that contemplates harmonized securities regulation and the passport system of regulation as a solution, in Part IV below. We also recognize that the model does not address by how much, in actual terms, the parties prefer one outcome over another.

welfare of the province as a whole. For the moment, we leave aside the difficult question of how provincial welfare is measured or aggregated.

In this game, each province is assumed to know the pay-offs for the other but must declare its choice of strategy simultaneously with the declaration of the strategy by the other province.²⁵ If the pay-offs are as shown in Figure 1, the result is a PD. In particular, Alberta will want to make its best choice given the actions of Ontario. If Ontario decides to cooperate, Alberta does best by not cooperating – in effect allowing Ontario to make changes to its detriment but not making any cooperative efforts itself. Given Ontario's cooperation, Alberta would receive a pay-off of 4 from not cooperating and a pay-off of only 3 if it cooperates. If, on the other hand, Ontario chooses not to cooperate, Alberta would still do better by not cooperating: given Ontario's defection, if Alberta chooses to cooperate it would receive a pay-off of 0, while defection would yield a pay-off of 1. Since the pay-offs are symmetrical, Ontario will go through the same decision-making process. For both, therefore, the best choice is to defect, given that there can be no credible commitment made by the other province with respect to its strategy and that the choices must be declared simultaneously.

This result is unsatisfying. The 'defect-defect' result is not Pareto optimal, since by moving to 'cooperate-cooperate,' each province could improve its pay-off from 1 to 3. One of the standard approaches to resolving a PD is a legislative solution that effectively mandates cooperation. Alberta and Ontario could jointly legislate a 'cooperate-cooperate' outcome, knowing that a 'defect-defect' outcome would result if the legislation failed; if neither province could scuttle the deal by defecting unilaterally, one would expect the outcome to be cooperation. Analogously, in such circumstances, if the federal government legislated a cooperative solution, both provinces would be better off. Each would approve of the associated welfare gains.

Another solution to a PD comes from repeated play of the game – each province could observe the other party's moves and punish non-cooperation in subsequent iterations of the game. It has been empirically shown that dynamic PD games of indefinite duration may be solved through 'tit-for-tat' strategies of this sort.²⁶ And it may be the case that cooperative outcomes that have previously been reached, such as the passport system discussed below, result from dynamic games.

Nevertheless, neither of these solutions has led to complete cooperation across provinces in the area of securities regulation.

25 Scott Barrett, *Environment and Statecraft* (Oxford: Oxford University Press, 2003) at 54–5 (setting out the basic conditions for the PD).

26 Robert Axelrod, 'Effective Choice in the Prisoner's Dilemma' (1980) 24 J.Confl.Resolution 3.

FIGURE 1

PD game for securities regulation

Ontario	Alberta	
	Cooperate	Defect
Cooperate	3, 3	0, 4
Defect	4, 0	1, 1

In particular, the federal government has not yet stepped in to regulate in this field (despite apparent constitutional authority to do so). Further, although there has been some cooperation among provinces with the passport system, provinces do not appear to have reached a consensus in favour of a form of cooperation involving a national regulator. In Part IV, we examine a potential explanation for this reluctance to cooperate – the problem of coordination.

IV *Securities regulation as coordination*

Cooperation and coordination are not synonymous.²⁷ A principal way in which coordination games differ from games like the PD is that they have multiple equilibria. A typical example of a coordination game is choosing which side of the road to drive on. If parties reach a consensus on ‘right’ or ‘left,’ then they will coordinate with each other and harmoniously share the road. The choice is more or less arbitrary; as long as everyone agrees and coordinates, all drivers are made better off. Although the choice of which side of the road to drive on has symmetrical pay-offs for drivers, all of whom can then more easily avoid collisions and drive more quickly, the pay-offs in coordination games do not always have to be symmetrical. There are games in which potential solutions do not render everyone as well off as everyone else. In these games, the choice of a particular equilibrium may have varying distributional impacts.

Cooperation and coordination games need not be mutually exclusive. In fact, one of the reasons that some PDs are difficult to solve is that they have nested within them a coordination game.²⁸ Consider a nested PD game in which the overall game is one of securing mutual cooperation. As in the driving example above, the source of difficulty lies in agreeing on the form of cooperation (*i.e.*, a coordination problem) rather than in a fear of defection. This model allows for multiple equilibria and different distributional effects from different forms of cooperation.

27 See McAdams, ‘Beyond the PD,’ *supra* note 6 at 212–3 (discussing the differences between PD and coordination games).

28 *Ibid.* at 226.

