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## **MANAGING CONFLICTS OF INTEREST IN TSX LISTED COMPANY REGULATION**

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Prepared for:

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## **1. Introduction**

### **1.1 Background to Report**

FAIR Canada has repeatedly expressed concerns about the inherent conflict of interest between the “for profit” status of the TSX, and the TSX acting as a regulator of listed companies where it has a responsibility to act in the public interest. FAIR Canada has advocated for regulators to address this conflict of interest in a way that is consistent with international standards.

Recently the Ontario Legislature’s Standing Committee on Government Agencies called on the Ontario Securities Commission to “review the potential for conflicts of interest between the regulatory and commercial functions at the TSX and [that it] take the steps necessary to address any problems identified.”

FAIR Canada commissioned this review of TSX’s management of conflicts of interest in the Exchange’s role as a regulator of listed companies. This Report reviews the conflicts of interest that arise when exchanges that are commercial businesses also act as regulators and supervisors of issuers. The Report sets out several policy options that would improve TSX’s management of conflicts of interest in regulating listed issuers. The purpose of the Report is not to make specific recommendations, but to stimulate debate on the issue with a view to encouraging the TSX and its supervising regulators to address the issue.

This Report briefly outlines how the conflicts in listing regulation have been addressed in several important developed markets, including the US (both NYSE and Nasdaq), the UK, Scandinavia, Australia, Japan and Hong Kong. The exchanges reviewed are all self-listed, commercial enterprises with strong listing businesses.

### **1.2 Conclusions**

The listings business function is a major commercial function of an exchange. The listings regulation function is an important regulatory or standard-setting role that has a significant impact on market integrity and investor protection.

The Report finds that the seven other major exchanges reviewed for this Report have addressed the conflicts of interest that arise between their listings business operations and listings regulation responsibilities by implementing specific and sound mechanisms to manage those conflicts. The responses vary, and include a combination of changes in corporate governance, organizational structure, corporate policies and internal procedures. The three main approaches used to address conflicts of interest in listings regulation are:

- 1) The exchange establishes a regulation subsidiary with independent governance to perform listings regulation.
- 2) The exchange establishes a listings regulation department that is separate from the business operations of the Exchange (including listings business development) to perform listings regulation.
- 3) The statutory regulator performs listings regulation.

The TSX is the only exchange among this group that has not implemented specific measures to manage its listings conflicts (other than direct conflicts involved in its own self-listing). The TSX carries out listings regulation as part of a unified Listings Department that is responsible for both listings regulation and the listings business. **This Report advocates that the TSX implement measures to better manage those conflicts, and sets out several alternative approaches that the Exchange might take.**

### **1.3 Terminology**

#### *Terms*

“Listings” refers to both the business of listing the securities of issuers on an exchange, and the related regulatory functions of setting and administering the requirements to qualify for listing and the administration of continued listing rules. Listings includes the function of “admission to trading” at exchanges that use that term.

“Listings regulation” refers to the regulatory responsibilities of an exchange related to Listings, including the functions of setting and administering:

- the requirements to qualify for initial listing
- the continuing requirements to remain listed
- the continued listing rules that listed issuers must comply with.

“Continued listing rules” refers the provisions of the listing rules on matters such as disclosure, corporate governance, additional issues of securities, corporate actions and shareholder rights that listed issuers must comply with. These are also referred to as “ongoing obligations” by some exchanges.

“Market regulation” refers to the regulation of trading activity, and includes market conduct rules and market surveillance.

“Member regulation” refers to the regulation of investment dealers’ operations, business conduct, dealings with clients and financial compliance.

#### *Abbreviations*

In this Report the following abbreviations are used:

ASX – Australian Securities Exchange

CSA – Canadian Securities Administrators

HKEx – Hong Kong Exchanges and Clearing Inc.

LSE – London Stock Exchange

MX – Montreal Exchange (a unit of TMX Group)

Nasdaq – The Nasdaq Stock Market

NYSE – New York Stock Exchange

OSC – Ontario Securities Commission

RS – Market Regulation Services (merged into IIROC in 2007)

SEHK – Stock Exchange of Hong Kong (a unit of HKEx)

TSE – Tokyo Stock Exchange

TSX – Toronto Stock Exchange (a unit of TMX Group)

TSXV – TSX Venture Exchange (a unit of TMX Group)

TSX Group – The name of the holding company of TSX and other operating units at the time of self-listing.

TMX Group – The current name of the holding company for operating units, including the TSX, TSXV and MX.

*Footnotes*

See the References section at the end of the Report for citation details on source documents referred to in the footnotes.

## **2. Exchanges' Roles in Listings and Issuer Regulation**

It is vital to differentiate the twin pillars of exchanges' listings functions for purposes of this Report. Exchanges' listings businesses are significant sources of revenue. In many cases exchanges face intensive competition for listings business. At the same time, exchanges have a responsibility to administer their listings rules, including both detailed requirements to qualify for listing on an exchange and a wide range of rules or "ongoing obligations" that an issuer must comply with once it is listed.

The listings business function is a major commercial function of an exchange. The listings regulation function is an important regulatory or standard-setting role that has a significant impact on market integrity and investor protection.

### **2.1 Listings Business Services**

Listing is a major business line for most traditional exchanges. As the IOSCO Technical Committee has stated, "The range and quality of listings and other services on an exchange and the ability of an exchange to attract and retain quality listings is critical in determining the level of total operating revenues".<sup>1</sup>

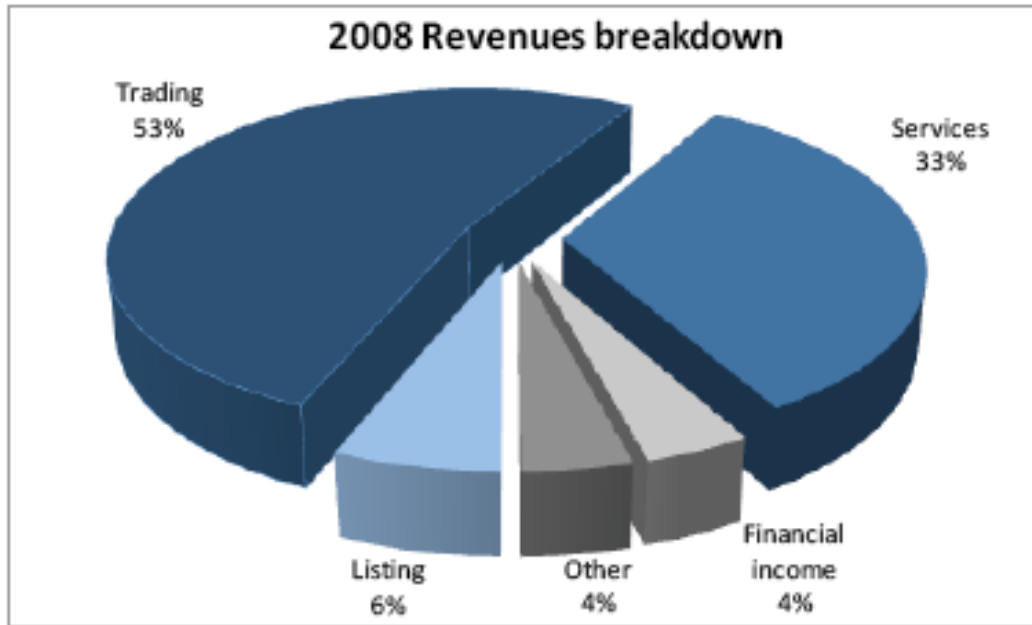
However, from an international perspective, exchanges' revenues from listings services are declining. According to the World Federation of Exchanges (WFE), listings revenues fell from 18% of total revenues in 1995 to only 6% in 2008.<sup>2</sup> As pointed out by Lee (2010), competition for trading services has reduced the market share in trading of the "primary markets". (NYSE and TSX are examples of primary markets within their national markets.) As the market share of the traditional exchanges declines, the justification for charging high listing fees is reduced because the listing exchanges cannot guarantee that they will provide the highest liquidity in their listed securities.<sup>3</sup> Nevertheless, the listings business is obviously vital to the trading services business, especially in markets where exchanges do not trade products without listing them.

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<sup>1</sup> IOSCO (2001)

<sup>2</sup> WFE (2009) Includes derivatives and other non-cash securities revenues.

<sup>3</sup> Ruben Lee (2010)



Source: WFE Cost and Revenue Survey 2008, p. 35

Annual listings fees accounted for 58% of listings revenues and initial (new) listings fees for 28%, in large part due to reduced primary market activity in 2008 compared to 2007.

## 2.2 Listings Regulation

In a large majority of markets, exchanges are responsible for two major listing regulation roles:

- 1) Determining whether an issuer qualifies to be listed based on exchange listing requirements; and
- 2) Applying a range of rules and requirements on listed companies in areas such as disclosure, protection of minority shareholders' interests, and corporate governance.

The IOSCO Technical Committee has specifically referred to listings as a "regulatory function".<sup>4</sup> Others see listing regulation as akin to a quality control function. Steil has written that "Listing is fundamentally a quality control function" comparable to that of ratings in the bond market.<sup>5</sup> Either way, most exchanges and their supervising regulators treat the administration of listing requirements and ongoing obligations of listed issuers as a self-regulatory function. Usually listings regulation is grouped with

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<sup>4</sup> IOSCO (2001), p. 4. The Technical Committee Report asked, "What conflicts of interest are created or increased where a for-profit entity also performs the regulatory functions that an exchange might have, especially primary market regulation (listing and admission of companies), secondary market regulation (trading rules) and member regulation?"

<sup>5</sup> Steil (2002) at page 72



other SRO functions such as market regulation. This is in spite of the fact that listings is not self-regulatory in nature because listed companies are not regulating themselves through the governance of the exchange, as member brokers traditionally did. Listings regulation is a form of private regulation by contract carried out by exchanges. Issuers agree to comply with exchange rules as a condition of listing.

The reason that exchanges treat listings regulation this way is that listings requirements and rules are undeniably regulatory in nature. New listings requirements must be met for a listing to be approved, and applications are subject to rigorous review. Ongoing obligations or rules that listed issuers must comply with are akin to securities regulations. They typically include disclosure requirements, investor protection requirements, transaction approval requirements and so on. Exchanges also monitor issuers' compliance with listing rules. So exchanges that adopt such rules and supervise companies' compliance with them are performing a regulatory function.

Listings regulation is an important part of an exchange's role in establishing standards to support the integrity of their markets. Statutory regulators, investors, dealers and other market participants rely on exchanges' performance of these roles.

In discussing listings regulation, it is important to recognize the difference between the functions of 1) approving an issuer's prospectus and the right to sell securities to the public and 2) the listing or "admission to trading" of an issuer's securities on an exchange.<sup>6</sup> In the great majority of markets these functions are separate. Regulators generally perform the former function and exchanges perform the latter.

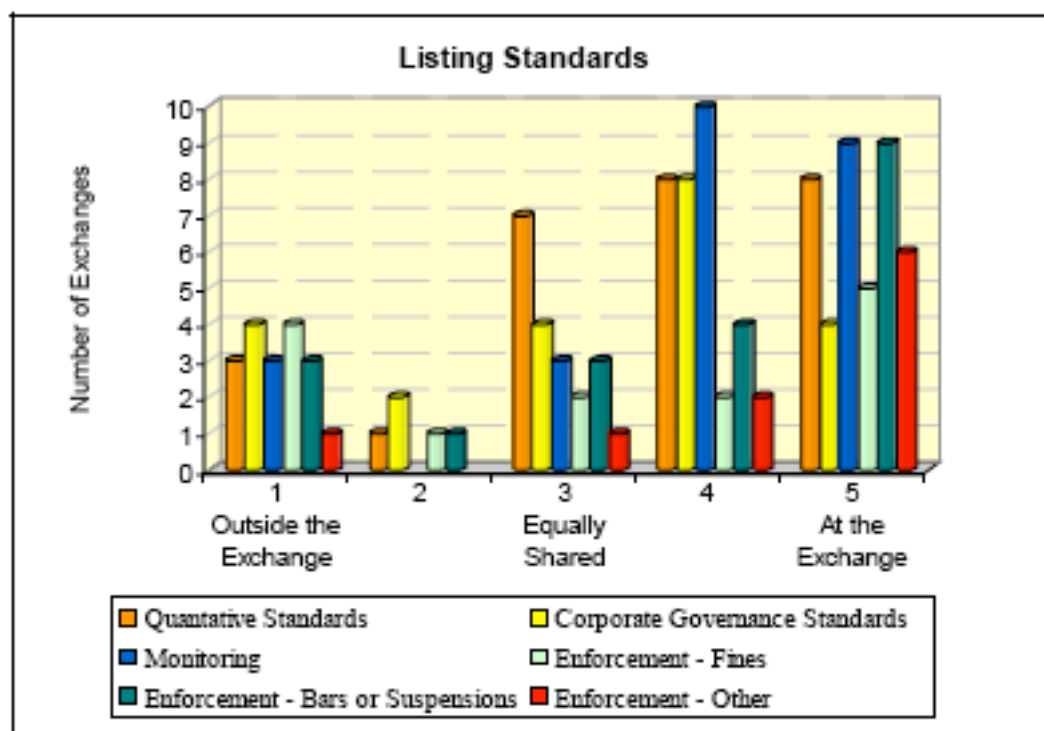
The precise division of responsibilities for listings functions between the statutory regulator and the exchange varies around the world, especially for ongoing obligations of listed issuers – regulations that a listed issuer must comply with as a public company. In some countries, exchanges traditionally performed the job of approving prospectuses too, but this function has migrated to regulators around the world. The regulator sets the main disclosure standards for issuers in most countries as well, although exchanges may impose additional requirements and often have specific rules on publication of material news (continuous disclosure). Many exchanges also retain an important role in setting corporate governance standards for listed issuers.

According to the *WFE Regulation of Markets Survey* in 2004, 79% of respondent exchanges established quantitative listing standards, and 69% established corporate governance standards. 86% monitored compliance such standards, and a large number

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<sup>6</sup> Listing is referred to as "admission to trading" standards in the EU and some other jurisdictions, to differentiate the exchange's standards from the regulator's requirements to authorize public trading of a security.

of exchanges enforced such standards.<sup>7</sup> Government regulators often shared these responsibilities with exchanges, as illustrated by the chart below.



Source: WFE *Regulation of Markets Survey 2004*, p. 11

In addition, at the time of the survey, 77% of responding exchanges established and monitored compliance with some disclosure standards, including annual and periodic disclosure, although in many cases the function was shared with statutory regulators.

Even in the UK, where the FSA’s “Listing Authority” determines whether an issuer qualifies for the “official list”, the LSE still has procedures for admission to trading on the Exchange that must be met.

In Europe, European Commission regulations transferred many of exchanges’ traditional responsibilities in the area of listings regulation and disclosure by issuers to statutory regulators (referred to as “competent authorities”).<sup>8</sup> The Markets in Financial Instruments Directive (MiFID) requires that exchanges (referred to as “regulated markets” in the MiFID) have clear and transparent rules on the admission of financial instruments to trading. It also requires a regulated market to establish and maintain effective arrangements to verify that issuers comply with their admission to trading requirements and their disclosure requirements. As a result, an exchange may impose

<sup>7</sup> WFE (2005)

<sup>8</sup> Specifically, the Prospectus Directive and the Transparency Directive.

listings and disclosure rules that exceed the requirements mandated by the EU directives. However, this is an option that many do not use.

In spite of a general global trend towards reduced SRO roles at exchanges, exchanges want to retain control over listings regulation. The main reason for this is obviously that listings is an important business, but the UK model shows that listings revenues are not necessarily tied to performance of listings regulation. However most exchanges believe that many aspects of issuer regulation are important to the competitive positioning of their listings business, to controlling the attributes of their listings services, as well as to maintaining market integrity and thus the exchange's reputation.

