

FAIR

Canadian Foundation *for*
Advancement *of* Investor Rights

November 7, 2011

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Re: Maple Group Acquisition Corporation Notices and Requests for Comment of the Ontario Securities Commission ("OSC"), British Columbia Securities Commission ("BCSC") and Alberta Securities Commission ("ASC") (jointly), and Autorité des marchés financiers ("AMF")

FAIR Canada is pleased to offer a submission to the Ontario Securities Commission ("OSC"), Alberta Securities Commission ("ASC") and British Columbia Securities Commission ("BCSC") jointly and the Autorité des marchés financiers ("AMF") (collectively, the "Requesting Regulators") in response to three related requests for comment in respect of the application by Maple Group Acquisition Corporation ("Maple") to acquire TMX Group Inc. ("TMX Group"), and its subsequent acquisition of Alpha Trading Systems Limited Partnership ("Alpha LP") and Alpha Trading Systems Inc. (collectively, "Alpha") and The

Canadian Depository for Securities Limited (“CDS Ltd.”) and, indirectly, CDS Clearing and Depository Services Inc. (“CDS Clearing “ and, collectively, “CDS”) (hereinafter referred to as the “Maple Proposal”).

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

FAIR Canada Comments and Recommendations – Executive Summary

1. If the Requesting Regulators determine that it would be in the public interest to make the requested orders, FAIR Canada recommends that the OSC’s orders be conditional on the implementation of specific and sound mechanisms to manage the various conflicts of interest that would arise out of the Maple Proposal, most importantly,
 - a. Conflicts associated with an exchange’s for-profit status and its regulatory mandate; and
 - b. Conflicts with respect to ownership – owner-dealer interests versus the public interest.
2. FAIR Canada recommends that the materiality threshold for what constitutes “independence” for a director be lowered from ten to five percent.
3. We also recommend that there be fair, meaningful and diverse representation on Maple’s board by requiring that two-thirds of the board be independent: one-third of the directors be representatives of Canadian investors (with at least two retail investor representatives), one-third of the board be composed of directors representing other stakeholders (including listed companies and the public interest) and one-third of the board be non-independent directors who could be representatives of the Maple shareholders.
4. FAIR Canada suggests that if CDS is to be converted into a for-profit entity, the Requesting Regulators should regulate the pricing of CDS in a manner similar to that of a public utility in order for the approval to be given for the conversion of CDS. Alternatively, any decision regarding CDS should be deferred until such time as a more fulsome consultation can be undertaken, given the critical role that CDS plays in the Canadian markets. A regulatory decision on CDS should not be rushed.

1. Governance – Listing Regulation Conflicts of Interest Must be Properly Addressed

- 1.1. The Requesting Regulators must consider the application with reference to their respective criteria for recognition. Under the OSC’s recognition criteria, the evaluation of that application must include considerations of whether “[t]he governance structure and governance arrangements of the exchange ensure...that business and regulatory decisions are in keeping with the exchange’s public interest mandate...[and] the exchange has policies and procedures to appropriately identify and manage conflicts of interest...”¹.
- 1.2. FAIR Canada’s concern relates to how the TSX and TSX Venture Exchange (“TSX-V”) are discharging their roles as regulators of listed companies and how the Maple Proposal would impact their regulatory roles. Currently, the TSX carries out the regulatory function of listings regulation while

¹ (2011) 34 OSCB 10461.

profiting from the listings business function. The listings regulation function is an important regulatory and standard-setting role that has a significant impact on market integrity and investor protection. We are concerned about the absence of adequate safeguards to manage the inherent conflict of interest arising between the for-profit status of TMX Group and the TSX and TSX-V's roles as regulators of listed companies. As stated in an expert report commissioned by FAIR Canada entitled "Managing Conflicts of Interest in TSX Listed Company Regulation"² (the "FAIR Canada Report"):

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.

- 1.3 The FAIR Canada Report also found that all of the other seven major exchanges worldwide that were reviewed have addressed their conflicts of interest by implementing one of three specific and sound approaches to conflict of interest management. **Of the exchanges reviewed, the report stated that "[t]he TSX is the only exchange among this group that has not implemented specific measures to manage its listings conflicts..."**
- 1.4 Since the TSX demutualized and went public a decade ago, its primary motivation has been value maximization for TMX Group shareholders, not the public interest or the best interest of the Canadian capital markets. Exchanges and regulators in other developed markets have recognized the problems arising from conflicts between their exchanges' business and regulatory functions and have taken steps to manage for these conflicts.³
- 1.5 In its March 2010 report on the Ontario Securities Commission⁴, the Standing Committee on Government Agencies (the "Committee") cited concern "with the perception that the TSX falls below international standards with respect to the separation of its regulatory and commercial activities."⁵ **The Committee recommended "that the [Ontario Securities] Commission review the potential for 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."**⁶
- 1.6 The TSX is a regulatory outlier of developed country exchanges in that it has not acted to adequately manage conflicts of interest inherent in its business and regulatory objectives. Canadian regulators must act to ensure that, at a minimum, the TSX meets the minimum international "best practice" standard for the management of conflicts of interest. This comment applies equally to the TSX-V.
- 1.7 An example of this conflict is illustrated in the TSX and TSX-V's marketing efforts to attract China listings over the last decade absent consideration of whether the regulatory framework in Canada