The embedded coordination game is the BOS game. It is based on the ideas that two or more parties can benefit if they reach some agreement and that they have a strong incentive to do so. The main impediment to reaching an agreement, however, is that there are differing alternatives on the table that lead to a coordination problem. The main issue is how parties coordinate in order to avoid (continued) disagreement.

Securities regulation in Canada may take the form of a BOS game because of differences in the pay-offs for the provinces depending on which form of cooperation is chosen. To understand the embedded BOS game, we need to make some assumptions about the players – Ontario and Alberta – that can lead to different preferences for cooperation. In particular, there must be some characteristic of Alberta versus Ontario that makes one coordination outcome more beneficial to one rather than the other. These characteristics could, for example, relate to the type of firm in each province, such as large versus small firms or natural resource firms versus manufacturing firms, that would have differing preferences for a local versus a national regulator. Alternatively, the coordination outcomes preferred may relate to differing perceptions of the optimal regulatory framework.

In this game, we will assume that the capital market in Ontario consists primarily of senior issuers, while in Alberta there are many small venture-capital firms. These two types of market players may be differentially affected *ex ante* by applicable legal rules or *ex post* by enforcement actions. For example, there may be certain rules that would be disproportionately costly or impossible for venture-capital firms to meet.²⁹ Moreover, there may be enforcement issues, such as the nature of the ‘public interest’ requirements, that differ between types of firms.³⁰ Finally, the type of regulation may be rules based or principles based, as is suggested in the Expert Panel’s Report³¹ (and discussed below).

The question becomes, what type of coordination will parties agree to? Much will depend on the potential pay-offs, which will have a number of different elements, including the regulating jurisdiction (provincial or federal) and the identity of the beneficiary (public or private). Also relevant will be political motivations of the relevant actors, which we discuss

29 Some legal instruments in Canada explicitly treat venture-capital issuers differently because they bear disproportionate costs under the legislation. See, e.g., *Disclosure of Corporate Governance Practices*, O.S.C. NI 58-101 (17 June 2005), online: Ontario Securities Commission <http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part5/rule_20050415_58-201_gov-practices_1.jsp>.

30 Each provincial or territorial jurisdiction in Canada has a ‘public interest’ power in its securities legislation. This broad power allows a securities commission to make one of a list of enumerated orders if, in its opinion, it is in the ‘public interest’ to do so. See, e.g., *Securities Act (Ontario)*, R.S.O. 1990, c. S.5, s. 127.

31 Expert Panel’s Report, *supra* note 5 at 17.

in Part v below. For now, we focus on the potential non-political pay-offs affecting the players, which can be disaggregated as follows:

- The benefits to the individual firms from regulation that is tailored to specific firms in the province (BC) – where BC is the sum of all benefits to individual firms from provincial regulation and includes benefits to particular firms from *ex ante* standards and *ex post* enforcement actions that favour those types of firms;
- The benefits to the province from regulation that is tailored to specific firms in the province (BP) – where BP is all benefits to the province beyond those that are directly related to the firm, and may include regulatory fees for access to the market, multiplier effects from any increased activity from favoured firms, and possibly other efficiency factors, such as the ability of regulators to issue receipts for prospectuses quickly;
- The marginal benefit to the individual firms of moving from a tailored provincial regulatory system to a national regulatory model (NC) – where NC is the sum of all the efficiency benefits to firms in the province, which may differ by type of firm depending on the rules and enforcement approach chosen, that is, a private benefit; and
- The marginal benefit to the province of moving from a tailored provincial regulatory system to a national regulatory model (NP) – that is, the public benefit from national regulation.

Assume now that the provinces’ choice sets are expanded. The provinces can still cooperate or not cooperate, but now there are two forms that the cooperation could take. ‘Cooperate A’ represents rules and institutions that favour small, high-risk venture-capital firms (*e.g.*, junior capital pool rules). ‘Cooperate o’ represents rules and institutions that tend to favour senior issuers (*e.g.*, short-form prospectus rules). Let B_{ij} be the benefit to province i of strategy j where $i = A$ for Alberta, $i = O$ for Ontario, and $i = B$ for both provinces; and $j = D$ for defect, $j = A$ for ‘Cooperate A,’ and $j = o$ for ‘Cooperate o.’ Also let $N = NP + NC$ and $B_{ij} = BC + BP$.