For example, the quality of an exchange's stock list, and therefore the positioning of its listings business, is largely defined through minimum standards for initial and continued listing. The continued listings rules on subjects like disclosure, corporate governance, shareholder rights and corporate actions protect investors and market integrity. An exchange can differentiate itself from competing markets by setting higher regulatory standards for listings.

Listings requirements vary widely across different markets. Of course standards are the differentiating factor between TMX's two equities exchanges, the TSX and TSXV. Many countries have junior markets that occupy a distinct market segment. The NYSE has historically differentiated itself from both domestic and international competition by imposing much higher listings standards. These standards are clearly observable by market participants, including investors, and are an important part of an exchange's "brand".

### **3. TSX Listings Role and Functions**

#### **3.1 Regulatory Status and Supervision of TSX**

##### *TSX's Self-Regulatory Responsibilities*

As described in section 6.1, the TSX transferred or outsourced its member regulation and market regulation functions in 1997 and 2002 respectively. IIROC now performs both functions. However, under the Ontario Securities Act the TSX remains responsible for all regulatory functions that are not being performed by IIROC, according to the terms of its recognition order issued by the OSC.<sup>9</sup> The TSX must also monitor IIROC's performance of market regulation functions for TSX under their regulation services agreement.

##### *Oversight of Exchanges*

Exchanges and similar institutions, such as SROs and clearing agencies, are licensed and subject to ongoing supervision by regulators because they provide essential infrastructure for the operations of the capital markets. In most cases it is vital for a market participant – whether an investor, issuer or intermediary – to obtain access to this infrastructure in order to participate in the market. The fact that many exchanges are de facto monopolies in their national markets reinforces the importance of licensing and supervision.

IOSCO stated on the role of exchanges:

Most jurisdictions regard the proper functioning of their exchanges as critical to the efficient operation of their capital markets. They therefore see a strong public interest in exchanges operating their markets in a way that promotes market efficiency and commands market confidence... The fair and efficient functioning of an exchange is of significant benefit to the public. The efficiency of the secondary market in providing liquidity and accurate price discovery facilitates efficient raising of capital for commercial enterprises, benefiting both the wider corporate sector and the economy as a whole. The failure of an exchange to perform its regulatory functions properly will have a similarly wide impact.<sup>10</sup>

IOSCO has formally recognized the importance of supervision – also referred to as oversight – of all types of exchanges and similar institutions in its Principles of Securities Regulation.<sup>11</sup> IOSCO Principle 26 states, “There should be ongoing regulatory

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<sup>9</sup> Paragraph 13 (d) of the amended recognition order

<sup>10</sup> IOSCO (2006)

<sup>11</sup> IOSCO Objectives and Principles of Securities Regulation (2003)

supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants". Principle 7 states: "SROs should be subject to oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and responsibilities".

Securities regulators supervise exchanges primarily for the purpose of ensuring that they meet their "public interest responsibilities". Two significant objectives of oversight are to ensure that an exchange operates in a neutral manner and does not create unreasonable barriers to access to its services, including listings services.

### *Oversight of TSX*

The OSC has the statutory power to recognize stock exchanges and register commodity futures exchanges. Recognition is akin to a license that permits an exchange to operate, and sets out the terms and conditions of its operation. The OSC has issued several recognition orders to the TSX over the last 10 years which reflect changes in the terms and conditions of operation due to changes in the TSX's corporate status, beginning with its demutualization.

In Canada, all organizations considered to be SROs have a responsibility to act in the "public interest". The Ontario Securities Act requires that SROs must regulate "with a view to promoting the protection of investors and the public interest".<sup>12</sup> For example, the new recognition order that the OSC issued to approve TSX's demutualization requires the Exchange to ensure at least half of its directors are independent of member dealers "...in recognition that the protection of the public interest is a primary goal of the TSX".

TSX's recognition order was revised in 2002 when the OSC approved the self-listing of TSX Group shares on the Exchange. The revised order added several conditions to address the conflicts of interest involved in self-listing, which are discussed in section 6.4 below.

## **3.2 TSX Listings Business**

The TMX Group dominates the listings business in Canada through its TSX and TSXV exchanges. Currently it has only one minor competitor, which focuses mainly on competing with TSXV in the junior issuer market. Alpha Group, the operator of an ATS that competes for trading in TMX Group stocks, has announced a proposed new exchange that will compete for listings business in the near future. But at the present time very little competition exists for listings services in Canada. However, TSX has

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<sup>12</sup> Clearing agencies and stock exchanges are not SROs as defined in the Act but in practice the OSC's recognition orders for these entities impose the same public interest responsibilities on them.

faced major competition from US exchanges for listings for decades and a large number of TSX's biggest listed companies are also listed on the NYSE or Nasdaq. In addition, stronger competition from US OTC markets for listing of junior issuers has emerged recently.

TSX had 1,465 listed issuers with 2,014 listed securities as of March 2010. The total market capitalization of these issues was \$1.845 trillion.<sup>13</sup> In 2009 total financings raised through the TSX were \$60 billion, a new record.

The TSX's listing business is of major importance to the TMX Group, as it accounts for a much higher share of the company's revenue than the global average. The TMX Group website promotes its status as one of the biggest listing businesses in the world: It is the 2<sup>nd</sup> largest exchange group by number of listed companies, and the 8<sup>th</sup> largest by domestic market cap.

In 2009 TMX reported that issuer services accounted for 26% of total revenue or \$ 142.1 million. This number includes both the TSX and TSXV. TSX listings fees accounted for 68% of total, TSXV fees 24% and other services 8%.<sup>14</sup> TSX has three main sources of listings revenues: 1) initial listings fees for newly-listed issuers, 2) additional listings fees for securities issued by existing listed companies, and 3) annual sustaining fees that are paid by all listed issuers to remain listed.

### **3.3 TSX Listings Regulation**

The CSA relies extensively on self-regulation by the TSX, other exchanges, IIROC and similar bodies. As the CSA described in its 2006 report on the oversight of SROs:<sup>15</sup>

The Canadian regulatory regime employs government regulation together with self-regulatory organizations and market infrastructure entities such as exchanges and clearing agencies to protect investors and to promote fair, efficient and competitive capital markets. Canadian securities legislation enables securities commissions to recognize self-regulatory organizations, exchanges and clearing agencies, and encourages reliance on SROs.

TSX's listings regulation plays a significant part in regulating the quality of equity securities and certain other types of securities that investment dealers sell to investors. The TSX's continued listings rules also play an important role in protecting investors.

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<sup>13</sup> TMX Group website

<sup>14</sup> TMX Group 2009 Annual Report, page 20. TMX subsidiary The Equicom Group Inc. provides other issuer services – “a leading provider of investor relations and related corporate communication services to public companies”.

<sup>15</sup> CSA – Review Of Oversight Of Self-Regulatory Organizations And Market Infrastructure Entities Report of the CSA SRO Oversight Project Committee, December 2006

TSX's listings rules extend well beyond setting requirements to obtain a listing; a range of rules apply to subjects such as disclosure, notices to shareholders, issuance of securities and changes in capital, stock options and so on. TSX listing rules impose requirements in several areas that US exchanges do not regulate. TSX listings regulation responsibilities are quite extensive, in spite of the expansion of the CSA's role in regulating listed issuers in the last two decades, and the CSA's assumption of responsibility for the corporate governance guidelines in 2005.

TSX listings rules cover the following matters:<sup>16</sup>

- 1) Requirements to qualify for initial listing on the Exchange, covering minimum standards for earnings, assets, working capital, operating history, corporate governance, distribution of securities, etc.
- 2) Continued listings requirements that listed issuers must meet on an ongoing basis to remain listed on the Exchange.
- 3) Filing requirements with TSX and notice to shareholders requirements for matters such as corporate disclosure, shareholder meetings, dividends, etc. These rules address certain rights of shareholders.
- 4) Timely disclosure policy requiring prompt announcement of material news.
- 5) Continued listings rules applicable to additional issues of existing listed securities by a listed issuer and other changes in its capital structure. The rules address listing of the new securities (if applicable), and impose specific requirements for additional issues by prospectus, private placements, warrants, convertible securities and so on. These rules cover approval of new issues of securities by TSX. The rules also require the approval of minority shareholders in certain cases, including:
  - Issuances to acquire public companies if existing shareholders' equity would be diluted by over 25%;
  - Change of control transactions that are based on issuances of securities from treasury;
  - Private placements if insiders may receive over 10% of outstanding shares, or if price discounts exceed specified levels.
- 6) Continued listings rules to protect the rights and interests of existing shareholders. For example, "disinterested" shareholders must approve acquisitions if insiders may receive more than 10% of the outstanding securities; and security-based compensation arrangements if more than 10% may be

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<sup>16</sup> See the TSX Company Manual, which contains the TSX listing rules.

- issuable to insiders. Special rules apply to early-stage or more junior issuers (“non-exempt issuers”) on transactions involving insiders.
- 7) Rules on issuances of, and disclosure requirements for, restricted voting shares.
  - 8) Rules applicable to other transactions in listed securities by control persons, insiders and the issuer itself, including issuer bids and sales from control positions.
  - 9) Rules on security-based compensation plans, such as stock options, including the structure of plans, disclosure, and shareholder approval.
  - 10) Disclosure of compliance with CSA corporate governance guidelines.

The TSX does not employ formal disciplinary actions with hearing procedures to enforce its listings rules, along the lines of the enforcement procedures it regularly used in the past to enforce its rules against member investment dealer firms. It does not have the power to fine listed issuers or their officers and directors. However, under the terms of TSX’s recognition order, the OSC requires the TSX to ensure that “... its listed issuers are appropriately sanctioned for violations of the Rules”. In addition, the Exchange must notify the Commission of any violations of securities legislation of which it becomes aware.

The TSX has advised that it uses a number of administrative remedies to ensure compliance with its listings rules. These remedies include:

- requiring an issuer to make a news release or to clarify a news release
- mandatory attendance at TSX workshops on disclosure practices
- requiring the adoption of disclosure policies or the establishment of a disclosure committee
- prohibiting or restricting individuals from being involved with TSX issuers
- requiring changes to the board of directors or to the composition of board committees

Of course the TSX also has discretion on whether to approve specific transactions or filings that the Exchange must approve under the listings rules, and may impose conditions on an approval.

In a serious case the TSX also has the power to delist a company’s securities, although that remedy is primarily used in cases where an issuer no longer qualifies for listing under the continued listing rules. There are formal procedures applicable to delisting of securities, including a right to a hearing if an issuer decides to contest a proposed delisting.



The TSX was not able to provide data on the number of times it has used certain specific powers under the listing rules, or the number of times it has notified the OSC of potential violations of securities laws. The TSX stated that it does not track these numbers.

It is unusual for a regulator or self-regulatory organization not to record and monitor information on its compliance activities, including the application of specific penalties or remedies under its rules. It appears that the TSX should be maintaining such data, at least for purposes of internal supervision and management of its listings regulation program, as well as for purposes of OSC oversight of the program. In fact, many regulators periodically release summaries of their compliance activities to the public.

## **4. Conflicts of Interest in Listings Regulation**

### **4.1 General Listings Regulation Conflicts**

It has always been acknowledged that conflicts of interest exist in self-regulation, so the existence of conflicts does not mean that an SRO should be disqualified from performing a regulatory role. If that were the case self-regulation would not exist. Rather the central issue with conflicts of interest at SROs is whether a conflict can successfully be managed in a manner that justifies continued reliance on self-regulation.

Conflicts of interest are greater for an SRO that is responsible for a wide range of regulatory functions. An exchange that is responsible for market regulation, member business conduct, listings, and clearinghouse operations obviously has more conflicts to manage than an exchange that has only limited market surveillance and listing functions. This reasoning is one major factor behind the global trend towards reduced regulatory responsibilities at many for-profit exchanges. Even if a conflict can successfully be managed, an exchange or the authorities may decide that the need to focus on business priorities and competitiveness require that the exchange relinquish certain regulatory responsibilities.

Regulation standards are a double-edged sword for exchanges: on one hand, an exchange's reputation and market quality are critical to its competitive position, investor confidence and brand; on the other hand, overly stringent and intrusive regulation may lead to loss of business. An exchange has business incentives to maintain market integrity and credible listed issuers in order to attract trading interest, maintain its reputation, and instill investor confidence in the market. But if an exchange is too aggressive in its regulatory approach, it may discourage listings or even create incentives for listed companies to move to competing exchanges that have less stringent rules. For instance, it has been widely reported that non-US companies are reluctant to list on US exchanges because of the stringent regulatory environment in the US, including the exchanges' rules on corporate governance. The LSE has been the prime beneficiary of this perspective.

Therefore it is vital for an exchange to strike the right balance in listings regulation. The competitive environment and an exchange's particular competitive position are important factors in striking the right balance.

While conflicts of interest between exchanges' business development interests and listings regulation functions have always existed, regulators and other participants believe these conflicts are exacerbated at demutualized, for-profit exchanges because their business objectives are primary, whereas non-profit exchanges have lower incentives to promote commercial objectives over regulatory objectives.<sup>17</sup>

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<sup>17</sup> See, for example, IOSCO (2006) at page 8

For instance, an IOSCO report on the commercialization of exchanges expressed concern that an exchange might lower listing standards in order to attract new listings.<sup>18</sup> The report added that:

... for-profit exchanges may reduce the resources they devote to regulation. Worse, they may place insufficient value on the regulatory process, fail to sustain a strong regulatory culture and be less willing to co-operate with their supervisory authorities...

In its 2004 review of the corporate governance of SROs, the SEC cited fears about increasing conflicts of interest at for-profit exchanges. The SEC specifically noted that competition for listings might lead to lower listing standards, among other concerns.<sup>19</sup>

The overall conflict between an exchange's business interests and its duties as a listings regulator may manifest itself in several ways:

- 1) High initial listing requirements and stringent continued listing rules on subjects such as corporate governance, disclosure, minority shareholder rights and dilution of shareholder equity can have a negative effect on attracting and retaining listings business.
- 2) Maintaining high standards of supervision of compliance may negatively affect relationships with listing customers. Strong compliance supervision can mean:
  - Extensive filing requirements
  - Requirements to obtain Exchange approval of corporate transactions
  - Making compliance enquiries on ongoing obligations
  - Issuing information requests
  - Enquiries on material developments and continuous disclosure
  - Requiring changes in filings, disclosure etc. if shortcomings are found.
- 3) Pressure from big listing customers could result in biased administration of rules if management's discretion in the interpretation or application of listings rules, or on the availability of exemptions (also called waivers), favours large issuers. This could be a bigger risk if transparency on listing interpretations and compliance decisions is lacking.
- 4) Regulatory policy initiatives or the activities of listings regulation staff may produce tensions between business development needs and regulation responsibilities. This can be reflected in strained relationships between regulation staff and listings customers, as well as with the exchange's business development staff.

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<sup>18</sup> Ibid.

<sup>19</sup> SEC (2005)

- 5) An exchange could discriminate against listed companies that compete with it in administering its listings rules. Conversely, an exchange could favour companies that are business partners. Such bias could be reflected in the handling of listing applications, the administration of continued listings rules, the use of investigation and enforcement powers, or in improper use of confidential information about listed companies for business instead of regulatory purposes.

In the normal course of business customer relationship management considerations are clearly a major factor in developing and applying corporate policies and procedures to customers. The listings business is necessarily different. The existence of listings regulation responsibilities at exchanges means that permitting customer relationship management considerations to unduly influence the development and application of corporate policy – in the form of rules, standards and interpretations – cannot be permitted. Regulatory policy must respond to a range of needs, and while the interests and needs of the customer may be one factor, they cannot be the main factor. Therefore there is a clear conflict between an exchange’s commercial interests in meeting its customers’ needs and the broader public interest that its regulatory program must address.

The existence of a conflict does not mean that an exchange will handle the conflict inappropriately. Steil wrote that, “Any assumption that listing standards will always be set too low if established on a purely commercial basis is clearly faulty”.<sup>20</sup> But while it is clear that exchanges have not set listings standards at levels that are designed simply to maximize the number of listings, it does not follow that when a commercial exchange aims to broaden its product range and focus on improving customer relationships that regulators and stakeholders can simply rely on market incentives and an exchange’s good intentions to maintain quality. As this Report shows, they have not done so – in most advanced markets where exchanges have a strong listings regulation role, special structures and procedures have been implemented to ensure that conflicts of interest do not compromise the integrity of exchanges’ regulatory decisions.