² John W. Carson, "Managing Conflicts of Interest in TSX Listed Company Regulation" (2010), online: FAIR Canada <<http://faircanada.ca/wp-content/uploads/2008/12/TSX-Listings-Conflicts-final-report-23-Jul1.pdf>> [Carson].

³ Carson, *supra* note 2 at 28.

⁴ Standing Committee on Government Agencies, "Report on Agencies, Boards and Commissions: Ontario Securities Commission" (March 2010), online: <http://www.ontla.on.ca/committee-proceedings/committee-reports/files_pdf/OSC%20Report%20English.pdf>.

⁵ *Supra* note 4 at 35.

⁶ *Supra* note 4 at 35.

is adequate to ensure sufficient oversight and investor protection⁷. Recent events involving Sino-Forest and, subsequently, more than a dozen TSX-V issuers that are also emerging market listings, have resulted in billion dollar losses for investors, and in particular, retail investors. This clearly demonstrates that the TSX and TSX-V have not properly considered the risks or the public interest in their campaign to increase their China listings.

- 1.8 The Maple Proposal will exacerbate the existing conflicts of interest given the TSX and TSX-V listing standards, and the administration of listing requirements may be influenced by the financial interests of the securities firms that are part of, or owned by, the consortium of Canadian investment dealers and financial institutions that make up Maple (i.e. CIBC World Markets Inc., Desjardins Financial Corporation, Dundee Capital Markets Inc., GMP Capital Inc., The Manufacturers Life Insurance Company, National Bank Financial Inc., Scotia Capital Inc. and TD Securities Inc.). A conflict of interest exists where the dealers who dominate the listing business are owners and significant shareholders of the exchange. The subsequent acquisition of Alpha, if it were also to become an exchange, would also likely result in an increased focus on the listings business function.
- 1.9 **FAIR Canada’s preferred approach to managing the TSX’s conflicts of interest in listings regulation would be to transfer its listings regulation functions to another regulator; preferably an independent self-regulatory organization (“SRO”). This was the approach taken by Canadian regulators with respect to the TSX’s member regulation and market regulation functions when it demutualized.**
- 1.10 Alternatively, we recommend that one of the other policy options presented in the FAIR Canada Report be adopted to ensure the adequate management of listings conflicts of interest by the TSX and TSX-V.⁸ These would involve either: (1) transferring the regulatory function from the exchanges to provincial regulators, which was the approach taken in the UK for listings regulation by the Financial Services Authority; or (2) establishing a separate subsidiary with an independent board of directors as the NYSE has done.
- 1.11 FAIR Canada has reviewed the Maple Proposal and its approach to addressing the potential for conflicts of interest through the adoption of a board code of conduct almost identical to TMX Group’s and through the composition and mandate of the committees of Maple’s board and, in particular, through the inclusion of independent directors on those committees, at the standard of “independence” currently adopted by the board of directors of TMX Group and within the meaning of section 1.4 of NI 52-110.
- 1.12 **FAIR Canada does not agree that the status quo is acceptable to address the conflicts of interest in listing regulation.** FAIR Canada does not believe that the presence of independent directors (as currently defined) is adequate. We discuss the issue of the composition of the board and the standard of “independence” in section 2 below.
- 1.13 Possible measures to address conflicts of interest are set out in the OSC’s Notice and Request for Comments⁹. The first three measures listed, namely: (i) enhanced conflicts of interest policies and procedures at the exchange level and at the individual dealer shareholder level; (ii) requiring dealer-owners to provide transparency to their clients regarding the dealers’ routing decisions and ownership in the exchange; and (iii) a regulatory oversight committee (ROC) at the board level are

⁷ See the marketing efforts on the TSX’s website at http://www.tmx.com/en/news_events/news/news_releases/2010/4-7-2010_TMXGroup-China.html.

⁸ *Supra*, note 2 at 52-56.

⁹ *Supra*, note 1 at 10448-10449.

not models that have been adopted by other leading international exchanges and have potential defects that warrant further examination.