Figure 2 illustrates the pay-offs for each province for each strategy. For example, if Alberta chooses to defect, it obtains BAD from being able to

FIGURE 2
Pay-offs where there are two coordination options

Ontario	Alberta		
	Cooperate A	Cooperate O	Defect
Cooperate A	N, BAA + N	0, 0	0, BAD
Cooperate O	0, 0	BOO + N, N	0, BAD
Defect	BOD, 0	BOD, 0	BBD, BBD

favour its chosen firms (small, high-risk venture-capital firms) but does not receive any of the added public benefits from national regulation ($N = 0$). If Alberta chooses 'Cooperate A,' it obtains both the benefits from favouring its firms under 'Cooperate A' (BAA) and the public benefits from national regulation (N). We assume $BAA < BAD$, since even with its preferred national program, Alberta would have to make some concessions in its rules (either *ex ante* or *ex post*) and therefore could not provide as many benefits to its favoured firms.

Finally, if Alberta chooses 'Cooperate O,' it receives N , but $BAO = 0$, because the rules favour Ontario's preferred type of firms (senior issuers). The exception is that if both provinces choose different forms of coordination, neither gets any benefits from efficiency or from favouring its particular type of firm (*e.g.*, if Alberta chooses 'Cooperate O' and Ontario 'Cooperate A,' the pay-off for both is 0). Finally, we assume that $BAD = BOD > BBD$ – that is, the benefit to each province defecting alone is greater than if both defect, as if only one province defects and the other attempts to cooperate, we assume that there is a gain to the defecting province in investments using its preferred rules.

The form of the game will depend on the relative size of the pay-offs. Figure 3 illustrates a PD with an embedded BOS game. As in the PD game in Part II, the best strategy for each province, given the choices by the other province, is to not cooperate. For example, if Ontario chooses 'Cooperate A,' Alberta is still better off by not cooperating. The benefit to Alberta from not choosing 'Cooperate A' may stem from the advantage it will have over Ontario if it uses its own rules and institutions; for example, it can ensure that its legal regime will favour venture-capital firms rather than being subject to rules and institutions that operate on a national level (which may tend to benefit venture-capital firms, but to a lesser extent). If Ontario chooses 'Cooperate O,' Alberta is also better off not cooperating. Finally, as in the game in Part II above, if Ontario chooses not to cooperate, Alberta is better off not cooperating.

As in Part II, the choice of both provinces not to cooperate is a Nash equilibrium, but each would be better off if it could agree to cooperate. The difficulty is that there are two possible forms of cooperation, each of which is better than defecting but each of which provides greater benefits

FIGURE 3

Securities regulation as a PD with an embedded BOS game

Ontario	Alberta		
	Cooperate A	Cooperate O	Defect
Cooperate A	2, 3	0, 0	0, 4
Cooperate O	0, 0	3, 2	0, 4
Defect	4, 0	4, 0	1, 1

to one province than to the other. Alberta is better off than Ontario with 'Cooperate A,' and Ontario is better off than Alberta with 'Cooperate O.' Each is efficient, and the question becomes how to choose between them.

A number of factors can be important to choosing among equilibria, including history and culture.³² It may be that because of the history or context of the issue, one of the equilibria becomes a focal point. For example, it may be possible to argue that the constitutional or economic history of Canada makes one of these focal or, conversely, ensures that neither is focal. Another source of information for solving the coordination problems is third-party intervention, such as a tribunal that interprets laws. Part v discusses the solutions so far for securities regulation, with a view to determining where differences in preferences between the provinces exist and the possible sources of these differences.

v *Non-cooperation and passports*

How does the foregoing analysis relate to the history of securities regulation in Canada? First we will examine the status of coordination and cooperation prior to the introduction of the passport system. We will then discuss the implications of the passport system, including Ontario's refusal to join the system.

A PRE-PASSPORT COOPERATION AND COORDINATION

Although each Canadian jurisdiction has a separate securities act and a separate regulator to implement and enforce the act, the provinces developed the 'mutual reliance review system' (MRRS) in or about 1999.³³ In fact, the passport system is an offshoot of this system. The MRRS permitted one regulator to rely on the analysis and review of another regulator. For example, in a national prospectus offering, the applicant would receive comments and a decision from only one regulator on behalf of itself and all the others. The applicant thus had to deal only with one regulator, as opposed to thirteen, if non-principal regulators did not exercise their

32 McAdams, 'Beyond the PD,' supra note 6 at 231.

33 See *Mutual Reliance Review System for Prospectus and Annual Information Forms*, O.S.C. NP 43-201 (28 November 2005), online: Ontario Securities Commission <<http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Policies/policies.html>>. Proposals for this system were discussed among the provinces prior to 1999. See, e.g., Notice, Mutual Reliance and Review Program: Memorandum of Understanding (n.d.), online: Manitoba Securities Commission <http://www.msc.gov.mb.ca/legal_docs/legislation/notices/mrrs_notice.pdf>. The expedited review for short-form prospectuses and renewal AIFs preceded the MRRS. See Mutual Reliance Review System Memorandum of Understanding (14 October 1999), online: Autorité des marchés financiers (Quebec) <<http://www.lautorite.qc.ca/userfiles/File/reglementation/valeurs-mobilières/Normes/A-XXX-43ang.pdf>>.

ability to opt out. The MRRS allowed for a greater level of harmonization than had existed prior to its inception in areas such as exemptive relief applications and prospectus approvals.