Commercial pressures are more likely to have an impact on listings standards and regulation programs in markets where strong competition for listings business exists. In Canada, exchanges that historically competed with the TSX – namely, the Alberta, Vancouver and Montreal Exchanges – used lower listings standards and continued listings rules to carve out niches with smaller issuers than the TSX aimed to attract. By merging the former junior exchanges into the TMX Group, this form of competition was eliminated. Instead, TMX is able to position its TSX and TSXV markets to appeal to specific target markets, drawing the line between the two exchanges where the Group believes it makes business sense.

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<sup>20</sup> Steil (2002) at page 73

But new listings competition has emerged in Canada. Today the Canadian National Stock Exchange (CSNX) employs a listings regime that is mainly disclosure-based, and imposes few requirements beyond those that securities commissions require of a public issuer. CSNX aims its listings marketing at junior issuers that may be dissatisfied with the regulatory burden. Recently the Alpha ATS announced that it is applying to the OSC for approval as an exchange, and will enter the listings business in competition with the TSX. If its listings rules apply lower standards than the TSX's, the TSX could face strong commercial pressures to compromise its standards.

Organizational influences must also be considered. If SRO functions are “part and parcel of the business”, listings regulation staff will be subject to the same cultural changes, values and incentives that apply to business units. This is especially the case at exchanges where there is no formal separation of business and regulation departments, or where there is weak separation. For instance, if Listings is treated primarily as a business unit, arguably listings decisions are more likely to be influenced by business considerations.

Even if an exchange pursues a compliance issue with a major listings client, subtle pressures to deal with the issue in a less stringent and more unobtrusive way are likely to arise. Such pressures can be unspoken. In a corporate culture that is increasingly dominated by values such as good customer relations, business innovation and financial performance, the unspoken message might be that regulatory objectives should be achieved without jeopardizing customer relationships and business objectives, if at all possible. Over time this could lead to subtle changes in regulatory approach. These changes do not need to be obvious to be harmful or inappropriate.

In addition, the profit motive and other business incentives change the emphasis to business development and customer focus from regulation. Exchanges are developing a range of new services for listed companies in an attempt to attract and retain listings customers, and to add value to their listings product. The emphasis of a Listings program can easily swing from investor protection, maintenance of high listings standards and strict neutrality to business development and customer relations – especially if the departments involved in each function are not separate and provided with incentives that are relevant to their individual mandates.

#### **4.2 Self-listing Conflicts of Interest**

Exchanges and supervising regulators have universally recognized the conflicts of interest that arise when an exchange lists its stock on its own market. Specific conflicts that can arise when an exchange is “self-listed” are:

- 1) An exchange might assess whether it meets its own initial listings requirements when it first applies for a listing.

- 2) Once it is listed, an exchange might monitor compliance with its continued listings rules in respect of its own listing.
- 3) An exchange might monitor trading in its own stock for potential irregular trading and decide whether to review or investigate trading for any reason.
- 4) An exchange might administer continuous disclosure requirements (for material news) as they apply to its own business.

In addition, similar conflict of interest issues could arise if an exchange lists securities of an affiliated party, such as a major shareholder in the Exchange (where an exchange is not a wholly-owned subsidiary of a holding company).

The US SEC expressed concerns about similar self-listing conflicts of interest in its 2004 release on proposed new rules on SRO governance. The proposal contained a specific set of rules on listing of affiliated securities by exchanges.<sup>21</sup> (The rules were never implemented.) The conflicts that the SEC cited were the potential for:

- Reluctance to effectively monitor compliance with initial and continued listings rules
- Reluctance to effectively regulate trading in its own stock
- Stricter treatment of listings regulations applied to competitors of the exchange.

Interestingly, the SEC has not taken over responsibility for approving self-listings or for monitoring compliance with listing standards or trading rules. It continues to rely on the exchanges to perform these functions directly, subject to regular reporting to the SEC.

Australia provided a good example of a conflict with a competitor. In 1998 the ASX made a take-over bid for the Sydney Futures Exchange (SFE). Later Computershare Limited, an ASX listed company, made a rival bid. Computershare's business included providing trading systems and share registry services, services that the ASX was also involved in. The Australian regulator, ASIC, made an agreement with ASX and Computershare that until the bids for SFE were resolved, ASX would not make any decisions about Computershare's listing without first consulting with ASIC and acting as required by ASIC.

Self-listing conflicts are fairly narrow in nature and easily defined. As such, the measures needed to manage them are not complicated and are fairly similar across jurisdictions.

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<sup>21</sup> SEC Proposed Rules – Fair Administration and Governance of Self-Regulatory Organizations; Proposed Regulation AL – National Securities Exchanges and Registered Securities Associations Listing Affiliated Securities, SEC Release 34-50699, Dec. 8, 2004. See <http://www.sec.gov/rules/proposed/34-50699.pdf>

## **5. Managing Conflicts of Interest in Self-Regulation**

### **5.1 Overall SRO Functions, including Listings Regulation**

Exchanges and their supervising regulators use a range of mechanisms and tools in managing conflicts of interest between their self-regulatory responsibilities and business interests. The mechanisms discussed here are relevant to the management of listings regulation conflicts, as well as overall regulatory conflicts. Section 5.3 describes how seven major exchanges manage listings regulation conflicts specifically.

The mechanisms that are used to manage conflicts at Exchange SROs generally involve one or more of the following:

- 1) Special corporate structure and governance arrangements, such as creating a subsidiary company to house SRO functions, or establishing an independent committee to oversee SRO functions.
- 2) Organization structures that separate regulation departments or units from business operations.
- 3) Internal policies and procedures designed to address conflicts of interest, such as imposing information firewalls and restricting access to premises and files.
- 4) Transfer or outsourcing of regulation functions to another SRO, a statutory regulator or a third party.
- 5) Regulatory oversight processes aimed at ensuring conflicts of interest are managed appropriately, such as special reporting to the regulator about conflicts that arise.

The International Council of Securities Associations (ICSA), a group of independent member SROs that includes IIROC, developed a set of “Best Practices for SROs” in managing conflicts of interest.<sup>22</sup> ICSA advocates that an SRO should establish appropriate structures, policies, and procedures to ensure that potential conflicts of interest between its regulatory and commercial activities are appropriately managed. ICSA specifically suggests the following:

- Use firewalls to separate regulatory operations from business or advocacy operations.
- Have a separate governing body to oversee regulatory operations.
- Separate organizational structures for regulatory and business operations.
- House regulatory operations in separate and secure premises.
- Contract out all or part of the SRO’s regulatory responsibilities.
- Establish policies and procedures on management of conflicts of interest.

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<sup>22</sup> ICSA (2006)

In 2007, France's Association française des marchés financiers (AMAFI) surveyed 41 organizations for IOSCO's SRO Consultative Committee.<sup>23</sup> The survey covered 25 exchanges and 16 member associations or CSDs. It showed that of 31 organizations that operated or regulated markets, 21 formally separated their commercial and regulatory activities, and 5 did not. (The others did not respond, perhaps because they had no commercial activities.) Of the 25 exchanges, 17 reported they have formal procedures for managing conflicts of interest, and the government regulator reviews the procedures of 15 of the 17.

### *1) Corporate Structure and Governance*

The organizational separation of the regulatory and the business operations of an exchange is now established as a best practice for exchanges that retain significant SRO functions. Some exchanges have established separate subsidiary companies with independent boards of directors and management to house SRO operations, including the NYSE, ASX and Brazil's BM&FBovespa. Several examples are described in section 5.3.

Another corporate governance solution to managing conflicts is to establish a special committee, usually of the Exchange's board of directors, to oversee SRO operations. The committees reinforce the independence of SRO functions by removing SRO oversight from the board as a whole to a committee comprised mainly or entirely of independent directors. For example, a number of Exchange SROs have created a board-level Regulatory Oversight Committee (a "ROC"). Their job is to supervise the SRO's regulation programs and to ensure the independence and effectiveness of the SRO department, particularly in light of the conflicts of interest discussed here. Several US exchanges that do not have independent subsidiaries to house SRO functions have established such committees, including BATS Exchange and Direct Edge's new exchanges. These exchanges have outsourced most of their regulation activities to FINRA, since they do not believe that the complexity and cost of setting up a separate subsidiary company to house SRO functions is justified.

Supervision of corporate governance of exchanges – both of the organization overall and SRO functions specifically – is one of the primary means that securities regulators worldwide use to ensure that Exchanges meet their public interest and regulatory responsibilities and manage conflicts appropriately.

### *2) Organizational Structure: Separation of business and regulation*

Many exchanges with SRO responsibilities have not gone as far as establishing a

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<sup>23</sup> AFEI/VD – 29/04/08 – SRO Consultative Committee Working Group on Self Regulation (unpublished). The Association française des marchés financiers (AMAFI) is the representative body for professionals working in the securities industry and financial markets in France.



separate subsidiary for SRO functions, but have addressed conflicts of interest by establishing an organization structure that formally separates management of regulation functions from business operations. This approach is well established as the minimum “best practice” standard for managing management of conflicts of interest. An extensive number of exchange SROs employ this approach, including several of the seven exchanges reviewed in this Report. Section 5.3 describes the organization structures of Nasdaq in the US, HKEx (for its listings department) and Nasdaq OMX Nordic in Europe.

### *3) Internal Policies and Procedures*

Exchanges generally have internal policies and procedures that apply to handling of issues and files where a conflict of interest may arise. Written policies and procedures usually supplement one of the other responses to conflicts listed here; rarely does an exchange rely only on internal policies and procedures to manage conflicts. Conflict of interest policies and procedures manuals typically cover the following matters:

- Definition of potential conflicts of interest
- General code of conduct and staff responsibilities concerning management of conflicts
- Responsibility for identifying and reporting conflicts that arise in handling files and addressing issues, and officers responsible for addressing conflicts
- Documenting handling of conflicts of interest, and procedures for any special processes that apply (for example, referrals to a conflicts committee or to a supervising regulator)
- Administration of information firewalls between business and regulation units
- Administration of physical separation of business and regulation units, and of policy on restricted access to regulation units (if applicable)
- Maintenance of confidentiality of information filed for regulatory purposes
- Sharing of information that is permitted to be shared with other departments

Other exchange SROs have created “conflicts committees” to address any conflicts between a listed exchange and listed companies that they regulate. Such committees are in place at HKEx, SGX and TMX. The committees generally review any dealings with companies that the exchange either competes with or has business dealings with to ensure that listings rules are administered in an unbiased manner, and they report their assessment to the regulator. In Hong Kong, issues are referred to the SFC if a conflict could even be perceived—for example, a listing application from a company that provides back office services to the HKEx.

*4) Transfer or Outsourcing of regulation responsibilities*

Canada is a very good example of this approach to reducing conflicts of interest in Exchange SRO functions. The TSX and the CDNX and Montreal exchanges (as they existed at the relevant time) transferred member regulation responsibilities to the Investment Dealers Association (now IIROC) over a period of several years starting with the TSX's transfer of its department in 1997. As described in this Report, the TSX and TSXV outsourced their market regulation functions to RS (now IIROC) in 2002. In addition, the TSX, TSXV and the CSA agreed that responsibility for setting guidelines on corporate governance for public companies would be transferred from the Exchanges to the CSA in 2005.

Other illustrations of the transfer or outsourcing of regulation functions by exchanges are set out below. There are many more examples.

As described in section 5.3, the UK government transferred the "Listing Authority" function from the LSE to the FSA in 2000 on LSE's demutualization because it did not believe that an exchange that competes with other exchanges for listings should perform that function.

In Europe, several European Commission financial services directives aimed at creating a "single market" for financial products in the EU led to the transfer from exchanges to statutory regulators ("competent authorities") of certain regulatory or supervisory functions that had been performed by exchanges in many EU countries. While not a response to the existence of conflicts, the reforms had the effect of strongly positioning European exchanges as commercial market operators that would compete for business in an integrated European market. Conflicts of interest have been minimized where regulators perform most regulatory functions.

In Hong Kong, the Securities and Futures Commission (SFC) assumed responsibility for supervision of broker-dealers (member regulation) and most market regulation functions from the exchanges in 2000 as part of an overall government policy to consolidate and demutualize Hong Kong's exchanges. (The SFC had been primarily responsible for market conduct and trading abuses since 1990.) The HKEx's remaining self-regulatory role is to supervise compliance with its trading rules, which are mostly business or operational rules. HKEx remains responsible for listings regulation, as described in detail in section 5.3.

Before Nasdaq was separated from the NASD in the 1990s, in the first step towards Nasdaq's demutualization, the two organizations concluded that conflicts of interest were much better managed if the exchange operator's business was separated from the SRO's operations. With encouragement from the SEC, they decided that Nasdaq would be more successful as a business and the NASD more successful as an SRO if their roles

were separated. Consequently Nasdaq retained the services of the NASD to perform most market regulation services by contract. Today the Nasdaq Stock Market continues to retain FINRA to carry out regulatory services on its behalf.

In Australia, the statutory regulator ASIC will assume most member and market regulation functions from the ASX Group this year.

#### *5) Strong Regulatory Oversight of Management of Conflicts of Interest*

Stronger supervision of SROs by government regulators has been an almost universal response to greater conflicts at Exchange SROs, with a particular focus on reviewing how exchanges manage conflicts of interest. This supervision includes both the policies and procedures adopted to address conflicts and the handling of specific cases of conflict. IOSCO has suggested that if an SRO has a conflict of interest, the regulator should assume responsibility for the investigation of a matter.

Effective regulatory oversight is viewed as a backstop by both exchanges and regulators. It is considered essential to ensuring conflicts of interest do not lead to lower standards, and that perceptions in the market about potential conflicts are addressed through ongoing oversight by supervising regulators. Some exchanges have acknowledged that under competitive pressure, standards could slip without strong oversight.

Oversight encompasses supervision processes such as approval of rules, periodic examinations of the performance of regulatory functions, assessments of corporate governance, monitoring financial viability, etc. Oversight processes that address conflicts of interest take several forms, including:

- Increased scrutiny of governance and management, in particular the governance of SRO operations, as well as decisions on business initiatives where conflicts might arise, to ensure continued compliance with the exchange's self-regulatory responsibilities and overall public interest obligations
- Review (and in some cases approval) of resources and budgets for SRO operations
- Strengthened examination of the adequacy of regulatory programs and processes, and staff and other resources made available to support them
- Review of the effectiveness of processes and procedures in place to manage conflicts of interest, such as organizational structures for SRO departments, information firewalls, conflicts committees and the like
- Specific review of the handling of files where conflicts may arise, such as listings applications and decisions on compliance with listings rules
- Closer examination of proposed rule changes to ensure investor protection needs are addressed, and that regulatory standards are not compromised by

commercial considerations.

More stringent oversight of an exchange's investigations and disciplinary processes should be imposed to ensure that the enforcement of the rules is not influenced by conflicts relating to relations with large listings or trading customers, or by other business considerations.

The transparency of an exchange's regulatory processes, for instance through a notice and comment process for rule changes and the publication of rule interpretations, exemptions and waivers, is also important in the effective management of conflicts. Communication and disclosure enables interested parties, including investors, regulated firms, listed companies and competitors of the exchange, to assess whether regulatory policy might be unreasonably influenced by the exchange's commercial interests over legitimate regulatory policy considerations. Transparency also strengthens the regulator's ability to identify and address potential conflicts and respond to them.

## **5.2 Managing Self-listing Conflicts of Interest**

Virtually all jurisdictions with listed exchanges have implemented special procedures to address these conflicts. The main procedures that have been used are:

- The supervising regulator either deals with the listing application, or reviews and approves the exchange's handling of the listing application.
- Administration of the continued listings rules in respect of the exchange's listing has either been transferred to the regulator, or is subject to close oversight by the regulator.
- Surveillance of trading in the exchange's stock is either the regulator's direct responsibility or is closely supervised by it.