- 1.14 FAIR Canada does not believe that enhanced conflicts of interest policies and procedures would be practical or effective. It is much preferable to avoid conflicts of interest altogether through sound approaches that meet an international best practice rather than attempting to “identify and manage” those conflicts of interests through “ethical” or “Chinese walls”, disclosure of the conflict to clients, and other policies. Effective mitigation of the conflicts of interests would be extremely problematic given the proposed structure and ownership of the exchange. Effective oversight of that process by Requesting Regulators would also be fraught with difficulties.**
- 1.15 The ROC approach to addressing conflicts of interest is not a model which has been adopted by other leading international exchanges and presents potential defects that warrant further examination. For example, FAIR Canada questions whether the ROC can be effective and efficient in its regulatory role of dealing with appeals from decisions made under the Trading Policies or Listings Handbook or in dealing with code of conduct and conflict of interest issues given its likely composition and its relationship to the exchange itself. The ROC would only improve its effectiveness if it is composed of independent directors (directors who are independent from the entities that make up the consortium that is Maple, and independent from the listed issuer users of the exchange), has decision-making capabilities and reports directly to the Commission rather than to the board of the exchange.
- 1.16 Irrespective of the approval of the Maple Proposal, specific and sound mechanisms must be implemented in order to manage the conflicts of interest arising from the TSX’s listings regulation responsibilities and its listings business operations. If the Maple Proposal is to proceed, the implementation of such mechanisms within a fixed timeframe (such as twelve months) must be one of the conditions imposed before the necessary approvals are granted.
- 1.17 FAIR Canada disagrees with the OSC’s statement that transferring the TSX’s listings regulation functions to another regulator, preferably an independent SRO, is only a “long term solution and cannot be imposed as part of our review of the Maple Application”¹⁰. Steps can be taken in the interim to manage the transition to ensure that conflicts of interest are managed appropriately, such as an independent subsidiary of Maple with the majority of its board consisting of independent directors (as defined below in section 2) and having final decision-making powers over such areas as listing policy, rule-making, budgetary matters, and handling conflicts under the Trading Policies or Listings Handbook.**

2. Governance – Need for More Robust Definition of Independence in Determining Composition of Boards of Directors

- 2.1. FAIR Canada is concerned that potential conflicts of interest arise from having bank dealer-owners, who have a significant shareholder interest in the exchange and who are also major users of the exchange, having significant representation on the board of directors of Maple, as their interests may not align with the public interest. FAIR Canada is particularly concerned that the proposed composition of the board will not result in diverse representation and that there will not be a proper balance of interests. Most importantly, FAIR Canada is concerned that the interests of retail investors will not be represented.

¹⁰ *Supra*, note 1 at 10449.

- 2.2. Under the OSC's recognition criteria, the evaluation of the application must consider whether "[t]he governance structure and governance arrangements of the exchange ensure: ...(b) that business and regulatory decisions are in keeping with the exchange's public interest mandate; (c) fair, meaningful and diverse representation on the governing body (Board) and any committees of the Board, including, (i) appropriate representation of independent directors, and (ii) a proper balance among the interests of the different persons or companies using the services and facilities of the exchange..."¹¹.
- 2.3. Nine of the thirteen entities which make up the Maple consortium will serve on the board of Maple. There is proposed to be fifteen members of the board in total. Four of the fifteen entities will be bank-owned dealers who control a majority of the order flow in Canada. After the acquisition, the Maple consortium will hold the majority of the shares of Maple.¹²
- 2.4. We share the concerns expressed by the OSC that an exchange should have directors that are independent not only of management but also from significant shareholders who may be able to exercise control: "An appropriate governance structure may assist in mitigating potential conflicts of interest between the dealer-owners, or other shareholders, and the exchange's operations. In particular, a governance structure with a board of directors independent of both management and certain ownership interests may be better positioned to supervise management, free from any incentive to see that the exchange's operations primarily benefit its owners, to the possible detriment of other stakeholders, end users, or the public interest."¹³
- 2.5. While it may be true that upon completion of the transactions, the different entities that make up Maple will not be acting "jointly or in concert"¹⁴ and there are no legal agreements in place that require them to vote or act in a particular manner¹⁵, in practical terms the interests of the bank-owned shareholders will be very much aligned. FAIR Canada does not agree that the entities that make up Maple (known as the "Investors") "are a diverse group"¹⁶ as is asserted by Maple in its application.
- 2.6. Fair, meaningful and diverse representation of the board requires that there be non-owner users, including representatives of retail and institutional investors, on the board in order that the exchanges operate in the public interest. **FAIR Canada recommends that the Requesting Regulators require that two-thirds of the board be independent: one-third of the directors be representatives of investors (with at least two retail investor representatives), one-third of the board be composed of directors representative of other stakeholders (including listed companies and the general public interest) and one-third of the board be non-independent directors, who could be representatives of the Maple shareholders.**
- 2.7. To address this concern about the lack of independence of the proposed board and the lack of fair, meaningful and diverse representation, FAIR Canada also recommends that the materiality threshold for "independence" should be lowered to five percent for purposes of the definition of "independence". The shareholders of Maple should not be considered "independent" if they own

¹¹ *Supra*, note 1.