The MRRS had drawbacks, however, some of which related to costs to market participants. First, it did not alleviate the need for market participants to pay fees in each jurisdiction. Second, a regulator could opt out of the system at any time and deal with the market participant directly. There was thus some uncertainty for market participants about the number of regulators they would be dealing with regarding individual matters. Finally, because securities laws are not uniform in each jurisdiction, market participants often had to obtain advice on applicable legal requirements in each jurisdiction.³⁴

This is not to say that rules of securities regulation in Canada are not harmonized. On the contrary, rules relating to disclosure obligations, public offerings, and corporate governance, among other areas, are generally consistent across jurisdictions, although this has not always been the case. The result is that market participants (including issuers and investors) benefit from knowing that, generally speaking, laws are uniform. In terms of the model discussed earlier, for most issuers the pay-offs for 'Cooperate o' and 'Cooperate A' appear to be the same (that is, there is no real advantage in terms of those rules in favouring a particular type of firm).

However, the law is not wholly consistent across jurisdictions, despite various attempts at creating uniform securities legislation across the country. A prime example is in the rules relating to exempt distributions³⁵ and exemptive relief orders. Such rules and rulings derive from individual regulators and form part of the securities law of the province, but they commonly differ across jurisdictions. It is also generally understood that philosophies relating to enforcement and resources allocated to enforcement differ, leading to different investigative and prosecutorial

34 *Five Year Review Committee Final Report: Reviewing the Securities Act (Ontario)* (Toronto: Ministry of Finance, 2003) at 36. See also Anita Anand & Peter Klein, 'Inefficiency and Path Dependency in Canada's Securities Regulatory System' (2005) 42 *Can.Bus.L.J.* 41, which is based on a report, prepared by the same authors, titled 'Costs of Compliance in Canada's Securities Regulatory System' in A. Douglas Harris, ed., *WPC – Committee to Review the Structure of Securities Regulation in Canada: Research Studies* (Ottawa: Department of Finance Canada, 2003), online: Wise Persons' Committee <http://www.wise-averties.ca/report_en.html>.

35 *Prospectus and Registration Exemptions*, O.S.C. NI 45-106 (2009), 32 O.S.C.B. (Supp-3). Although a national instrument exists, giving the appearance of uniformity across jurisdictions with regard to exemptions, individual jurisdictions have adopted specific exemptions within the instrument, while others have not. See, e.g., the offering memorandum exemption and the friends and family exemption, which are not uniformly adopted across Canadian jurisdictions.

decisions across jurisdictions.³⁶ Finally, the regulation of derivatives differs substantially: Quebec is the only province to have full-fledged stand-alone legislation governing over-the-counter and exchange-traded derivatives,³⁷ while Ontario has less comprehensive legislation.³⁸ Differences therefore continue to exist between some of the rules that are set *ex ante*, as well as between how the rules are enforced *ex post*. For these differences, the game may be more like that illustrated in Figure 3.

Returning to the issue of choosing among different efficient and yet distributionally heterogeneous equilibria, we noted in Part IV that history may play a role in making one of the equilibria focal. In particular, it may be that Ontario's formerly dominant economic role in Canada, and the fact that it has historically been home to Canada's largest capital market, led to a reasonable assumption that 'Cooperate o' would be the adopted solution. This assumption would solve the coordination problem, but, by the same token, it overlooks western Canada's and Quebec's historical reluctance to sign on to federal initiatives.³⁹

Thus, it is possible that neither of the equilibria has been focal in the last twenty years, as Ontario may have felt that its interests should prevail while some provinces were reluctant to cooperate based on central Canadian dominance. Moreover, in recent years Ontario's economic dominance has markedly declined, and Alberta's has risen. Again, this context may work against what would otherwise be a focal equilibrium. The result is that, for the most part, the provinces appear to be playing a PD game that they have overcome through cooperation (manifested in the MRRS, for example) or, at least, harmonization. However, the obstacle to a national securities regulator is that although parties would benefit from greater cooperation in other areas, they have different ideas about the cooperative outcome they prefer.