## **5.3 Managing Listings Conflicts of Interest – Country Examples**

### *Summary*

For purposes of this Report we reviewed the approach to addressing conflicts of interest in listings regulation at seven other exchanges: NYSE and Nasdaq in the US, LSE in the UK, Nasdaq OMX Nordic in Europe, ASX in Australia, TSE in Japan and HKEx in Hong Kong. These exchanges were chosen because all have the following points in commonality with TSX:

- All are major exchanges in developed markets
- All have significant and successful listings businesses
- All face strong competition for listings services, regionally and / or nationally

- All are subject to strong oversight by statutory regulators
- All operate in jurisdictions where government and / or regulators have thoroughly addressed conflicts of interest issues at the exchanges, with specific reference to regulatory responsibilities
- All (or their parent holding companies) are self-listed on their own market.<sup>24</sup>

In summary, three main approaches are employed to address conflicts of interest in listings regulation in these seven markets:

- 1) **A regulation subsidiary company with independent governance** performs listings regulation:
  - NYSE (as well as NYSE Amex and NYSE Arca, all US markets owned by NYSE Euronext)
  - Tokyo Stock Exchange (a unit of TSE Group)
  - Australian Securities Exchange (a unit of ASX Group)
- 2) **A special independent committee and a listings department that is separate from the business operations of the Exchange** (including listings business development) performs listings regulation:
  - Nasdaq Stock Market (a unit of Nasdaq OMX Group)
  - Nasdaq OMX Nordic (a unit of Nasdaq OMX Group that operates 4 exchanges in Scandinavia)
  - Stock Exchange of Hong Kong (a unit of HKEx)
- 3) **The statutory regulator** mainly performs listings regulation.
  - UK – for LSE and other UK exchanges

Of the jurisdictions reviewed, only the TSX carries out listings regulation as part of a unified Listings Department that is responsible for both listings regulation and the listings business.

Special procedures to address the specific conflicts of interest that arise in regulating the exchange's own listing (self-listing) are in place at all of the exchanges reviewed, including the TSX.

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<sup>24</sup> The Nasdaq OMX Group, Inc. is listed on Nasdaq in the US and Nasdaq OMX Dubai. It is not listed on the Nasdaq OMX Nordic markets.

## **USA – NYSE**

NYSE Euronext manages conflicts of interest between its business and regulatory responsibilities mainly through strong structural separation of all regulation functions into an independent subsidiary company, NYSE Regulation, Inc. (NYSER). NYSER is a non-profit company with independent governance and management from NYSE Euronext and its operating exchanges.

Since NYSE Regulation was first established, NYSE Euronext has significantly streamlined its regulation activities – and in doing so further minimized conflicts of interest between business and regulation functions – by transferring major regulation responsibilities to FINRA. First, it agreed with the NASD to form FINRA by merging its member regulation program with the NASD's program. Secondly, very recently NYSE Euronext announced that all market surveillance functions for its US markets (including the NYSE<sup>25</sup>, NYSE Amex and NYSE Arca exchanges) will be performed by FINRA, thus enabling FINRA to carry out centralized supervision of most US equity trading through regulation services agreements with Nasdaq, NYSE Euronext and several other equities marketplaces.

NYSER is a not-for-profit corporation that is responsible for enforcing the Exchange rules and federal securities laws at the New York Stock Exchange. NYSER also oversees regulation at its other two US markets: NYSE Arca Regulation and NYSE Amex Regulation through regulation services agreements.<sup>26</sup>

NYSE Regulation's board of directors is comprised of a majority of directors unaffiliated with any other NYSE board: 3 NYSE Euronext directors, 6 independent of NYSE Euronext, and the NYSER CEO. As a result, NYSE Regulation is independent in its decision-making. The CEO of NYSER has primary responsibility for the regulatory oversight of the U.S. market subsidiaries within NYSE Euronext and reports solely to the NYSER board of directors. There is no reporting relationship to the NYSE Euronext CEO.

According to NYSE Euronext: “This organizational structure preserves and extends the separation yet pervasive communication between business and regulatory activities achieved under the NYSE's previous governance architecture that was comprehensively reformed in 2003. It also seeks to insulate NYSE Regulation from the additional crosscurrents created by public ownership.”

The Listed Company Compliance Division ensures that companies listed on NYSE, NYSE Amex and NYSE Arca meet their financial and corporate governance listing standards. The Division has two units: Financial Compliance and Corporate Compliance. Financial Compliance reviews a company's reported financial results both for new applicants and for existing listings to ensure that the company meets original listing and continued

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<sup>25</sup> New York Stock Exchange LLC

<sup>26</sup> All information from NYSE Regulation website:

<http://www.nyse.com/regulation/nyse/1145313073247.html>

listing requirements. Corporate Compliance ensures that listed companies adhere to the rules on corporate governance and disclosure.

### *Self-listing Conflicts*

On listing of NYSE Group's shares on the NYSE through its merger with Archipelago Holdings Inc. in 2006, the SEC's decision approving the transaction imposed a requirement to file a quarterly report with the SEC on monitoring of compliance with listings standards by NYSE Group, as well as monitoring of trading in its stock.<sup>27</sup> NYSE Regulation carries out such monitoring. NYSE Group also agreed to an annual audit of compliance with listing standards by an independent accounting firm.

### **USA – Nasdaq Stock Market**

Nasdaq manages listings regulation conflicts by using a listings regulation department that is separate from Nasdaq's business operations to perform regulatory functions, as well as through an independent committee called the "Listings Council". The "Listing Qualifications" department provides listing regulation services. It is organizationally separate from the business, although this fact is not generally promoted on the Nasdaq website. Listing Qualifications reviews all listing applicants and existing listed companies for compliance with both initial and continued listing requirements. Each listed company is assigned to a specific qualifications analyst who reviews its SEC and other regulatory filings.<sup>28</sup>

Listing Qualifications deals with queries on listing standards and the application process. Nasdaq has a Corporate Client group that promotes listings and provides additional services and products to listed issuers. In addition, a relationship manager from the business side is assigned to all Nasdaq listed companies.

The Listings Qualifications department has 4 units:

- Initial Listings & Structured Financial Products team
- Continued Listings team
- Corporate Governance & Listing of Additional Shares
- Listing Investigations.

Although most of Nasdaq's regulatory functions are carried out by FINRA under a regulatory services agreement, Nasdaq is an SRO by law, and one of the main

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<sup>27</sup> <http://www.sec.gov/rules/sro/nyse/34-53382.pdf>

<sup>28</sup> All information from Nasdaq OMX website. The Nasdaq Listing Information page is at <http://www.Nasdaq.com/services/insideNasdaq.stm#resources>

responsibilities of its board of directors is to oversee the Exchange's regulatory program. This obligation is primarily discharged through the Board's Regulatory Oversight Committee (the "ROC"). The ROC's mandate is to "oversee the adequacy and effectiveness of Nasdaq's regulatory and self-regulatory organization responsibilities; assess Nasdaq's regulatory performance; and assist the Board and other committees of the Board in reviewing the regulatory plan and the overall effectiveness of Nasdaq's regulatory functions". The ROC's responsibilities include oversight of the Listing Qualifications Department, which is one of three main regulation departments at Nasdaq.<sup>29</sup>

Nasdaq's independent listing committee is the Listing Council, which provides advice to its Board on listings matters and hears appeals on the application of listings rules and policies. The Nasdaq Listing and Hearing Review Council (Listing Council) is a standing independent advisory committee appointed by the Nasdaq Board of Directors to provide advice to the Board on issues relating to listed companies, and to review certain decisions made under the Listing Rules by hearing panels. All Council members are independent of the Exchange, and include institutional investor advocates, company representatives, lawyers, accountants, securities industry professionals and academics.<sup>30</sup>

The Listing Council hears appeals from decisions to deny listing or to delist securities made by Nasdaq's independent hearing panels. (A company that is denied initial listing, that is being delisted for failure to satisfy the continued listing requirements, or that has been issued a public reprimand letter may request review of the decision by an independent body through the hearing process.) In addition, the Council also reviews all Hearing Panel decisions, regardless of whether they are appealed, and may decide on its own to reverse or modify a Panel decision. Decisions of the Listing Council may be appealed to the SEC.

### *Self-listing Conflicts*

In a rule filing with the SEC in 2005 on its self-listing, Nasdaq agreed to conditions similar to those described for NYSE Group above.<sup>31</sup>

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<sup>29</sup> Duties and Obligations of NASDAQ Directors: Prepared for the Board of Directors of The NASDAQ Stock Market LLC, at <http://files.shareholder.com/downloads/NDAQ/926657225x0x242365/c00d892b-e8af-4d4b-bfdc-c0ca5fa14f3e/LLCDutiesandObligations.pdf>

<sup>30</sup> Nasdaq OMX website. Information on Listings Council at <http://www.Nasdaq.com/about/FAQsAppeals.stm>

<sup>31</sup> <http://www.sec.gov/rules/sro/nasd/34-51123.pdf>



## Australia – ASX

After taking a number of smaller steps to address conflicts of interest since ASX demutualized in 1996, the ASX Group finally established an independent subsidiary, ASX Markets Supervision Pty Limited (ASXMS), to carry out self-regulatory responsibilities in 2006. ASX states that, “The subsidiary was created to provide greater transparency and accountability of ASX’s supervisory operations, strengthen market integrity and address the perception of conflict between ASX’s regulatory and commercial functions”.<sup>32</sup>

The Issuers Unit of ASXMS is responsible for the supervision of all listed entities and monitors compliance with the listing rules. Other units oversee compliance with ASX market rules, clearing and settlement rules, as well as SFE rules.

This chart illustrates the structure adopted by ASX:



Source: ASX website

ASXMS has an independent board of directors – only one of its five directors is also a director of other companies in the ASX Group. The Chief Supervision Officer (CSO) who is in charge of all ASX supervisory activities reports to the ASXMS Board and not to the CEO of ASX Limited. The ASXMS Board receives regular reports from the CSO on the

<sup>32</sup> ASX website: [http://www.asx.com.au/supervision/approach/supervision\\_subsidary.htm](http://www.asx.com.au/supervision/approach/supervision_subsidary.htm)

conduct of supervisory activities and also approves all the ASX Group arrangements for handling conflicts, including the internal information barrier arrangements and codes of conduct for supervisory staff.<sup>33</sup>

This year ASIC will assume direct responsibility for many of ASX's current market regulation responsibilities, including market surveillance. This restructuring of the regulatory system will further reduce conflicts of interest at ASX, but it will not affect the ASX's listings responsibilities. The Exchange will continue to supervise listed issuers under its listings rules.

In Australia the Corporations Act requires the ASX Group to have adequate arrangements to handle conflicts between its commercial interests and its obligations to ensure a fair, orderly and transparent market, and to ensure that clearing and settlement services are provided in a fair and effective manner. To meet this requirement, ASX Group has developed the ASX Commercial and Supervisory Conflict of Interest Policy.

The Policy is a code of conduct that applies to all ASX Group staff, and requires staff to be cognizant of potential conflicts of interest and to "do the right thing". The Policy specifically acknowledges the potential listings conflicts set out in this Report, and requires regulatory decisions to be made only by ASXMS staff. It prohibits staff members from being influenced by other staff members who may have business objectives. Supervisory decisions must be made solely for the purposes envisaged by the rules and must not take into account commercial considerations or what will benefit ASX as a commercial entity. Internal compliance reviews are carried out to ensure that supervisory decisions are made in accordance with the required standards.

ASX states that it "has also recognized that conflicts between its commercial interests and its statutory obligations could occur not only when supervisory decisions are made, but also when the policy to be applied in making those decisions is devised or changed". To address this concern, any change in policy must be agreed to by the CSO, who is accountable to the ASXMS Board for this function.

ASIC monitors compliance by the ASX Group with its statutory obligations and performs examinations of ASX to ensure it meets its obligations, including the adequacy of its arrangements for handling conflicts of interest and supervising the market.

#### *Self-listing conflict*

ASIC is responsible for supervising ASX Group's compliance with the listings rules. ASIC may also intervene, at the request of a commercial competitor of ASX, to take a

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<sup>33</sup> ASX website

supervisory role where there is a specific and significant conflict, or potential conflict, between the commercial interests of ASX and its regulation obligations in dealing with a listed entity that is a competitor.

## **Europe**

In the EU, the Markets in Financial Instruments Directive requires all regulated markets to have governance arrangements to identify and manage the potential adverse consequences of any conflict of interest between the regulated market, its owners or its operators and the sound functioning of the market.

### **UK – London Stock Exchange**

In the UK the listings regulation conflict was addressed by transferring the function of “competent authority for listing” from the London Stock Exchange to the FSA following the LSE’s announcement of its demutualization in 1999. Since the LSE would be competing for listings with other exchanges as a commercial entity, it was agreed this regulatory role should be transferred to the FSA. The transfer took place in 2000.

The FSA is the UK’s competent authority to regulate the admission of securities to the “Official List” pursuant to European Community directives. The UK Listing Authority (UKLA), a division of the FSA, carries out this function. The FSA makes rules governing prospectuses, admission to listing, the continuing obligations of issuers, the enforcement of those obligations and suspension and cancellation of listing. These rules are the Listing Rules, the Prospectus Rules and the Disclosure and Transparency Rules.

The LSE is still responsible for the “admission to trading” of issues on the Exchange. (Any other UK exchanges trading listed companies have the same responsibility.) The LSE requires listed companies to meet the requirements of its Admission and Disclosure standards. However, these requirements are minimal – to be “listed on the LSE” the main approval required is UKLA’s approval.

To add to the complexity of the system, the LSE continues to be responsible for setting listings standards and approving listings on AIM, its market for junior issuers, because these securities are not part of the “Official List”.

### **Scandinavia – Nasdaq OMX Nordic**

Nasdaq OMX Nordic consists of four local stock exchanges in Copenhagen, Stockholm, Helsinki and Iceland. The four exchanges are separate legal entities in different jurisdictions, and therefore each exchange has its own regulation. The exchanges are responsible for initial and continuous listings regulation, and have their own “rule books

for issuers". In Sweden the Nasdaq OMX Stockholm listings rules encompass requirements set out in legislation and by the Swedish regulator.

Nasdaq OMX Nordic has a separate Market Surveillance unit that is responsible for both trading and issuer surveillance at the four exchanges. Issuer surveillance applies and enforces initial and continued listing qualifications of listed companies, and is also responsible for the formal listings process and monitoring companies' compliance with rules on information disclosure, corporate governance and takeovers.<sup>34</sup> The unit also develops listings rules.

In Stockholm and Helsinki, a Listing Committee makes decisions on new listings. The Board of each Exchange appoints the Committee, a majority of which is independent of the Exchange.

