

March 9, 2011

REMARKS TO SELECT COMMITTEE OF THE ONTARIO LEGISLATURE

PROPOSED MERGER OF THE TMX GROUP AND THE LONDON STOCK EXCHANGE GROUP

Ermanno Pascutto, Executive Director

Mr. Chairman, members of the Committee. Thank you for the opportunity to appear here today.

1. About FAIR Canada

The Canadian Foundation for Advancement of Investor Rights (“**FAIR Canada**”) is an independent, national non-profit agency. The mission of FAIR Canada is to be a national voice for investors in securities regulation and a catalyst for enhancing the rights of Canadian shareholders and individual investors. See www.faircanada.ca for more information.

GENERAL COMMENTS ON PROPOSED MERGER

- 2. Merger or Takeover** – While on paper the proposed transaction is a merger of equals, in reality it is a take-over by the LSE Group. Over time, foreign control over the TMX Group assets will solidify, especially after any guarantees expire in 4 years on matters like the number of Canadian directors on the holding company board.

In our view, the Committee should approach this as a takeover of the TSX and TMX Group by the LSE Group.

- 3. Benefits to Canada** – FAIR Canada does not see any clear benefits to the Canadian capital markets or to Toronto as a financial center from the merger.
 - If anything, most directors and executives of the new Exchange Group company will be less knowledgeable about, and more remote from, the needs of Canadian investors, as well as the needs of Canadian issuers and securities dealers.
 - While we see benefits to TMX shareholders, we do not believe that there are real benefits for listed issuers or investors.

4. Listed Companies' Access to Capital

- TMX and LSE have stated that the merger will enable Canadian issuers to have better access to an overseas listing and foreign capital by virtue of LSE's international status as a listings destination.
- We do not see how that is the case. In order to list on the LSE, Canadian companies would still be required to meet the UK legal requirements (including Financial Services Authority's listing requirements), the LSE's requirements, and pay the various costs and fees associated with a listing. This is what listed companies have to do now and this will not change as result of the merger.
- Few Canadian companies have pursued overseas listings since they apparently do not feel the benefits outweigh the costs. In particular, small Canadian issuers are most unlikely to benefit from an overseas listing given that the investor base for small companies, especially venture companies like those listed on the TSX Venture Exchange, tends to be local.

Access to US Capital Markets

- Canadian companies that want to expand their investor base through a foreign listing have overwhelmingly chosen the US markets, in particular listing on the NYSE and NASDAQ Exchanges. The proposed deal with LSE Group is very unlikely to change that, and the merger will not do anything to support Canadian companies' desire to tap American markets.
- **Access to US capital markets has been facilitated by a Multijurisdictional Disclosure System (or MJDS) arrangement negotiated by the OSC and the other Canadian securities regulators with the US SEC.**
 - The MJDS permits eligible issuers in Canada to effect offerings of securities in the United States based on disclosure documents prepared in accordance with Canadian requirements, and vice versa. It further permits issuers to use Canadian continuous disclosure documentation and file Canadian-style insider reports in satisfaction of U.S. requirements and, conversely, allows U.S. issuers to file their continuous disclosure and insider reports in satisfaction of the equivalent Canadian requirements.

- **If the goal is to support Canadian issuers' ability to list on the LSE or another foreign exchange, that could be achieved:**
 - **through a listings alliance or other arrangement with the LSE to promote listings on the LSE.**
 - **by urging Canadian and UK regulators to work out the equivalent of a MJDS system similar to that negotiated with the US.**
- Pursuing the goal of increased access to capital for Canadian issuers does not require a merger of the two Exchange groups.
- In summary, FAIR Canada does not believe that the ability of the TSX and TSX Venture Exchanges to serve Canadian listed issuers or investors will be enhanced by the merger.

5. Benefits to TMX Shareholders

- FAIR Canada recognizes that the proposed merger may strengthen the financial and competitive position of the TMX and the new Exchange Group company as a whole.
- As such, the merger may well be in the interests of TMX shareholders. Those benefits may be enough to justify the merger – that is not for us to say. But if the only real benefits of the deal are to TMX and LSE shareholders, the TMX Group and LSE Group should simply say so.

6. Is TSX a Strategic Asset?

- There has been discussion in the media and elsewhere of whether the TSX is a strategic asset for Canada or Toronto.
- It may be useful to compare the role of the TSX with the role and treatment of the exchanges which form part of Government strategy to develop their capital markets.
- **Hong Kong and Singapore** – Certain countries have positioned their Exchanges as key strategic assets for the development of local capital markets – for example in Hong Kong and Singapore. Based on Government policy initiatives, the Hong Kong and Singapore markets were reorganized to consolidate local securities and derivatives exchanges, plus related clearing and settlement agencies, when they demutualized about 10 years ago.
- **Strategic Role and Monopoly** – The HKEx and SGX were expressly positioned to promote and develop local capital markets, and to enhance their city's competitive position in the region and globally.