B THE PASSPORT SYSTEM

One attempt to circumvent the underlying cooperation/coordination problem in Canadian securities regulation is the 'passport' system.

36 Mary Condon, 'The Use of Public Interest Enforcement Powers by Securities Regulators in Canada' in A. Douglas Harris, ed., *WPC – Committee to Review the Structure of Securities Regulation in Canada: Research Studies* (Ottawa: Department of Finance Canada, 2003) 411. See also Licht, 'Games,' *supra* note 13 at 104, discussing differences in enforcement capabilities across states.

37 *Derivatives Act*, S.Q. 2008, c. 24.

38 *Over-the-Counter Derivatives*, O.S.C. Rule 91-504 (entered into force 1 December 2000).

39 This reluctance, voiced perhaps most strongly by the province of Alberta, may have originated with the policies of the Trudeau government, including the National Energy Program. In the province of Quebec, also, opposition to federalist initiatives, including a national securities regulator, is of long standing.

Under this system, if an issuer or investment dealer is in compliance with the rules of one jurisdiction, it is deemed to comply with the rules of the other participating jurisdictions. Practically speaking, the issuer or dealer is able to submit filings and registrations in one jurisdiction and, once these are accepted, have them recognized by all other jurisdictions. Because it views a national securities regulator as the optimal regulatory structure for Canada, Ontario has declined to participate in the passport system.⁴⁰

Since its inception in 2003, the passport system has taken various forms.⁴¹ It attempts to be a system of mutual recognition wherein provinces defer to the decisions and judgments of other provinces. For example, in obtaining a receipt for a prospectus, a firm can choose one jurisdiction as its 'principal regulator' to regulate the offering (review the prospectus, provide comments, etc.). All other jurisdictions then defer to the decision of the principal regulator (which is typically chosen on the basis of where the issuer's head office is located). However, issuers continue to pay filing fees to thirteen separate regulatory authorities, and enforcement actions are initiated and prosecuted separately, though regulators may cooperate with respect to any particular enforcement matter.

While the passport system exemplifies mutual recognition, the system does not differ significantly from previous models of securities regulation in Canada. The crucial element underpinning the model is that securities laws are generally harmonized across jurisdictions. Without harmonization at such a high level, the passport system would likely not be palatable to a number of jurisdictions. And, given harmonized law, the pay-offs to issuers from choosing certain regulators over others are (likely) not high overall (*i.e.*, there is little regulatory arbitrage). Furthermore, the costs to individual regulators of signing on to the system are likewise not significant. For instance, all regulators still retain the fees that they would otherwise receive, and capital market activity does not decline, since issuers are able to offer securities in jurisdictions that recognize the principal regulator.

Enforcement actions may be an exception. Regulators have differing resources to allocate to enforcement matters. They also have differing philosophies about enforcement (which matters to investigate and prosecute, including which conduct is contrary to the 'public interest,' which matters to refer to the Attorney General's office to be pursued under alternative legislation, the extent and severity of sanctions, etc.). As a

40 See 'OSC rejects passport system of regulation' *CBC News* (28 March 2007), online: CBC News <<http://www.cbc.ca/money/story/2007/03/28/oscpassport.html>>.

41 See note 4 *supra*.

result, issuers may experience differing pay-offs from choosing one regulator over another.⁴²

As noted above, Ontario has not joined the passport system, and stands alone among Canadian provinces in withholding its support. However, all of the signatory provinces have agreed that if the issuer's principal regulator is Ontario and the prospectus is also filed in a passport jurisdiction, they will defer to Ontario's review of the documents; as a result, Ontario is an indirect participant in the passport system. In fact, Ontario benefits from the stance it has taken on both models of securities regulation. Because of the collective position the other jurisdictions have taken, Ontario benefits from the passport system without formally signing on to it, while continuing to hold out for, and maintain strong federal ties by supporting a federal solution in the form of a national securities commission.

In terms of the model discussed in Part IV, the pay-off structure under the passport system may look more like Figure 4, with Alberta allowing Ontario to join in without formally accepting. The biggest change to the game is that if both choose 'Cooperate P' (passport), each gets the same benefits as if they had both defected, but there is an efficiency gain (N' , where $N' < N_P$ because the passport system has more minor efficiency gains than an actual national system). In order for Ontario not to want to sign on and Alberta to want in, it must be the case that $BOD > BBD + N' > BAD$. Earlier we had assumed that $BAD = BOD > BBD$. For Alberta and not Ontario to want to join the passport system, it could be that there is a wedge between BOD and BAD and that the difference between BAD and BBD is sufficiently small for Alberta, and the difference between BOD and BBD sufficiently large for Ontario, that the passport system makes sense for Alberta but not for Ontario.