The Surveillance Committee of Nasdaq OMX Nordic was established to monitor the performance of the Surveillance unit and to advise the Board of Nasdaq OMX Nordic on surveillance related matters. The Committee operates independently from the exchanges' business. The Committee's role is to enhance the integrity of and confidence in the Nordic markets. One function of the Committees is to protect surveillance functions from conflicts of interest. The Surveillance Committee is appointed by the Nasdaq OMX Nordic board and has five members – three independent members and two representatives of the exchanges. The Chairman is an independent member.<sup>35</sup>

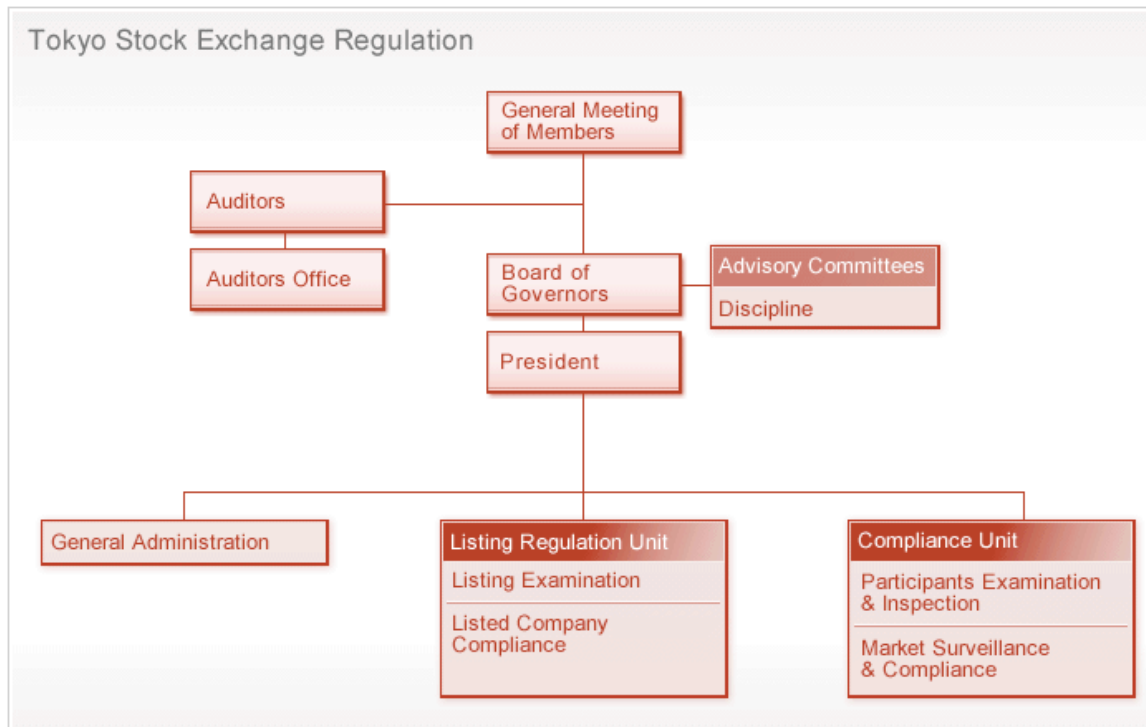
### **Japan – Tokyo Stock Exchange**

The Tokyo Stock Exchange (TSE) has a separate regulation subsidiary, Tokyo Stock Exchange Regulation. It is similar to NYSE Regulation in structure. The company has its own board of governors. The Listing Regulation Unit carries out listings regulation functions. The structure of TSE Regulation is set out below.

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<sup>34</sup> Nasdaq OMX Nordic website. On listing on Nasdaq OMX Stockholm, see <http://www.Nasdaqomx.com/listingcenter/nordicmarket/equities/stockholm/?languageId=1>

<sup>35</sup> Nasdaq OMX Nordic website. Re Surveillance, see <http://www.Nasdaqomx.com/listingcenter/nordicmarket/surveillance/aboutsurveillance/>



Source: TSE website<sup>36</sup>

The Listing Regulation Unit has two divisions. The Listing Examination Division conducts examinations of companies applying to list on the TSE to determine if they qualify for listing. The Listed Company Compliance Division examines compliance with continued listing rules, including eligibility for continued listing.

The Listing Department of Tokyo Stock Exchange, Inc. is a business unit that provides consultation and support for disclosure of corporate information. If the Listed Company Compliance Division determines that penalties or other measures against a listed company should be imposed, the TSE Listing Department will delist or otherwise penalize the company.

The Listed Company Compliance Department performs the following functions:

- 1) Decide if a company or instrument qualifies for continued listing, and if not, delist the company or instrument
- 2) Transfer of issues from the 1st Section to the 2nd Section of listings
- 3) Assess the adequacy and timing of corporate disclosure and if necessary impose penalties or take other compliance measures

<sup>36</sup> <http://www.tse.or.jp/english/about/index-r.html>

- 4) Issue alerts, advisories and warnings on issues of securities under TSE rules.

### **Hong Kong – Hong Kong Exchanges and Clearing**

In Hong Kong, the Stock Exchange of Hong Kong (SEHK), which is part of Hong Kong Exchanges and Clearing Inc. (HKEx), is the frontline regulator of all listing-related matters and of issuers listed on its markets. The SEHK is also responsible for authorizing prospectuses of companies listed on the Exchange. The SEHK Listings Rules are the main form of regulation of listed issuers in Hong Kong, so the Stock Exchange plays a very important role in regulating public companies. Its role has been maintained in spite of proposals to make regulation statute-based and to move most listings regulation functions to the Securities and Futures Commission (SFC).

Given the SEHK's strong role in regulating listings and issuers, conflicts of interest with HKEx's business interests have been a significant policy issue. The conflicts have been addressed in three main ways:

- 1) Most listings regulation powers are vested in a Listing Committee that is independent of the Exchange.
- 2) The Listings Division of the SEHK is structurally separate from HKEx's business operations.
- 3) The SFC exercises very strong oversight over listings regulation functions, and has special powers in the listings arena.

In addition, if the SFC is satisfied that a conflict of interest exists between the SEHK and "the proper performance" of a regulatory function, the law empowers the SFC to direct the Exchange to take steps to address the conflict. Therefore a person who believes he or she has been prejudiced by a conflict of interest at SEHK can pursue the issue with the SFC.

The roles of the SEHK and SFC in listings regulation are set out in a detailed MOU. Key points of the MOU<sup>37</sup> include the following:

- The board of the SEHK will not make any decisions on matters covered by the listings rules, except in exceptional circumstances and with prior notice to the SFC.
- If the SEHK materially fails to comply with the MOU, the SFC can take any action it considers necessary.
- SEHK must obtain SFC approval of any policy decisions or directives of general application, in addition to approval of rules.

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<sup>37</sup> See [http://www.hkex.com.hk/eng/rulesreg/regdoc/documents/mou\\_28jan03.pdf](http://www.hkex.com.hk/eng/rulesreg/regdoc/documents/mou_28jan03.pdf)

- The SFC receives copies of listing applications, and may provide comments on them to SEHK or object to approval of the application.
- Comprehensive reporting arrangements to the SFC are set out, to facilitate its oversight of SEHK's listings regulation.
- SEHK and SFC will hold monthly "listings liaison meetings".

In theory, the SEHK Board has the power to make and amend the Listing Rules subject to the approval of the SFC. However, as required by the MOU, the Listing Rules provide that all powers and functions of the Board on listings matters are delegated to the Listing Committee or the Listings Division of the Exchange. The Listing Committee has delegated most day-to-day decisions to the Listings Division. The Committee makes important decisions, including approval of new listings, findings of breaches of the rules, imposition of disciplinary penalties or conditions, and reviews of Listings Division decisions.<sup>38</sup>

The Listing Committee acts both as an independent administrative decision maker and an advisory body for the Exchange. The Listing Committee has four principal functions:<sup>39</sup>

- 1) To oversee the Listings Division
- 2) To provide policy advice to the Listings Division and to approve amendments to the Listing Rules
- 3) To take decisions of material significance for listing applicants and listed companies
- 4) To act as a review body for decisions made by the Listings Division and by the Listing Committee.

The Listing Committee has a minimum of 28 members (they share the workload), including 19 representatives of listed issuers and market practitioners who advise issuers, and 8 persons who represent investors. It is appointed by the SEHK Board based on nominations from the Listing Nominating Committee, which is made up of three non-executive directors from the HKEx board and the Chairman and two executive directors of the SFC.

The Listing Committee has specific procedures for handling conflicts of interest that preclude a member with a material conflict of interest from participating in the deliberation of an issue.

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<sup>38</sup> Role and Mode of Operation of the Committee:

[http://www.hkex.com.hk/eng/listing/listcomrpt/documents/LCRole\\_Mode.pdf](http://www.hkex.com.hk/eng/listing/listcomrpt/documents/LCRole_Mode.pdf)

<sup>39</sup> HKEx Listing Committee Report 2009

A Listing Appeals Committee is responsible for reviewing decisions made by the Listing Committee. It consists of three members of the HKEx Board including the Chairman of HKEx who chairs the committee.<sup>40</sup> Appropriate modifications to membership are made where conflicts of interest arise.

### *Self-listing Conflicts*

In order to manage the conflicts of interest in HKEx acting as market regulator and at the same time being a listed company, before HKEx could list legislation required the SFC to confirm in writing that:

- 1) satisfactory arrangements had been made to amend the Listings Rules to deal with the potential conflicts of interest arising should HKEx become a listed company, and
- 2) HKEx had made arrangements with the SFC to ensure market integrity and HKEx compliance with its obligations as a listed company.

If a conflict of interest arises between HKEx's status as a listed company and the SEHK's role as the front-line listings regulator, the SFC assumes the Exchange's functions relating to HKEx's listing, unless the SFC determines that no conflict exists.

Conflicts with other listed companies have also been addressed. Potential conflicts of interest are referred to a Conflicts Committee that is comprised of three HKEx senior executives. If the Committee determines that a conflict exists, it must refer the matter to the SFC, which may then assume and exercise SEHK's powers and functions. If an applicant for listing or a listed company identifies a potential conflict of interest between HKEx and SEHK's role as a regulator, the company may raise the issue with the SFC, and again the SFC may assume the Exchange's functions on the listings file. The SFC has established processes for the exercise of SEHK's listings powers and functions, when required.

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<sup>40</sup> Ibid.



## **6. TSX Management of Conflicts of Interest**

### **6.1 TSX Demutualization and Management of Regulatory Conflicts of Interest**

Historically the TSX has a strong record of taking a proactive approach to ensuring effective management of the conflicts of interest between its self-regulatory and business functions. This was the case even though the TSX demutualized well before most other exchanges – it was the first exchange in North America to demutualize. At that time many global exchanges took the position that conflicts of interest were not a major issue because conflicts had always existed in self-regulation and an exchange has strong incentives to maintain market integrity and to protect its reputation. The creation of independent subsidiary companies such as NYSE Regulation was still years away.

Even before it demutualized, the TSX transferred its member regulation functions – supervision of investment dealers’ business conduct, financial compliance and sales compliance – to the IDA in 1997. The consolidation of the two major SROs’ member regulation departments streamlined the Canadian SRO system and at the same time addressed the increasing conflicts of interest with the Exchange’s business strategy as it positioned itself for demutualization. This step significantly reduced the TSX’s regulatory footprint, and therefore reduced the scope of the potential conflicts.

Also prior to its demutualization, the TSX reformed its corporate governance and adopted the standard of requiring 50% of its directors to be independent of both the Exchange and its member firms, well before this level of independence became the standard for North American exchanges and SROs.

When it demutualized, in order to address conflicts of interest issues between its remaining SRO functions and its business operations, the TSX planned to establish an independent, not-for-profit entity, TSE Regulation Services, to carry out its market regulation functions. A new board-level committee, the Regulation Committee, was established to oversee regulatory operations. The Committee was comprised of a majority of independent directors. This committee’s structure and responsibilities were very similar to those of the Regulatory Oversight Committees (ROCs) that later became a popular response to conflicts of interests issues at other Exchanges and SROs, especially in North America. The new structure for the TSX’s SRO functions was approved by the OSC and recognized in the new recognition order made by the OSC following its review of the Exchange’s proposed demutualization.

However, some investment dealers advocated a further separation of TSX’s market regulation functions because of concerns that TSX could use its regulatory powers to hinder the development of competitors for trading services – ATs for example. As a result, the TSX agreed to create a new, independent SRO in cooperation with the IDA,

Market Regulation Services (RS). Although the two established SROs sponsored the new SRO and nominally “owned” RS, half of the board of directors of RS was comprised of directors who were independent of the TSX, the IDA and member firms.

RS commenced operations in 2002 with a mandate to carry out market regulation for the TSX and other equity marketplaces – including the new ATs that were being launched at the time – on a contract basis. A common set of market conduct rules, the universal market integrity rules (UMIR), was developed to apply to all exchanges, and RS performed market surveillance for all equity markets. The OSC amended TSX’s recognition order to approve TSX retaining RS to carry out market regulation services for the Exchange.

When market regulation was contracted to RS, the TSX retained its listings operations, which were and remain an important business for the Exchange. This included all listings regulation functions. (Note that issuers’ compliance with TSX’s timely disclosure policy was contracted to RS as part of its market surveillance functions – although TSX retained ultimate authority over compliance.) At the time both listings business development functions (including customer services) and listings compliance functions were part of a unified Listings Department, albeit carried out by separate units.

With the merger of the IDA and RS in 2007 to create IIROC, the TSX became a “marketplace member” of IIROC and retained IIROC to perform market regulation services. Because of this relationship, the TMX Group continues to have a director’s seat on IIROC’s board of directors, which is filled by TMX’s CEO.

It is important to understand the history above because the fact that the TSX relinquished responsibility for directly carrying out member and market regulation functions meant that the majority of its business–regulation conflicts had effectively been addressed. Basically listings regulation was the sole remaining self-regulatory function carried out directly by the TSX after it transferred performance of member regulation to the IDA and market regulation to RS. This may have reduced the onus on the Exchange and the OSC to introduce formal structures and procedures to address conflicts of interest in TSX’s remaining self-regulatory role, listings regulation (other than for purposes of its self-listing). The fact that no one voiced concerns over listings regulation conflicts at the time was no doubt a factor.

## **6.2 Current TSX Management of Overall Conflicts of Interest**

Except on the issue of self-listing conflicts (as described below) the TSX does not have any policies or procedures that apply to conflicts of interest between its self-regulatory responsibilities and its business activities. However, the TMX Group has implemented strong conflict of interest policies in other operating units, which indicates that it is sensitive to the need to manage conflicts of interest in certain areas.

*Montreal Exchange Regulatory Division and CDCC*

The TMX Group's Montreal Exchange (MX) does have strong mechanisms in place to address conflicts of interest relating to its Regulation Division. Although the TSX's former self-regulatory responsibilities for member and market regulation are now covered by IIROC, the Montreal Exchange continues to perform market regulation functions for its derivatives market. The Exchange and the Division are both recognized as a self-regulatory organization by Quebec's Autorité des marchés financiers (AMF).

According to the MX: "The Regulatory Division governance and structure are designed to ensure its independence, given the status of the Exchange as a for-profit corporation. ... due regard is given to the preservation of the independence of the self-regulatory function of the Division and to its obligations to investors and the general public."<sup>41</sup>

The MX's mechanisms to address conflicts of interest comply with the terms of its recognition order from the AMF, and include corporate governance, organizational structure and internal policies and procedures, specifically:

- The Division operates as a separate and independent business unit of the Exchange. Its financial budgets, as well as its financial results, are separated from those of the Exchange. Its operations are self-funded and are carried out on a not-for-profit basis.
- The Special Committee – Regulatory Division, which is appointed by the Board of Directors of the Exchange, oversees the Division.
- The Special Committee – Regulatory Division must be composed of a majority of independent members.

In addition the TMX Employee Code of Conduct contains specific "partition measures" between the Regulatory Division and business operations.<sup>42</sup> The code states that:

To ensure the independence of the Regulatory Division and that of its employees, MX has established strict partition measures to ensure that there is no conflict of interest with the other activities of MX, and that confidential information currently or potentially held by the Regulatory Division concerning its functions, activities or files remain confidential and is not communicated, disclosed or exchanged inappropriately to the for-profit services of MX or third parties.

The code requires physical separation of offices of the Regulatory Division, restricted access to its paper and computer files, maintenance of confidentiality, and restricts

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<sup>41</sup> Montreal Exchange website: [http://reg.m-x.ca/en/about/governance\\_structure](http://reg.m-x.ca/en/about/governance_structure)

<sup>42</sup> TMX Employee Code of Conduct, October 2009:  
<http://www.tmx.com/en/pdf/TSXGroupEmployeeCodeOfConduct.pdf>

involvement in regulatory matters. It is strictly forbidden for the Regulatory Division to disclose, communicate or exchange with other departments or services of TMX any information or data on transactions conducted by a participating organization of TMX.

The code also requires a staff member who becomes aware of a situation of real, potential or apparent conflict of interest involving TMX and the Division to immediately report it in writing, for referral to the Vice-President, Legal Affairs.