¹² *Supra*, note 1 at 10481.

¹³ *Supra*, note 1 at 10444.

¹⁴ *Supra*, note 1 at 10471.

¹⁵ *Supra*, note 1 at 10471.

¹⁶ *Supra*, note 1 at 10471.

more than five percent of the shares for purposes of governance. FAIR Canada notes that prior to 2002, the threshold stipulated in the *Securities Act* (Ontario) was five percent¹⁷.

3. Change in Structure of CDS: Change from Cost Recovery Model to For-Profit Model

- 3.1. Currently in Canada, CDS operates as a horizontal organization providing its services to all market participants and all marketplaces operating in Canada. CDS is considered a user-owned and user-governed entity as is operated on a cost-recovery basis. The Maple Proposal would change this to a vertical model, to be run on a for-profit basis, governed by a board with a greatly reduced representation of users, where all Canadian trading venues would have access to its clearing and settlement services. In addition, the Maple Proposal will horizontally integrate the clearing services for equities, bonds, debt securities and derivatives in both exchange-traded and over-the-counter markets onto a common platform.¹⁸
- 3.2. The Requesting Regulators must consider the application with reference to their respective criteria for recognition. Under the recognition criteria, the evaluation of that application must consider whether “[a]ll fees imposed by the clearing agency are equitably allocated. The fees do not have the effect of creating unreasonable barriers to access”¹⁹ and “[t]he process for setting fees is fair and appropriate and the fee model is transparent”²⁰.
- 3.3. **We suggest that given the vertical integration that would result from the Maple Proposal, the Requesting Regulators require the regulation of the pricing of CDS in a manner similar to that of a public utility in order for the transaction to proceed. In the alternative, the Requesting Regulators should consider deferring a decision regarding CDS and conduct further consultation focused on the conversion of CDS into a for-profit entity. CDS plays a crucial market infrastructure role in the Canadian markets and the Requesting Regulators should not be rushed into making a decision with widespread implications for the markets to suit the timing of the Maple Proposal.**
- 3.4. The AMF’s Notice of Public Consultation refers to specific risks related to securities clearing, settlement and depository activities and refers to a number of possible measures to deal with issues such as controlling conflicts of interest, mitigating systemic risk and promoting competition, including measures proposed by the U.S. Commodity Futures Trading Commission and the U.S. Securities and Exchange Commission. Given the critical importance of CDS to our markets and financial system²¹, such issues should not be rushed but, rather, deserve their own separate consultation.
- 3.5. We agree with the AMF when it states: “Although Maple believes that the acquisition will benefit the financial markets, the possible consequences of this acquisition should be properly assessed, particularly with respect to (i) the change in the business model of CDS Ltd. and of CDS Clearing arising from their new status as a for-profit subsidiary of a public corporation and (ii) the integration within Maple of CDS Clearing, whose CDSX platform has been designated by the Bank of Canada as a clearing and settlement system that could pose systemic risk under the Clearing Act. As well, the Bank of Canada may designate the CDCC system as a clearing and settlement

¹⁷ The 5 percent threshold required under section 21.11 of the *Securities Act* (Ontario) was increased by regulation (Ont. Reg. 261/02, September 3, 2002).

¹⁸ AMF Notice of Public Consultation at 3.

¹⁹ *Supra*, note 1 at 10464; section 2.1 of Schedule A-2.

²⁰ *Supra*, note 1 at 10464; section 2.2 of Schedule A-2.

²¹ *Supra* note 18 at 6 and 12.

system that could pose systemic risk in connection with the upcoming clearing activities of CDCC for fixed-income trading (repurchase transactions and cash buy or sell trades) subject to conditions to be met by CDCC.”²²

- 3.6. The AMF Notice of Public Consultation also points out that there is no undertaking with respect to share ownership by Maple with respect to CDCC or CDS, even though a change in ownership of such entities could have consequences similar to those related to a change in share ownership of Maple.²³ This raises serious concerns that require further deliberation and discussion.

FAIR Canada would like to participate in the OSC’s public hearing related to the Maple Proposal that will take place on December 1 and 2, 2011 to express its views directly to the OSC.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-472-2282/ermanno.pascutto@faircanada.ca or Marian Passmore at 416-572-2728/marian.passmore@faircanada.ca.

Sincerely,



Canadian Foundation for Advancement of Investor Rights

²² *Supra* note 18 at page 13.

²³ *Supra* note 18 at 6 and 8.