In terms of the coordination game we have set out, therefore, Alberta (and other provinces) see pay-offs from coordinating under the passport system, as they retain dominance over their own capital markets. Politically, this has been important for western provinces⁴³ that have historically exhibited an anti-federal stance. These provinces have been reluctant to allow regulators from 'central Canada' to have control over

42 It should be noted that securities regulators in Canada can claim jurisdiction on the basis of a variety of factors, including whether it is necessary to do so to prevent future harm to the province's capital markets. Therefore, if Issuer A does not choose Province A as its principal regulator, Province A can nevertheless pursue Issuer A if it believes that Issuer A meets the 'real and substantial' connection threshold. See *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132.

43 Although British Columbia has voiced its support for the national securities regulator proposed in the Expert Panel's Report, *supra* note 5, it had for at least the past ten years opposed the creation of a national securities regulator.

FIGURE 4

Pay-offs under a passport system

Ontario	Alberta		
	Cooperate P	Cooperate O	Defect
Cooperate P	BBD + N', BBD + N'	0, 0	0, BAD
Cooperate O	0, 0	BOO + N, N	0, BAD
Defect	BOD, 0	BOD, 0	BBD, BBD

their markets. Western provinces believe that their regulatory expertise enables them to deal more effectively with what they perceive to be distinct capital markets populated by venture issuers in the mining and oil and energy sectors. The passport system provides some efficiencies, but arguably fewer than would be the case under a truly national form of regulation.⁴⁴

Ontario, on the other hand, does not prefer the passport system. It likely believes that it has little to gain by moving to the passport system, given that any major offering in Canada would need to occur in Ontario. Furthermore, it may be unwilling to rely on rules and institutions framed around venture-capital firms, given that its issuer base contains a large portion of senior issuers.⁴⁵ In addition, Ontario is mindful of costs to issuers – which include filing multiple fees and retaining lawyers in multiple jurisdictions – to ensure compliance with securities law. In any case, the pay-offs of formally adopting the passport system are not high for Ontario, given the move by all other regulators to ensure that Ontario is effectively included in the system should issuers wish to distribute securities there. Thus, Ontario participates by default; that is, it does not fully defect, and receives some benefit as under ‘Cooperate A’ above. Ontario’s pay-off from defecting may effectively be $BBD + N$, so that it has a slightly more beneficial pay-off than if all provinces had defected.

VI *The Expert Panel’s Report*

The Expert Panel’s Report recommends a single securities commission for Canada, built on a uniform securities act and principles-based regulation. The proposed model has three defining features. First, it recommends a decentralized approach in which vice-chairs are distributed

44 Wise Persons’ Report, *supra* note 3; Expert Panel’s Report, *supra* note 5 at 39.

45 In March 2009, there were 1 541 issuers on the Toronto Stock Exchange and 2 269 issuers on the TSX Venture Exchange; that is, senior issuers were approximately 40 per cent of all issuers. Thomas Kloet, ‘2009 U.S. Campaign – New York Luncheon’ (Presentation at the Metropolitan Club for the TMX Group’s 2009 US Campaign, 5 May 2009), online: TMX Group <http://www.tmx.com/en/pdf/USCampaignNY_May6-2009_Presentation.pdf>.

across regional centres and provinces have representation at various decision-making levels.⁴⁶ Second, it contains a multifaceted opt-in concept under which provinces and issuers within provinces can forego provincial regulation and voluntarily join the national regulatory model. Third, it recommends the creation of a separate adjudicatory body. We argue that the Expert Panel's Report is optimal for Ontario, but not for Alberta, in terms of their respective preferences. It is useful to think through these recommendations in two parts – the first being the decentralized approach and the independent tribunal, and the second being the opt-in provisions.

A SETTING UP THE NATIONAL SYSTEM: DECENTRALIZATION AND INDEPENDENCE

The Expert Panel's Report recommends the establishment of a national securities regulatory system with a decentralized approach. Decentralization is to be achieved via the creation of regional offices in major centres and a series of smaller regional offices.⁴⁷ The regional offices would 'be responsive to the distinct needs of regionally-based sectors and local market participants.'⁴⁸ These offices would have a role in supporting local enforcement actions and would be a first point of contact for complaints of misconduct. However, policy making and enforcement actions would occur at a national level in the Canadian Securities Commission (csc). The report does not recommend the place of head office of the csc but suggests that it be located in one of the four largest provinces: British Columbia, Alberta, Ontario, or Quebec.