Similar provisions apply to partition measures between the MX and its clearing agency, the Canadian Derivatives Clearing Corporation (CDCC).

### *Market Information Processor*

In the TSX's 2009 application to be appointed by the CSA as the official market information processor for exchange-traded securities, the TSX revised its original proposal to include a Governance Committee with representation from various marketplaces to oversee the operations of the information processor. It also took other steps to reinforce the neutrality of the information processor and its independence from the business of TMX Group. These changes were made to "address CSA staff concerns regarding the proposed governance structure and the potential conflicts of interest, real or perceived, associated with TSX, a competing marketplace, acting as an information processor". In approving the TSX as an information processor, the CSA concluded the TSX met all of its criteria, adding:<sup>43</sup>

We note that the governance structure proposed by the TSX promotes the independence of the governance of the information processor from that of TSX's business operations, and also ensures representation from each of the marketplaces contributing the data. The technology solution provides no unfair advantage to TSX, and an undertaking to this effect has been provided by TSX.

### **6.3 TSX Management of Listings Regulation Conflicts**

This section addresses management of the overall conflicts of interest between listings regulation and the TSX's business. Section 6.4 addresses self-listing conflicts relating to the listing of TMX Group shares on the TSX.

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<sup>43</sup> CSA Staff Notice 21-309, Information Processor for Exchange-Traded Securities Other Than Options, June 5, 2009: <http://www.bcsc.bc.ca/policy.aspx?id=7846&cat=2%20-%20Certain%20Capital%20Market%20Participants>

*Listings Department Organization and Internal Policies*

While the TSX's recognition order contains specific conditions to address the self-listing conflicts of interest, it does not contain any terms that require the TSX to separate its listings regulation operations from business operations, or to implement any policies or procedures to address the conflicts of interest between its listings business and listings regulation mandates. Only two sections of the recognition order address listings regulation in general; both pertain to the listings rules:

- Paragraph 18 Sanction Rules – TSX shall ensure, through RS Inc. and otherwise, that its Participating Organizations and its listed issuers are appropriately sanctioned for violations of the Rules. In addition, TSX will provide notice to the Commission of any violations of securities legislation of which it becomes aware in the ordinary course operation of its business.
- Paragraph 21 Listed Company Rules – TSX shall ensure, through RS Inc. and otherwise, that it has appropriate review procedures in place to monitor and enforce issuer compliance with the Rules.<sup>44</sup>

As noted above, when market regulation was contracted out to RS shortly after the TSX demutualized, the TSX retained its listings operations, including all listings regulation functions, excepting day-to-day administration of TSX's timely disclosure policy, which was contracted to RS as part of its market surveillance functions. The listings regulation functions are the primary self-regulatory responsibilities that the TSX still performs directly.

At the time that the TSX demutualized, both listings business development functions and listing regulation functions were part of a unified Listings Department, but separate groups performed the functions. This structure remains in place today. TMX Group's "Issuer Services" business line encompasses both TSX and TSXV listings operations. The TSX Issuer Services Department is responsible for all TSX listings functions, which are performed by three units:

- Listings Services – administers the initial listing requirements and the continued listing rules on additional issues of securities, corporate transactions, etc.
- Compliance and Disclosure – administers the continuing requirements to remain listed (including delisting procedures), review of the suitability of proposed directors and officers, and deals with compliance with the timely disclosure policy.
- Business Development – promotes listing on both the TSX and TSXV and advises issuers on the listing process.

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<sup>44</sup> OSC - Amendment to Recognition Order, September 3, 2002, (2002) 25 OSCB 6141

All three units report to the Senior Vice-President, Toronto Stock Exchange.

The TSX advised that it does not have any formal organization structure or documented policies and procedures in place to address conflicts of interest between its business operations and its listings regulation responsibilities. The Compliance and Disclosure unit is physically separate from the rest of the Department and it is assumed that access to its files is restricted – but these policies are not documented, nor are there any documented policies on maintaining confidentiality of information or on what information may be shared with other parts of the Department or TMX Group.

Decisions on approving new listings and on the application of continued listing rules (other than the rules administered by the Compliance and Disclosure unit) are made by its staff listing committee. Only directors and managers of Listings Services are on the committee and involved in decisions on applications. TSX's SVP and Compliance and Disclosure unit staff are invited to attend committee meetings but are not voting members. Business development staff does not attend.

The TSX also has a Listings Advisory Committee that provides input on regulatory policy issues and proposed changes to the listings rules. The Committee's 16 members represent stakeholders including securities lawyers, investment bankers and institutional investors. The Exchange does not disclose the identity of members. The Committee does not review individual files or specific applications; it deals with issues on a general level. The appointment process is informal. The TSX appoints members based on internal suggestions.

The TMX Group website pages on Listing services do not describe the organizational structure of the TSX Issuer Services Department, or state that any particular group within the department is responsible for regulatory matters such as approving listing applications and administering compliance with continued listing rules. It is also not clear from the site who is on the staff listing committee and how the integrity of its decision-making process is protected. The role of the Listings Advisory Committee is not described on the website, nor is the make-up of the Committee disclosed.

The website does not provide any information about policies and procedures to address conflicts of interest, except for those applicable to self-listing conflicts as noted in section 6.4 below.

The website pages for listings provides a list of contacts, first and foremost "business

development” contacts who advise issuers interested in applying for listing.<sup>45</sup> Persons responsible for administering the continued listing rules are listed under “Listed Issuer Services”. There is also a “Relationship Management” team “available to discuss any concerns and/or answer any questions with respect to your listing...”. A few contacts are listed under “Compliance and Disclosure”: two at IIROC covering market surveillance and news releases, one at TSX for mining disclosure standards, and a general line and email address at TSX for disclosure issues. This contact information does not make it clear that there is a unit of the Issuer Services Department that is responsible for some compliance functions.

The TSX listings web site content contrasts with those of most of the other exchanges covered in this Report, which are generally careful to make clear the organizational structure of listings services functions, and which group is responsible for vetting new listing applications and for compliance and regulatory matters under the listing rules. Some websites, notably those of ASX and HKEx, provide extensive disclosure on how conflicts of interest are managed and the policies and procedures that are in place to ensure that the integrity of regulatory decisions is maintained.

In general the TSX listings web pages are very thorough, providing access to a wide range of rules, regulatory guidance, information about products and services, and contacts. From a service standpoint, the website content is better than the other exchanges’ content, in the author’s assessment. It raises a question about why the conflicts issue has not received similar treatment.

#### *TSX View on Conflicts of Interest*

The TSX advised that it does not believe there are any conflicts of interest between its listings regulation functions and its listings business, or the TMX Group’s overall businesses, given how its processes work and its approach to listings regulation. The interests of the TSX and maintaining a successful and credible listings business are best served by maintaining the integrity of the listings rules and standards. Therefore the TSX believes that the goals of maintaining the profitability of the business and regulatory standards are congruent.

The TSX noted that the listings committee, which is comprised only of staff involved in administering the listings rules, makes decisions on initial listing. In its view, staff members are very focussed on quality and ensuring that applicants meet the requirements. The TSX also pointed out that there is a great deal of transparency around the listings process, which is followed closely by investment bankers involved in new issues and lawyers who advise issuers. Extensive disclosure is required for IPOs and

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<sup>45</sup> See Listings “Contact Us” page:  
<http://www.tmx.com/en/listings/contact.html?relationblock=1#relation>

other forms of listings, so it is clear if an applicant does not meet a requirement. The media also scrutinizes any significant issues around IPOs, new listings and additional issues made by existing listed companies.

The Exchange believes that it takes regulatory policy stances in favour of sound regulation and maintenance of high standards. It points to these examples:

- In 2009, the TSX implemented a new rule requiring shareholder approval of the acquisition of a public company if the transaction would result in dilution of current shareholders' equity by more than 25%. A number of listed issuers and securities lawyers strongly opposed this change.
- TSX is currently proposing to require unitholder approval for investment fund acquisitions as well.
- TSX issued a staff notice in 2009 that provided guidance on use of the "financial hardship exemption" from shareholder approval of additional issues. TSX has rejected several applications to use the exemption.
- A staff notice issued in 2006 provided guidance on the pricing of rights offerings, stating that offerings should be priced at a level that encourages participation by small shareholders, to ensure that large holders do not obtain a large block without paying a premium.
- Another notice in 2005 imposed disclosure and disinterested shareholder approval requirements on exploration company spinouts in the oil and gas sector, where management teams were purchasing securities in private placements at low values.

#### *Other Views on Conflicts of Interest*

While the TSX maintains that it does not face conflicts of interests relating to listings regulation given its business objectives and approach, several issues have led to complaints about the potential for conflicts of interest to affect decisions on regulatory policy in the listings area, as well as on decisions taken in administering TSX's listing requirements and continued listing rules.

Recently the Ontario Legislative Assembly's Standing Committee on Government Agencies issued a report on the OSC. The report addressed the TSX's listings regulation functions, based in part on representations from FAIR Canada. The Committee's report stated that, "Our concern is with the perception that the TSX falls below international standards with respect to the separation of its regulatory and commercial activities". It concluded:

The Committee recommends that the Commission review the potential for the conflict of interest between the regulatory and commercial functions of the



Toronto Stock Exchange and that it take the steps necessary to address any problems identified.<sup>46</sup>

Our Report finds that the “perception that the TSX falls below international standards” in this area is accurate.

FAIR Canada is on record as advocating implementation of specific mechanisms to address conflicts in the listings area.<sup>47</sup>

It is our position that the TSX/TSX-V listed company regulatory function should either operate as a separate entity within the TSX with its own board of directors or at the very least the regulatory function should operate independently of the business side of the TSX with appropriate Chinese Wall and other checks and balances.

FAIR Canada cited two TSX listing rule changes in its comment on conflicts in listings regulation.<sup>48</sup>

Firstly, it noted the TSX’s speedy passage of a new rule to permit the listing of special purpose acquisition corporations (SPACs), which it characterized as “blank cheques” offerings. (SPACs have no existing business so it is difficult to assess what one is investing in.) The proposed rule was adopted and approved by the OSC following a short 30-day comment period in spite of comments (including FAIR Canada’s) questioning the appropriateness of SPACs as investment vehicles. The total timeframe from the initial rule proposal to implementation was four months. In FAIR Canada’s view the fast process for implementation of this rule reflected TSX’s business interest in introducing a new listing product as soon as possible.

FAIR Canada contrasted the fast process for adopting the rule on SPACs with the lengthy process for adopting a rule that strengthened protection of shareholders against dilution of their equity when a listed company issues additional shares to pay for an acquisition. The rule was initially proposed in 2007 but following the expiry of a 60-day comment period the TSX had still not acted on the proposal over one year later. The TSX issued a specific rule proposal on the issue in 2009 and the rule was adopted in September 2009. It was implemented in November 2009, just over two years after the original request for comments was issued. FAIR Canada stated that the slowness of TSX’s response to the dilution issue indicated that investor protection issues are a lower priority for the Exchange.

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<sup>46</sup> SCOGA (2010), recommendation 12, page 44

<sup>47</sup> FAIR Canada website, “Is the TSX leading Canada in a ‘Race to the Bottom’”, April 13, 2009: <http://faircanada.ca/top-news/is-the-tsx-leading-canada-in-a-race-to-the-bottom/>

<sup>48</sup> Ibid.

#### **6.4 TSX Management of Self-listing Conflicts**

The OSC issued an amended recognition order in 2002 to permit the listing of TSX Group<sup>49</sup> shares on the TSX.<sup>50</sup> In the order the OSC imposed detailed requirements that the TSX must comply with in managing conflicts that arise from self-listing – namely, conflicts in the approval of the initial listing of TSX Group under the TSX listing requirements; conflicts in the TSX monitoring compliance by its parent company with TSX listing rules and potential conflicts in the TSX regulating compliance with its listings rules by companies that compete with the TSX as a business.

Several safeguards to address conflicts of interest were instituted under the terms of the order:

- Initial listing of TSX Group – The TSX was required to file a report with the OSC on its review of its own listing application with a recommendation for decision by the OSC’s Director of Corporate Finance.
- TSX Group’s compliance with continued listings rules – The TSX was required to establish a Conflicts Committee to consider any matters on TSX Group’s ongoing compliance with the listings rules. In addition the TSX must file with the OSC all materials that a listed issuer is required to file with TSX, and advise of any deficiencies in those filings.
- TSX’s handling of listing applications and compliance issues for issuers that are competitors of TSX Group – The Conflicts Committee also addresses the Exchange’s application of listing rules to competitors.

##### *TSX Conflicts Committee*

The Conflicts Committee’s mandate is to review any matter that concerns a “conflict of interest or potential conflict of interest relating to the continued listing of TSX Group or the initial listing or continued listing of competitors”. (A competitor is basically any entity that is in competition to a significant extent with a business of TMX Group. The TSX must maintain a list of competitors. It advises that the list is quite short.) If the Committee finds that a conflict exists in a listings regulation matter, it makes a written recommendation to the OSC on how to deal with the matter along with a summary of the issues. The OSC may then approve the recommendation, ask the TSX to reconsider, or direct the TSX to take other action.

If a competitor believes it is not being treated fairly by TSX due to a conflict then TSX must refer the matter to the Director of the OSC. The OSC may also intervene to ensure that a competitor’s listing is treated fairly by TSX. A competitor may waive the conflict

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<sup>49</sup> The TSX Group has since changed its name to the TMX Group.

<sup>50</sup> OSC - Amendment to Recognition Order, September 3, 2002, (2002) 25 OSCB 6141

procedures, in which case the TSX deals with the matter in the normal course.

The Committee's members are five TMX Group executives, two independent persons and a representative of RS. The TMX Group Governance Committee nominates the two independent members of the Conflicts Committee.<sup>51</sup> The Committee meets as needed, but at least twice annually.

The Conflicts Committee has considered several issues relating to its parent's listing, including its normal course issuer bids and an issuance of shares when the TMX Group acquired the MX. Apparently the Committee has not addressed any conflicts with competitors because where such issues have arisen, the listed company involved waived the application of the special procedures that are available to prevent conflicts of interest.

In the author's assessment, the arrangements imposed by the OSC in the order are thorough and appear to effectively address the self-listing conflicts.

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<sup>51</sup> <http://www.tmx.com/en/pdf/TMXGroupGovCmteCharter.pdf>

## **7. Policy Options for Strengthening TSX's Management of Listings Conflicts of Interest**

### **7.1 Overall Conflicts of Interest in Listings Regulation**

The author acknowledges that the TSX is largely correct in asserting that its regulatory and commercial objectives are aligned because a successful business depends on market integrity. Other exchanges have long taken the same position, including the exchanges reviewed for this Report. However, that does not mean that depending only on this broad alignment of interests to manage conflicts of interest in listings regulation is adequate, for two reasons. Firstly, even if the two interests are broadly aligned, conflicts could result in commercial interests influencing individual regulatory policy decisions, listing decisions and decisions on the application of listing rules. Examples were noted in section 4.1. Secondly, a perception clearly exists that conflicts of interest could affect the administration of an exchange's listings regulation program, especially at a for-profit, self-listed exchange that operates in a competitive environment. Governments, regulators, investors, media and other observers have expressed this perception around the world.

Therefore, the TSX should implement safeguards to minimize the risk that conflicts will affect the administration of listings regulation, as well as to address the perception that they could do so. It is important to address perception issues because failure to do so could have a negative impact on the credibility of, and confidence in, the Exchange and its listings program. Other major exchanges have responded to both the perception and the reality of potential conflicts of interest arising by implementing concrete mechanisms to mitigate conflicts, and to ensure they are properly managed if they arise. This Report concludes that the TSX should do the same – even if it believes it is only to address a perception problem.

The purpose of this Report is not to recommend that the TSX adopt specific mechanisms to address conflicts of interest. Other exchanges have adopted a range of structures, policies and procedures to address conflicts and it is not clear that any single approach represents the “best practice”. It is clear, however, that the TSX's current approach is not best practice, and lacks basic safeguards that one would expect to see in place.