- The Hong Kong and Singapore exchanges have been given a virtual monopoly in their home market. This monopoly plus its role as being the international financial center for China is why the HKEx is by far the most valuable stock exchange in the world even though it is similar in size to TMX (\$23 billion market capitalization for HKEx vs. \$3 billion for TMX). It is also a major reason why the market capitalization of the shares of SGX (Singapore) exceeds that of ASX (Australia).
- Given that the Governments of Hong Kong and Singapore have positioned their exchanges as strategic part of their financial center strategy, it is highly doubtful they would permit a takeover of their exchanges by an exchange based in a foreign country.
- **Canadian Regulators Promote Competition** – In Canada, the TSX and TSX Venture have not been so positioned. On the contrary, the regulatory authorities have focused on promoting competition with the TSX for trading services and ensuring that the regulatory environment accommodates new entrants. A number of new securities marketplaces have launched in recent years and have now taken significant market share of trading from the TSX and TSX Venture Exchanges and forced a dramatic reduction in trading fees.
- The same promotion of competition approach has been taken in the US and the UK.
- **Alpha** – Alpha is a particular threat to the TSX. In 18 months since its launch, it has taken approximately 20-25% of the trading in TSX listed securities. Alpha is owned by the 6 major banks, CPP and a couple of other financial institutions. It leverages the dominance of its shareholders to help grow its business.
- **Alpha Threat to Listing Revenue** – Alpha ATS has applied to the OSC for designation as an exchange, which would enable it to compete with the TSX and TSXV for listing of issuers. In our view, granting Alpha exchange status will pose a threat to TSX's listing business especially given that Alpha's shareholders dominate new listing activity in Canada. Fees from new listings and annual fees paid by listed companies is a major source of revenue for the TSX.
- **Conclusion:** While the TSX still plays a central role in financing of listed companies and trading, that role has diminished in recent years and is likely to continue to diminish in future.

7. Conflicts of Interest in TSX Listings Regulation

- **Investor Protection and Effective Regulation** – FAIR Canada’s primary concern is whether the TSX is properly discharging its role as a regulator of listed companies and protecting the interests of investors and how a merger will impact on its regulatory role. In summary, we do not believe that the TSX is properly discharging its regulatory responsibilities and this will only be exacerbated by a merger with LSE Group.
- **Regulatory Role** – The TSX plays a significant role in the regulation of listed companies and protection of investors, a role that should be discharged in the public interest. Since the TMX demutualized and went public a decade ago, its driving motivation has been value maximization for its shareholders, not the public interest or the best interests of the Canadian capital markets.
- Since its launch in 2008, FAIR Canada has expressed concerns about the inherent conflict at the TSX between the TSX’s commercial listings business and its regulatory responsibilities, and has urged regulators and the TSX to address this conflict of interest in a way that is consistent with international standards.
- **Expert Report** – Last year FAIR Canada released an [expert report](#) entitled “**Managing Conflicts Of Interest in the TSX’s Listed Companies Regulation**”. The Report outlines how these types of conflicts have been addressed in several important developed markets, including the US (both NYSE and NASDAQ), the UK, Scandinavia, Australia, Japan and Hong Kong. Like the TSX, the exchanges reviewed are all self-listed, commercial enterprises with strong listings businesses.
- The Report found that all of the other seven major exchanges reviewed have addressed the conflicts of interest that arise between their Listings business and regulatory responsibilities by implementing one of three specific and sound approaches to conflict of interest management.
- **TSX an Outlier** – The TSX is the only exchange among this group that has not implemented specific measures to manage its conflicts of interest in regulating listed companies. The TSX carries out regulation functions as part of a unified Listings Department that is responsible for both regulation and the listings business including marketing of TSX as a venue for listing.
- **No Record of Compliance Activities** – Under its recognition order with the OSC, the TSX is required to sanction persons for breaches of its listing rules and to report violations of securities laws to the OSC. The

TSX was unable to provide any data on the use of sanctions for breaches of its rules or of reporting violations of laws to the OSC. The absence of any record of compliance activities is highly unusual for a regulator.

- **Alternatives to Address Conflicts** – Based on the mechanisms used in other markets to manage conflict of interests, the Report set out three approaches for the TSX to consider:
 - 1) Transfer Listings regulation responsibilities to another regulator, such as IIROC or the securities commissions;
 - 2) Establish an independent regulation subsidiary company with an independent board of directors; or
 - 3) Establish a separate Listings regulation department with independent management and governance.

- **Ontario Legislative Committee Report** – In March 2010, the *Ontario Legislative Assembly's Standing Committee on Government Agencies* issued a unanimous [report](#) on its review of the OSC. Among other things, the report addressed the TSX's listings regulation functions, based in part on representations from FAIR Canada in early 2009. The Committee's report states 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”.

- The Committee's report concluded as follows:

“The Committee recommends that the [Ontario Securities] 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.”

- In spite of these two reports' recommendations, neither the TMX/TSX nor the OSC have taken steps to address the TSX's management of the conflicts of interest.

- **Condition of Approval** – If the proposed merger is to proceed, FAIR Canada believes that the TSX must be required to address these issues as one condition of the authorities' approval of the merger.

8. Merger and Alpha Heighten Concerns about Conflicts

- **Alpha Competition for Listings** – The Alpha application to become an exchange and compete with the TSX for listings will also give rise to conflicts of interest and exacerbates the existing TSX conflict of interest problem. Will Alpha’s listing standards for listed companies be lower than these of the TSX? If so, will this prompt a “race to the bottom” and a lowering of investor protection?
- **LSE No longer a Regulator** – In the UK, listing requirements are set and administered by an arm of the UK FSA, the UK Listing Authority – not the LSE. Therefore the LSE faces minimal, if any, conflicts in carrying on its business. If a new Exchange Group is created through a merger, it is very unlikely that the Group would create new organizational structures within the listings function to improve management of conflicts of interest.
- **Condition of Approval** – Therefore FAIR Canada submits that the conflicts of interest in TSX’s management of its listing regulation responsibilities should be addressed as a condition of the approval of the proposed merger, if it is to proceed.
- It is imperative that any structure that the TSX adopts to manage conflicts of interest be independent of the new Group’s commercial listings operations, and be subject to the oversight and supervision of Canadian regulators – primarily the OSC.
- In light of the introduction of competition for listings from Alpha and the proposed merger, we are of the view that the best way forward may be to transfer the TSX’s regulatory functions to another regulator (such as IIROC) and to have a uniform set of listing standards so that competition for listings will not be based on reduced investor protection.

Thank you for the opportunity to provide FAIR Canada’s comments today.