At first glance, it might appear that this model would lead to cooperation in some form contemplated above, especially given the creation of local and regional offices. Indeed, recall that one of the main attributes of the coordination game above is that under some versions of the game, parties can cooperate in different ways, with some (though not maximum) pay-offs to each. However, the Expert Panel's proposed model results in few if any pay-offs for Alberta, which can no longer set *ex ante* rules, since the law is set federally and, moreover, would be composed of principles that would differ in form and perhaps in substance from provincial law.

Further, Alberta would lose its enforcement powers, given the creation of a national adjudicative tribunal. The regional offices might assist with enforcement investigations and actions, but the initiation, prosecution, and adjudication of enforcement matters would, it appears, occur at the national level. Thus, an independent tribunal would negate any

46 Expert Panel's Report, *supra* note 5 at 47.

47 *Ibid.*

48 *Ibid.* at 43.

current benefit to Alberta from interpreting and enforcing its own rules as they apply to firms in that market. Overall, the prospective pay-offs to Alberta are lower under the Expert Panel's model than under the passport system. The Expert Panel's Report therefore does not solve the underlying coordination problem for Alberta, or, at least, it does not do so in a way that is advantageous to Alberta.

B. FORCING A NATIONAL SYSTEM: THE OPT-IN

Given that the pay-offs for Alberta (and perhaps other provinces) may not be high under the new system, there remains divergence in the form of coordination that each province views as optimal. This divergence could be overcome in different ways. It could be that some event (such as a global financial crisis) makes a particular form of coordination focal. Alternatively, the federal government could legislatively mandate a particular legal system.⁴⁹ This system could become preferred over the existing system if the pay-offs to each changed.

For example, differences in the distributional impacts could be overcome through side payments from provinces receiving higher pay-offs from the new system to provinces whose pay-offs are relatively low. One form of such side payments would be to locate the head office of the new CSC outside Ontario, perhaps in Alberta, or to choose the CSC's chair from western Canada. These proposals could provide some rents to Alberta and might aid in overcoming the perception that the CSC is a central Canadian body.⁵⁰

The main strategy advocated in the Expert Panel's Report for reaching compromise on national securities regulation is not side payments but an 'opt-in' procedure.⁵¹ In particular, the report recommends that provinces choosing not to participate in the federal scheme be allowed to opt in to the national regulatory model over time. In addition, the report recommends that until all provinces have adopted the federal regime, certain market players, such as issuers and registrants, be permitted to opt to be regulated under the federal regime (*i.e.*, even if their home

49 The federal government has referred to the global credit crisis of 2008 as a reason for forming a national securities regulator. See, *e.g.*, Michaëlle Jean, Speech from the Throne, 'Protecting Canada's Future' (19 November 2008), online: Government of Canada <<http://www.sft-ddt.gc.ca/eng/media.asp?id=1364>> ('The credit crisis has also underlined the dangers of a fragmented financial regulatory system. To further strengthen financial oversight in Canada, our Government will work with the provinces to put in place a common securities regulator').

50 See Expert Panel's Report, *supra* note 5 at 43, where the option of side payments is possibly being suggested (*e.g.*, it is proposed that the Head Office be located in one of the four largest provinces – BC, Alberta, Ontario, and Quebec – assuming they participate.)

51 Expert Panel's Report, *supra* note 5 at 60, 91ff.

province has not yet opted in). In other words, these players would forego being regulated at the provincial level (thereby becoming exempt from provincial law) and would instead be regulated by the csc and federal securities law alone.⁵² Ontario and British Columbia support the proposed model, while Alberta and Quebec oppose it.

Will Alberta firms (which are typically small venture-capital firms) opt into the Expert Panel's model if their home province opposes the creation of a national securities regulator? If these firms seek to issue securities only in Alberta, they may not opt in to the federal model. As firms grow, however, they will seek to access larger capital markets and, in particular, the markets of BC and Ontario (as Canada's largest capital markets are in Ontario). Thus, even venture-capital firms may have an incentive to opt in to the Expert Panel's model. Regardless of their size, firms generally will also find it more cost-effective to opt in, given that they will pay fees to one regulator only and will comply with a single set of rules.⁵³ The efficiency gains from opting in are generally higher for all firms that wish to distribute securities outside the province of Alberta.