This Report's review of approaches adopted by other exchanges to manage conflicts of interest in listings regulation indicate there are three main alternatives:

- 1) Transfer most listings regulation responsibilities to another regulator – either the securities commissions or an independent SRO such as IIROC.
- 2) Establish a regulation subsidiary company with independent governance to perform listings regulation.

- 3) Establish a listings regulation department that is separate from the business operations of the Exchange (including listings business development) to perform listings regulation.

The first alternative is not currently considered realistic in Canada since the TSX has not indicated that it has any interest in relinquishing its listings regulation role, nor has any regulator indicated any interest in assuming it. The last two alternatives are considered realistic options for the TSX today. These alternatives are analyzed below.

#### *1) Transfer of Listings Regulation Responsibilities to Another Regulator*

This approach would be similar to the UK's approach, where the FSA carries out most listings regulation functions that apply to the LSE and all other equity exchanges in the UK. This model has not found favour in other jurisdictions, where Listings is seen as an exchange function and, at a minimum, exchanges set their own requirements for initial listing. This is true even where exchanges have relinquished most of their self-regulatory responsibilities. Nasdaq is a prime example.

There are also several important disadvantages to vesting listings regulation in a statutory regulator or independent SRO rather than the exchanges. The main disadvantage is that Listings is and will remain an important business line for stock exchanges. It is an important business driver and a successful listings business is very important to the competitive position of an exchange, not only nationally but also internationally. This is particularly true for the TSX, because of its strong reputation as a listings venue, the profitability of its listings business, and the longstanding significance of competition with the major US exchanges for listings business.

While the UK's example illustrates that an exchange does not necessarily need to set the listings requirements and carry out continued listings regulation in order to offer valued listings services, it is difficult for exchanges to differentiate their listings services and position in the markets if the same listings requirements and rules apply on all exchanges. The historical experience in Canada demonstrates that there is value in enabling exchanges to carve out different market segments in the listings business, to customize their rules and services to meet the specific needs of those market segments, and to position their markets with investors accordingly. In addition, arguably an exchange that can charge sizeable fees for listings should assume a reasonable degree of responsibility for ensuring that its listed securities meet certain standards of integrity and quality, for carrying out "due diligence" on listing applicants to ensure they meet those standards, and for setting and ensuring ongoing compliance with rules that protect the interests of shareholders and prospective investors in listed companies to the extent that their interests are not already protected by law.

In spite of these disadvantages, centralizing at least part of the listings regulation

function is a policy option that could be explored if concerns that increased competition for listings services within Canada could lead to lower standards of regulation become real concerns. If another regulator assumed some of the TSX's listings regulation functions and imposed a single, sound set of minimum standards that applied to listing on all exchanges, it would ensure that competition did not lead to a "race to the bottom". The minimum standards could cover continued listings rules, such as rules on disclosure and minority shareholder protection, thus leaving it to each exchange to set its own requirements for initial listing.

Several precedents exist for regulators establishing minimum standards applicable to all exchanges and marketplaces. The CSA has already assumed responsibility for the corporate governance guidelines for public issuers in Canada, which the TSX used to set. In the area of trading rules, the universal market integrity rules (UMIR) that IIROC sets and administers provide a similar set of uniform standards. UMIR establishes the standards for trading conduct on all exchanges and other equity marketplaces in Canada, including the TSX and TSXV. And finally, IIROC already provides several types of regulatory services to the TSX and other marketplaces under regulation services agreements.

## *2) Establish an Independent Regulation Subsidiary*

The main advantage of establishing a regulation subsidiary company with independent governance to perform listings regulation is that it provides the strongest safeguards against conflicts of interest. A subsidiary has independent governance in the form of its own board of directors, and management that is independent of an exchange's business if the subsidiary's CEO reports only to its board. A subsidiary is a separate organization and is likely to have more stringent policies on Chinese walls, confidentiality of information and so on. A subsidiary can operate as a non-profit entity in a clear-cut manner, and has an opportunity to develop its own corporate culture, operating policies and procedures, and human resources policies. Finally, a separate organization is the most visible and transparent solution for the public, regulated firms, supervising regulators and other stakeholders.

On the other side of the coin, creating a subsidiary with its own board and structure is more complex and expensive than other mechanisms. It could reduce synergies between the business and regulation functions of listings services, including introducing limits on the legitimate sharing of information and views. It could also lead to the imposition of unnecessary requirements to minimize conflicts.

The TSX might argue that a subsidiary is not necessary or practical considering that its SRO responsibilities are limited, compared to those of many other exchanges. Exchanges that established SRO subsidiaries did so mainly because they had a wide range of SRO functions, so the scale of their regulation operations justified such an approach. As it turns out, the NYSE and ASX have transferred most of their member and

market regulation functions to FINRA and ASIC respectively, leaving listings regulation as the main function administered by NYSE Regulation and ASX Market Supervision. But the subsidiaries were established under different circumstances. Exchanges that have more limited SRO functions have not set up SRO subsidiaries, and use less complex approaches to manage listings regulation conflicts.

### *3) Establish a Separate Listings Regulation Department*

The advantages of establishing a listings regulation department that is separate from the business operations of the Exchange (including listings business development) to perform listings regulation are:

- The model should produce strong safeguards against conflicts, since there is a clear line between business and regulation activities and staff.
- The model is reasonably visible and clear to listed companies and other stakeholders, if communicated and administered properly.
- It is less complex and costly than a subsidiary, and fairly easy to implement.

The only potential disadvantage of this model is that an exchange might argue that a separate department is unnecessary given the degree of conflicts that actually arise. But the appearance of the potential for conflicts suggests that this model may be a minimum standard to address conflicts. Arguably the minor additional costs and additional policies and procedures involved are justified in the context of the need to manage conflicts in a sound, transparent manner.

### *Summary*

Under either of the last two alternatives above, the TSX should establish internal policies and procedures to identify and ensure appropriate handling of conflicts. The TSX might consider adopting policies and procedures as the sole response to strengthen its management of conflicts, but it is questionable if adopting internal policies alone would be adequate because they do not address all of the management, cultural and staff incentive issues that arise.

In the author's view, a sound starting point for the TSX to address listings regulation conflicts would be to simply build on the structures, policies and procedures that the TMX Group already has in place at the MX for the MX Regulatory Division. (See section 6.2.) The MX's arrangements have not been reviewed for this Report, but one assumes that both the Exchange and AMF are satisfied that those arrangements are working satisfactorily. The MX Regulatory Division provides an existing, operating separate structure for SRO functions and a set of internal policies and procedures at TMX that could easily be adapted to the TSX's listings regulation functions.

The TSX could also build on its existing Conflicts Committee to support management of conflicts of interest by expanding the mandate of the Committee to review other issues where a conflict may arise or has been alleged to exist. The Exchange might also consider raising the level of transparency around listings regulation processes, including how listings applications are vetted and the role of the staff listing committee, how decisions on administration of continued listings rules are made, and the mandate, activities and composition of the Listings Advisory Committee.

## **7.2 Self-listing Conflicts of Interest**

The assessment of the author is that self-listing conflicts have been satisfactorily dealt with in the terms and conditions of the recognition order issued by the OSC, as described in section 6.4 above, and in the TSX's administration of those terms and conditions. Therefore we have not set out proposed alternatives for improving management of those conflicts in this Report. If the TSX implements policy changes to address overall conflicts of interest in listings regulation as suggested above, some consequential changes to the policies and procedures on self-listing conflicts may need to be made. For example, this could be the case if the mandate of the Conflicts Committee was amended to cover additional types of conflicts.

## **7.3 Policy Review Process**

This section covers potential next steps in reviewing the TSX's management of conflicts of interest in its Listings functions.

As noted above, the Ontario Standing Committee on Oversight of Government Agencies (SCOGA) has called for the OSC to review the TSX's handling of conflicts of interest in listings regulation. But rather than placing the initial onus on the OSC to act, the author believes it is preferable for the TSX to take the initiative to address the issues identified in this Report. It is the TSX's organization, business and regulatory responsibilities that are in question, and the TSX is most familiar with those operations and the issues that arise. As a recognized body with self-regulatory responsibilities and a public interest mandate, the Exchange should take these issues on board and develop appropriate responses.

The TSX should undertake to review its approach to managing those conflicts of interest and, following internal review and consideration, propose changes that would significantly strengthen safeguards designed to mitigate conflicts and ensure they are appropriately managed. The TSX should then publish its proposed changes for public comment, and file the proposals with the OSC for approval. (While rule changes would not necessarily be involved, it is assumed that the OSC would want to review any change



in the TSX's organizational structure or internal policies that address conflicts of interest between its business interests and its regulatory responsibilities, since the latter are covered in several sections of the TSX's recognition order issued by the OSC.)

The public comment process should allow sufficient time for interested persons to digest the TSX's proposals and formulate responses, including advocacy groups like FAIR Canada, as well as listings customers and those who advise listings applicants and listed issuers. This suggests that proposals should be open for comment for at least 60 days. Consistent with the established public notice and comment process, the TSX would be required to consider and respond to all comments received, which would ensure that the OSC considers both comments submitted and the TSX's responses to them in evaluating the TSX's proposals.

The benefits of this approach are that it would ensure that:

- The TSX is given the opportunity to first propose an approach that it believes is the most practical and effective response to the issues, given its experience in its Listings business and regulation functions.
- Market participants and other stakeholders have an opportunity to participate in the debate by commenting on the TSX's proposals, and the process would ensure that the TSX and OSC consider their comments.

If the TSX declines to take the initiative to review its approach to managing conflicts of interest in its listings regulation functions then it may be necessary for the OSC to encourage it do so, or for the OSC to take the initiative itself, as the SCOGA report recommended.

*– End of Report –*

## **Appendix A**

### **TSX Company Manual Special Provisions on Conflicts of Interest**

**Location:** [TSX Company Manual](#) > [Special Provisions Respecting Conflict of Interest and Competitors of TSX Group Inc.](#)

[http://tmx.complinet.com/en/display/display\\_main.html?rbid=2072&element\\_id=440](http://tmx.complinet.com/en/display/display_main.html?rbid=2072&element_id=440)

#### **Special Provisions Respecting Conflict of Interest and Competitors of TSX Group Inc.**

##### **General**

The Toronto Stock Exchange is operated by TSX Inc. TSX Inc. is recognized as a stock exchange by the Ontario Securities Commission ("OSC") under a recognition order which contains certain terms and conditions. In conjunction with the listing of TSX Group Inc. (TSX Group"), the parent company of TSX Inc. on the Toronto Stock Exchange, the OSC amended the terms and conditions applicable to TSX Inc. to detail certain special listing related conditions to ensure TSX Inc. follows appropriate standards and procedures with respect to the initial and continued listing of TSX Group and Competitors of TSX Group (as defined below). These procedures require TSX Inc. to provide the following disclosure in the Toronto Stock Exchange Company Manual.

##### **Definition of Competitor**

For the purposes of these special provisions, Competitor" means any person, the consolidated business and operations or the disclosed business plans of which are in competition, to a significant extent, with the listing functions, trading functions, market data services or other material line of business of TSX Group or its affiliates.

##### **Conflicts Committee**

TSX Inc. has established a Conflicts Committee to review any matters brought before it regarding a Conflict of Interest. "Conflict of Interest" is defined as a conflict of interest or potential conflict of interest relating to the continued listing on TSX Inc. of TSX Group or the initial listing or continued listing of Competitors.

##### **Referrals to Director of the OSC**

Where a Competitor certifies to TSX Inc. that information required to be disclosed to the Conflicts Committee or TSX Inc. in connection with an initial listing or continued listing matter of the Competitor is competitively sensitive and the disclosure of that information would in its reasonable view put it at a competitive disadvantage with respect to TSX Group, TSX Inc. will refer the matter to the Director of the OSC requesting that the Director review issues relating to the competitively sensitive information. The

Conflicts Committee will consider all other aspects of the matter in accordance with the listing-related procedures. In addition, at any time that a Competitor believes it is not being treated fairly by TSX Inc. as a result of TSX Inc. being in a Conflict of Interest position, TSX Inc. will refer the matter to the Director of the OSC. Finally, the OSC has the jurisdiction under the Securities Act (Ontario) to intervene at any time to ensure that Competitors are treated fairly in respect of listing and continued listing matters.

**Waiver by Competitor**

In any initial listing or continued listing matter of a Competitor, the Competitor may waive the application of the procedures set out in these special provisions by providing a written waiver to TSX Inc. and the Director of the OSC. Where a waiver is provided, TSX Inc. will deal with the initial listing or continued listing matter in the ordinary course as if no Conflict of Interest exists.

**Listing Related Procedures**

A complete copy of the listing related procedures is attached and can also be found in the September 13, 2002 edition of the Ontario Securities Commission Bulletin, (2002) 25 OSCB 6141.

## **Appendix B**

### **OSC Recognition Order of TSX (2002) – Listing-Related Conditions**

**Location:** [TSX Company Manual](#) > [Special Provisions Respecting Conflict of Interest and Competitors of TSX Group Inc.](#) > [Appendix I Listing-Related Conditions](#)

[http://tmx.complinet.com/en/display/display\\_content.html?rbid=2072&element\\_id=447&record\\_id=447](http://tmx.complinet.com/en/display/display_content.html?rbid=2072&element_id=447&record_id=447)

#### **1. Underlying Principles**

- 1.1. TSX carries on the business of the Toronto Stock Exchange.
- 1.2. TSX Group proposes to become a listed company on TSX, which will be wholly-owned by TSX Group.
- 1.3. TSX will report to the Director (the "Director") of the Ontario Securities Commission ("OSC") or other members of the staff of the OSC certain matters provided for in this Appendix I (the "Listing Related Procedures") with respect to TSX Group or certain other TSX-listed issuers that raise issues of conflict of interest or potential conflict of interest for TSX,
- 1.4. The purpose of this reporting process is to ensure that TSX follows appropriate standards and procedures with respect to the initial and continued listing of TSX Group and Competitors, to ensure that TSX Group is dealt with appropriately in relation to, and Competitors are treated fairly and not disadvantaged by, TSX Group's listing on TSX. For purposes of these Listing-Related Procedures, "Competitor" means any person, the consolidated business and operations or the disclosed business plans of which are in competition, to a significant extent, with the listing functions, trading functions, market data services or other material line of business of TSX Group or its affiliates.

#### **2. Initial Listing Arrangements**

- 2.1. TSX will review, in accordance with its procedures, the TSX Group initial listing application. A copy of the application will be provided by TSX to the OSC's Director, Corporate Finance at the same time that the application is filed with TSX.
- 2.2. Upon completing its review of the application and after allowing TSX Group to address any deficiencies noted by TSX, TSX will provide a summary report to the OSC's Director, Corporate Finance, with its recommendation for listing approval, if made. The summary report will provide details of any aspects of the application that were atypical as well as any issues raised in the process that required the exercise of discretion by TSX. Any related staff memoranda, analysis, recommendations and decisions not included in

the summary report will be attached for review by the OSC's Director, Corporate Finance. A copy of TSX's current listing manual will also be provided to the OSC's Director, Corporate Finance.

2.3. The OSC's Director, Corporate Finance will have the right to approve or disapprove the listing of the TSX Group shares. In the event of disapproval, TSX Group will have the opportunity to address the concerns of the OSC's Director, Corporate Finance and may resubmit an amended application for listing, or amended parts thereof to TSX, which will provide a revised summary report and any new materials to the OSC's Director, Corporate Finance in accordance with section 2.2, along with a copy of the amended application.

### **3. Conflicts Committee**

3.1. TSX will establish a committee (the "Conflicts Committee") that will review any matters brought before it regarding a conflict of interest or potential conflict of interest relating to the continued listing on TSX of TSX Group or the initial listing or continued listing of Competitors (each, a "Conflict of Interest"). Without limiting the generality of the above sentence, continued listing matters include the following;

- (a) matters relating to the continued listing of TSX Group or a Competitor or of a listing of a different class or series of securities of TSX Group or a Competitor than a class or series already listed;
- (b) any exemptive relief applications of or approvals applied for by, TSX Group or a Competitor;
- (c) any other requests made by TSX Group or a Competitor that require discretionary involvement by TSX; and
- (d) any listings matter related to a TSX-listed issuer or listing applicant that asserts that it is a Competitor.

3.2. Notwithstanding section 3.1, where a Competitor certifies to TSX that information required to be disclosed to the Conflicts Committee or TSX in connection with an initial listing or continued listing matter of the Competitor is competitively sensitive and the disclosure of that information would in its reasonable view put it at a competitive disadvantage with respect to TSX Group, TSX will refer the matter to the Director, requesting that the Director review issues relating to the competitively sensitive information. The Conflicts Committee shall consider all other aspects of the matter in accordance with the procedures set out in section 3.8. In addition, at any time that a Competitor believes that it is not being treated fairly by TSX as a result of TSX being in a conflict of interest position, TSX will refer the matter to the Director.

3.3. In any initial listing or continued listing matter of a Competitor, the Competitor may waive the application of these Listing-Related Procedures by providing a written waiver

to TSX and the Director. Where a waiver is provided, TSX will deal with the initial listing or continued listing matter in the ordinary course as if no Conflict of Interest exists.

3.4. The Conflicts Committee will be composed of the Chief Executive Officer of TSX, the general counsel of TSX (the "Committee Secretary"), the senior officer responsible for listings of each of TSX and TSX Venture Exchange Inc., the senior officer responsible for trading operations of TSX, a senior management representative of Market Regulation Services Inc. and two other persons who shall be independent of TSX (as independent defined in paragraph I (a) of Schedule "A" of the terms and conditions of the recognition order). At least one such independent member must participate in meetings of the Conflicts Committee, in order for there to be a quorum.

3.5. TSX shall use its best efforts to instruct senior management and relevant staff at TSX, and relevant senior management and staff at RS, in order that they are alerted to, and are able to identify, Conflicts of Interest which may exist or arise in the course of the performance of their functions. Without limiting the generality of the foregoing:

3.5.1 TSX shall provide instruction that any matter concerning TSX Group that is brought to the attention of staff at TSX must be immediately brought to the attention of the Committee Secretary.

3.5.2 TSX shall maintain a list in an electronic format, to be updated regularly and in any event at least monthly and reviewed and approved by the Conflicts Committee at least monthly, of all Competitors that are TSX-listed issuers, and shall promptly after the above-noted approval by the Conflicts Committee provide the current list to managers at TSX and RS who supervise departments that (i) review continuous disclosure; (ii) review requests/applications for exemptive relief; (iii) perform timely disclosure and monitoring functions relating to TSX-listed issuers; and (iv) otherwise perform tasks and/or make decisions of a discretionary nature. In maintaining this list, TSX shall ensure that senior executives in the issuer services division of TSX regularly prepare and review and update the list and provide it promptly to the Conflicts Committee.

3.5.3 TSX shall provide instruction to staff at TSX that any initial listing or continued listing matter or a complaint of a Competitor or of any TSX-listed issuer or listing applicant that asserts that it is a Competitor must be immediately brought to the attention of the Committee Secretary.

3.5.4 TSX shall provide to staff who review initial listing applications and to senior executives in the issuer services division of TSX a summary of the types of businesses undertaken to a significant degree by TSX Group or its affiliates and shall update the list as these businesses change, in order that initial listings staff and senior executives in the issuer services division of TSX may recognize a Competitor.

3.6. The Committee Secretary shall convene a meeting of the Conflicts Committee to be held no later than one business day after a Conflict of Interest has been brought to his or her attention. The Committee Secretary or any member of the Conflicts Committee

may also convene a meeting of the Conflicts Committee whenever he or she sees fit, in order to address any conflict issues that may not be related to any one specific matter or issuer.

3.7. TSX shall, at the time a Conflicts Committee meeting is called in response to a Conflict of Interest, immediately notify the OSC's Manager of Market Regulation that it has received notice of a Conflict of Interest and shall provide with such notice: (i) a written summary of the relevant facts; and (ii) an indication of the required timing for dealing with the matter.

3.8. The Conflicts Committee will consider the facts and form an initial determination with respect to the matter. The Conflicts Committee will then proceed as follows depending on the circumstances:

3.8.1 If the Conflicts Committee determines that a conflict of interest relating to the continued listing on TSX of TSX Group or the initial or continued listing of a Competitor on TSX does not exist and is unlikely to arise, it will notify the OSC's Manager of Market Regulation of this determination. If the OSC's Manager of Market Regulation approves such determination, TSX will deal with the matter in its usual course. When it has dealt with the matter, a brief written record of such determination with details of the analysis undertaken, and the manner in which the matter was disposed of will be made by TSX and provided to the OSC's Manager of Market Regulation. If the OSC's Manager of Market Regulation does not approve the determination and provides notice of such non-approval to TSX, TSX will follow the procedures set out in section 3.8.2.

3.8.2 If the Conflicts Committee determines that a conflict of interest relating to the continued listing on TSX of TSX Group or the initial or continued listing of a Competitor on TSX does exist or is likely to arise or if TSX is provided non-approval notice from the OSC's Manager of Market Regulation under section 3.8.1, TSX shall: (i) formulate a written recommendation of how to deal with the matter; and (ii) provide its recommendation to the OSC's Manager of Market Regulation for his or her approval, together with a summary of the issues raised and details of any analysis undertaken. If the OSC's Manager of Market Regulation approves the recommendation, TSX will take steps to implement the terms of its recommendation.

3.9. Where the OSC's Manager of Market Regulation has considered the circumstances of an issue based on the information provided to him or her by the Conflicts Committee under section 3.8.2, and has determined that he or she does not agree with TSX's recommendation (i) and has requested that TSX reformulate its recommendation, TSX shall do so; or (ii) the OSC's Manager of Market Regulation may direct TSX to take such other action as he or she considers appropriate in the circumstances.

3.10. Where the OSC's Manager of Market Regulation or the Director is requested to review a matter pursuant to section 3.9 or 3.2, respectively, TSX shall provide to the OSC's Manager of Market Regulation or the Director any relevant information in its

possession and, if requested by the OSC's Manager of Market Regulation or the Director, any other information in its possession, in order for the OSC's Manager of Market Regulation or the Director to review or, if appropriate, make a determination regarding the matter, including any notes, reports or information of TSX regarding the issue, any materials filed by the issuer or issuers involved, any precedent materials of TSX, and any internal guidelines of TSX. TSX shall provide its services to assist the matter, if so requested by the OSC's Manager of Market Regulation or by the Director.

3.11. TSX will provide to the OSC's Manager of Continuous Disclosure a copy of TSX Group's annual questionnaire and any other TSX Group disclosure documents that are filed with TSX but not with the OSC's Continuous Disclosure department. TSX will conduct its usual review process in connection with TSX Group's annual questionnaire and all prescribed periodic filings of TSX Group. Any deficiencies or irregularities in TSX Group's annual questionnaire or other TSX-issuer prescribed filings will be communicated to the OSC's Manager of Continuous Disclosure and brought to the attention of the Conflicts Committee which shall follow the procedures outlined in this section 3.

#### **4. Timely Disclosure and Monitoring of Trading**

4.1. TSX shall use its best efforts to ensure that RS at all times is provided with the current list of the TSX-listed issuers that are Competitors.

#### **5. Miscellaneous**

5.1. Information provided by a Competitor in connection with an initial listing or continued listing matter to the Conflicts Committee will not be used by TSX for any purpose other than addressing Conflicts of Interest. TSX will not disclose any confidential information obtained under these Listing-Related Procedures to a third party other than the OSC unless:

- (a) prior written consent of the other parties is obtained;
- (b) it is required or authorized by law to disclose the information; or
- (c) the information has come into the public domain otherwise than as a result of its breach of this clause.

5.2. TSX will provide disclosure on its website and in the TSX Company Manual to the effect that an issuer can assert that it is a Competitor and will outline the procedures for making such an assertion, including appeal procedures.



## **Appendix C**

### **TSX Conflicts Committee Mandate**

**Source: TSX COMPANY MANUAL – CONFLICTS OF INTEREST**

[http://tmx.complinet.com/en/display/display.html?rbid=2072&record\\_id=450&element\\_id=450&highlight=conflicts#r450](http://tmx.complinet.com/en/display/display.html?rbid=2072&record_id=450&element_id=450&highlight=conflicts#r450)

3.1. TSX will establish a committee (the "Conflicts Committee") that will review any matters brought before it regarding a conflict of interest or potential conflict of interest relating to the continued listing on TSX of TSX Group or the initial listing or continued listing of Competitors (each, a "Conflict of Interest"). Without limiting the generality of the above sentence, continued listing matters include the following;

- (a) matters relating to the continued listing of TSX Group or a Competitor or of a listing of a different class or series of securities of TSX Group or a Competitor than a class or series already listed;
- (b) any exemptive relief applications of or approvals applied for by, TSX Group or a Competitor;
- (c) any other requests made by TSX Group or a Competitor that require discretionary involvement by TSX; and
- (d) any listings matter related to a TSX-listed issuer or listing applicant that asserts that it is a Competitor.

3.2. Notwithstanding section 3.1, where a Competitor certifies to TSX that information required to be disclosed to the Conflicts Committee or TSX in connection with an initial listing or continued listing matter of the Competitor is competitively sensitive and the disclosure of that information would in its reasonable view put it at a competitive disadvantage with respect to TSX Group, TSX will refer the matter to the Director, requesting that the Director review issues relating to the competitively sensitive information. The Conflicts Committee shall consider all other aspects of the matter in accordance with the procedures set out in section 3.8. In addition, at any time that a Competitor believes that it is not being treated fairly by TSX as a result of TSX being in a conflict of interest position, TSX will refer the matter to the Director.

3.3. In any initial listing or continued listing matter of a Competitor, the Competitor may

waive the application of these Listing-Related Procedures by providing a written waiver to TSX and the Director. Where a waiver is provided, TSX will deal with the initial listing or continued listing matter in the ordinary course as if no Conflict of Interest exists.

3.4. The Conflicts Committee will be composed of the Chief Executive Officer of TSX, the general counsel of TSX (the "Committee Secretary"), the senior officer responsible for listings of each of TSX and TSX Venture Exchange Inc., the senior officer responsible for trading operations of TSX, a senior management representative of Market Regulation Services Inc. and two other persons who shall be independent of TSX (as independent defined in paragraph I (a) of Schedule "A" of the terms and conditions of the recognition order). At least one such independent member must participate in meetings of the Conflicts Committee, in order for there to be a quorum.

3.5. TSX shall use its best efforts to instruct senior management and relevant staff at TSX, and relevant senior management and staff at RS, in order that they are alerted to, and are able to identify, Conflicts of Interest which may exist or arise in the course of the performance of their functions. Without limiting the generality of the foregoing:

3.5.1 TSX shall provide instruction that any matter concerning TSX Group that is brought to the attention of staff at TSX must be immediately brought to the attention of the Committee Secretary.

3.5.2 TSX shall maintain a list in an electronic format, to be updated regularly and in any event at least monthly and reviewed and approved by the Conflicts Committee at least monthly, of all Competitors that are TSX-listed issuers, and shall promptly after the above-noted approval by the Conflicts Committee provide the current list to managers at TSX and RS who supervise departments that (i) review continuous disclosure; (ii) review requests/applications for exemptive relief; (iii) perform timely disclosure and monitoring functions relating to TSX-listed issuers; and (iv) otherwise perform tasks and/or make decisions of a discretionary nature. In maintaining this list, TSX shall ensure that senior executives in the issuer services division of TSX regularly prepare and review and update the list and provide it promptly to the Conflicts Committee.

3.5.3 TSX shall provide instruction to staff at TSX that any initial listing or continued listing matter or a complaint of a Competitor or of any TSX-listed issuer or listing applicant that asserts that it is a Competitor must be immediately brought to the attention of the Committee Secretary.

3.5.4 TSX shall provide to staff who review initial listing applications and to senior executives in the issuer services division of TSX a summary of the types of businesses

undertaken to a significant degree by TSX Group or its affiliates and shall update the list as these businesses change, in order that initial listings staff and senior executives in the issuer services division of TSX may recognize a Competitor.

3.6. The Committee Secretary shall convene a meeting of the Conflicts Committee to be held no later than one business day after a Conflict of Interest has been brought to his or her attention. The Committee Secretary or any member of the Conflicts Committee may also convene a meeting of the Conflicts Committee whenever he or she sees fit, in order to address any conflict issues that may not be related to any one specific matter or issuer.

3.7. TSX shall, at the time a Conflicts Committee meeting is called in response to a Conflict of Interest, immediately notify the OSC's Manager of Market Regulation that it has received notice of a Conflict of Interest and shall provide with such notice: (i) a written summary of the relevant facts; and (ii) an indication of the required timing for dealing with the matter.

3.8. The Conflicts Committee will consider the facts and form an initial determination with respect to the matter. The Conflicts Committee will then proceed as follows depending on the circumstances:

3.8.1 If the Conflicts Committee determines that a conflict of interest relating to the continued listing on TSX of TSX Group or the initial or continued listing of a Competitor on TSX does not exist and is unlikely to arise, it will notify the OSC's Manager of Market Regulation of this determination. If the OSC's Manager of Market Regulation approves such determination, TSX will deal with the matter in its usual course. When it has dealt with the matter, a brief written record of such determination with details of the analysis undertaken, and the manner in which the matter was disposed of will be made by TSX and provided to the OSC's Manager of Market Regulation. If the OSC's Manager of Market Regulation does not approve the determination and provides notice of such non-approval to TSX, TSX will follow the procedures set out in section 3.8.2.

3.8.2 If the Conflicts Committee determines that a conflict of interest relating to the continued listing on TSX of TSX Group or the initial or continued listing of a Competitor on TSX does exist or is likely to arise or if TSX is provided non-approval notice from the OSC's Manager of Market Regulation under section 3.8.1, TSX shall: (i) formulate a written recommendation of how to deal with the matter; and (ii) provide its recommendation to the OSC's Manager of Market Regulation for his or her approval, together with a summary of the issues raised and details of any analysis undertaken. If the OSC's Manager of Market Regulation approves the recommendation, TSX will take

steps to implement the terms of its recommendation.

3.9. Where the OSC's Manager of Market Regulation has considered the circumstances of an issue based on the information provided to him or her by the Conflicts Committee under section 3.8.2, and has determined that he or she does not agree with TSX's recommendation (i) and has requested that TSX reformulate its recommendation, TSX shall do so; or (ii) the OSC's Manager of Market Regulation may direct TSX to take such other action as he or she considers appropriate in the circumstances.

3.10. Where the OSC's Manager of Market Regulation or the Director is requested to review a matter pursuant to section 3.9 or 3.2, respectively, TSX shall provide to the OSC's Manager of Market Regulation or the Director any relevant information in its possession and, if requested by the OSC's Manager of Market Regulation or the Director, any other information in its possession, in order for the OSC's Manager of Market Regulation or the Director to review or, if appropriate, make a determination regarding the matter, including any notes, reports or information of TSX regarding the issue, any materials filed by the issuer or issuers involved, any precedent materials of TSX, and any internal guidelines of TSX. TSX shall provide its services to assist the matter, if so requested by the OSC's Manager of Market Regulation or by the Director.

3.11. TSX will provide to the OSC's Manager of Continuous Disclosure a copy of TSX Group's annual questionnaire and any other TSX Group disclosure documents that are filed with TSX but not with the OSC's Continuous Disclosure department. TSX will conduct its usual review process in connection with TSX Group's annual questionnaire and all prescribed periodic filings of TSX Group. Any deficiencies or irregularities in TSX Group's annual questionnaire or other TSX-issuer prescribed filings will be communicated to the OSC's Manager of Continuous Disclosure and brought to the attention of the Conflicts Committee which shall follow the procedures outlined in this section 3.

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