The hope, then, is that enough firms will use the opt-in provisions that their cooperation will bleed the benefits that Alberta may obtain by defecting. The idea is that if the game in Figure 2 is seen as a long-run game (and 'Cooperate o' is taken to represent the Expert Panel's Report recommendations), BAD is made sufficiently low by firms formerly in the Alberta system opting into the Expert Panel's model that it falls below the efficiency gains from the new system plus whatever (small) benefits Alberta could continue to provide to venture-capital firms through the new decentralized system. The proportion of Alberta firms

52 Ibid. at 91 ('Issuers and registrants who make such an election [*i.e.*, to be regulated under the federal regime only] would then, for securities laws purposes, be regulated in Canada by the federal regime only, and would not be regulated by the non-participating jurisdictions'). The constitutionality of this aspect of the proposal can certainly be debated. A central question is whether it would be constitutional for the federal government to implement legislation that had the effect of superseding provincial securities law. See Christopher Guly, 'Proposed National Securities Regulator Sparks Debate,' Editorial comment, *The Lawyer's Weekly* 28:34 (23 January 2009) 20. The province of Quebec has sought a reference from the Court of Appeal of Quebec on the constitutionality of the Expert Panel's recommendations. See 'Reference to the Court of Appeal of Québec Regarding the Jurisdiction of the Parliament of Canada in Matters of Securities' (Communiqué, 9 November 2009, online: Government of Quebec <<http://www.communique.gouv.qc.ca/gouvqc/communique/GPQE/Novembre2009/09/c7403.html>>). The federal government is seeking a reference from the Supreme Court of Canada regarding the constitutionality of a federal scheme of securities regulation. At the time of writing, the precise questions at the heart of this reference were not publicly available. See Akin, 'Feds seek,' *supra* note 20.

53 Expert Panel's Report, *supra* note 5 at 47.

opting in to the new system will therefore determine whether the welfare gains from defecting remain positive.

VII *Can coordination be fostered?*

We have assumed that provinces make choices based on their own overall welfare. For this to be an explanation of the Canadian securities scheme, the wedge between the provinces that drives the preference for different forms of coordination needs to be sufficiently large to obstruct the provinces from agreeing on a harmonized system. If the wedge is sufficiently large, it is not really addressed by the Expert Panel's Report's combination of a principles-based approach to regulation and centralized policy making and enforcement. The opt-in provisions are necessary to overcome these different preferences and, if adopted, would likely be successful in doing so.

However, a wedge based on welfare considerations may not be sufficiently large to drive the non-coordination seen to date. There is another potential story based on considerations of public choice. Provinces may choose whether to cooperate based not only on whether the choice increases the overall welfare of the province but also on the returns that those in government can receive from the choice – for example, political support (or funds) in elections or future job opportunities. Indeed, some have argued that the absence of a national securities regulator in Canada results from the fact that securities law issues are not 'vote-getters,' unlike health care and Canada's participation in war efforts.

To account for the possibility – indeed, likelihood – of political motivation, consider the pay-offs in terms of political benefits. Political benefits may accrue to politicians when they disavow federal initiatives that will not be palatable to their provincial electorate. Thus, even though defecting leads to lower welfare pay-offs for Alberta in Figure 2 above, it may result in high political pay-offs for politicians who find favour with their electorate in adopting an anti-federal, anti-Expert Panel stance. The real sticking point for coordination would then be not differences in welfare or the distributional consequences of a national regulatory system but the political resistance to national regulation. In fact, those political pay-offs from defecting may even be larger with the opt-in system, as the opt-in system may be (rightly) viewed as an attempt to force non-participants into adopting national regulation. At the same time that the opt-in system reduces the welfare benefits to Alberta from defecting, it increases the political benefits of not joining in.

One possible solution to the coordination game is for the federal government to step in and impose one of the coordination options. It has not done so, however, perhaps because of uncertainty over its

constitutional authority and because it is unwilling to be seen to be imposing yet another central Canadian policy that will have differential impacts on different regions. The Expert Panel's model appears on the surface to be a model for voluntary cooperation. However, the consequences of the recommendations effectively provide Alberta with the choice either to join the national model or to become less relevant in terms of its regulatory role in the securities area. Indeed, the inclusion of the opt-in program is recognition of the possibility that provinces may not choose to participate in the proposed system. Given the likely impact of these provisions on the political benefits from defecting, the federal government may do better by taking an open and transparent approach to imposing a national system of securities regulation on the provinces.

In short, the Expert Panel's Report may allow a new equilibrium to be reached, not because of its new decentralized approach or its independent enforcement but because of the opt-in provisions. As a result of its opt-in feature, Alberta issuers need not be held hostage by their province's (possibly politically motivated) refusal to accept a federal regime. Practically speaking, the future of securities regulation in Canada holds significant potential for coordination along these lines. Regardless of the welfare benefits, however, the federal government will likely increase some provinces' ire by attempting to do through the back door what it seems unwilling to do through the front.