

# FAIR

Canadian Foundation *for*  
Advancement *of* Investor Rights

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**RE: TMX Group Inc. and TSX Inc. – Proposed Transaction with London Stock Exchange Group PLC – Notice and Request for Comment**

**RE: BCN 2011/10 Joint ASC/BCSC Notice and Request for Comment – Application by TSX Venture Exchange Inc. to Amend the Recognition Orders of the Alberta Securities Commission and the British Columbia Securities Commission**

**RE: Notice of Public Consultation – Application Related to Proposed Transaction Between TMX Group Inc. and London Stock Exchange Group PLC**

FAIR Canada is pleased to offer a submission to the Ontario Securities Commission (“OSC”), Alberta Securities Commission (“ASC”), British Columbia Securities Commission (“BCSC”), and the Autorité des marchés financiers (“AMF”) (collectively the “Requesting Regulators”) jointly in response to three related requests for comment in respect of the TMX Group Inc. (“TMX Group”) and London Stock Exchange Group plc (“LSEG”) proposed transaction (the “Proposed Transaction”).

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](http://www.faircanada.ca) for more information.

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### **FAIR Canada Comments and Recommendations – Executive Summary:**

1. If the Requesting Regulators determine that it is 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 conflicts of interest arising from the TSX’s listings regulation responsibilities and its listings business operations.
2. FAIR Canada does not see any clear benefits to the Canadian capital markets arising out of the Proposed Transaction between TMX Group and LSEG. FAIR Canada does not believe that the Proposed Transaction is clearly in the public interest.
3. FAIR Canada is concerned that Canadian directors would form a minority of the members of the board of directors of the post-transaction holding company. After four years the number of Canadian directors could be reduced to as few as three of fifteen. The primary duty of all directors would be to the UK-domiciled holding company.

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### **1. Governance - Conflicts of Interest in TSX Listings Regulation**

- 1.1. The Requesting Regulators must consider the applications with reference to their respective criteria for recognition. Under the OSC’s recognition criteria, the evaluation of that application must consider 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...”<sup>1</sup>
- 1.2. FAIR Canada’s primary concern relates to how the TSX and TSX Venture Exchange (“TSX-V”) are discharging their roles as a regulators of listed companies and how the Proposed Transaction would impact their regulatory roles. Currently, the TSX carries out the regulatory function of listings regulation while 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 the

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<sup>1</sup> (2011) 34 OSCB 5722.

TMX 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"<sup>2</sup> (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 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. As cited in the Ontario Legislature's Select Committee's Final Report<sup>3</sup>, "...the main benefit of mergers is the economies of scale that result from combining technology investment and listings revenue". Clearly focus will be placed on the listings business function following any merger. The existing conflicts of interest will only be exacerbated by a merger with (or takeover by) LSEG due to additional business pressures resulting from the merger.
- 1.5. Since the TMX demutualized and went public a decade ago, its primary motivation has been value maximization for its shareholders, not the public interest or the best interest of the Canadian capital markets. Major exchanges 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.<sup>4</sup>
- 1.6. In its March 2010 report on the Ontario Securities Commission<sup>5</sup>, 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."<sup>6</sup> **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."**<sup>7</sup>
- 1.7. 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

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<sup>2</sup> 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].

<sup>3</sup> Select Committee on the Proposed Transaction of the TMX Group and the London Stock Exchange Group – Final Report, April 2011 at 4.

<sup>4</sup> Carson, *supra* note 1 at 28.

<sup>5</sup> 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](http://www.ontla.on.ca/committee-proceedings/committee-reports/files_pdf/OSC%20Report%20English.pdf)>.

<sup>6</sup> *Supra* note 2 at 35.

<sup>7</sup> *Supra* note 2 at 35.

international “best practice” standard for the management of conflicts of interest. This comment applies equally to the TSX-V.

- 1.8. 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.
- 1.9. Alternatively, we recommend one of the other policy options presented in the FAIR Canada Report to ensure adequate management of listings conflicts of interest by the TSX and TSX-V.<sup>8</sup> 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 (“FSA”), or (2) establishing a separate subsidiary with an independent board of directors as the NYSE has done.
- 1.10. Irrespective of the Proposed Transaction, 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 Proposed Transaction is to proceed, the implementation of such mechanisms must be a condition imposed before the necessary approvals are granted.

## 2. Risks to Canada’s National Interest

- 2.1. FAIR Canada does not see any clear benefits to the Canadian capital markets arising from the Proposed Transaction between TMX Group and LSEG. FAIR Canada recognizes benefits to current TMX shareholders, but does not foresee real benefits for listed issuers or investors resulting from the Proposed Transaction.

### Mergco Governance

- 2.2. Under the terms of the Proposed Transaction, most directors and executives of the new exchange group company will be less knowledgeable about, and more remote from, the needs of Canadian investors and the needs of Canadian issuers and securities dealers.
- 2.3. The undertakings proposed provide that Canadian directors would form a minority of the members of the board of directors of the post-transaction LSEG (“Mergco”) (seven of fifteen), meaning that LSEG would effectively control the board. This undertaking would only be effective for four years following the Proposed Transaction after which the number of Canadian directors could be reduced to as few as three. Additionally, FAIR Canada points out that it is not which country the directors come from that is important but rather that their duty as directors will be to the best interests of the corporation on whose board they serve. If the Canadian component of that corporation and the proportion of Canadian shareholders are smaller than that of the UK, then decisions can be made which are not in the best interests of the TSX or TSX-V and by extension Canada.

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<sup>8</sup> *Supra* note 2 at 52-56.

### Regulatory Oversight

- 2.4. As stated in the OSC's Notice and Request for Comment<sup>9</sup>, "[r]egulatory oversight is critical to maintain confidence in the operations of an exchange and to support overall market quality, including liquidity, transparency and transaction costs. This oversight is also an important tool for securities regulators to manage systemic risk."
- 2.5. While Canadian securities regulators would retain significant regulatory oversight over the TMX Group if the Proposed Transaction were approved, ultimate regulation of the overall holding company would lie with the UK's FSA. This could pose risks for investor protection in Canada, particularly given the self-regulatory nature of functions of the TMX Group, including listings regulation.
- 2.6. Additionally, if orders are issued approving the beneficial ownership by LSEG of all the common shares of TMX Group, future changes in control of TMX Group would only be subject to approval by UK authorities. Authorization by Canadian securities regulators would be unnecessary unless this was expressly mandated in a recognition order.

### Australian Precedent

- 2.7. In a media release accompanying an order prohibiting the acquisition of Australian Securities Exchange ("ASX Limited" or "ASX") by Singapore Exchange Limited ("SGX"), Australia's Deputy Prime Minister and Treasurer stated the following:

To diminish Australia's economic and regulatory sovereignty over the ASX could only be justified if there were very substantial benefits for our nation, such as greatly enhanced opportunities for Australian businesses and investors to access capital markets... [N]ot having full regulatory sovereignty over the ASX-SGX holding company would present material risks and supervisory issues impacting on the effective regulation of the ASX's operations, particularly its clearing and settlement functions. Australia's financial regulators have advised me that reforms to strengthen our regulatory framework should be a condition of any foreign ownership of the ASX to remove these risks."

- 2.8. The importance of the ASX to Australia's economic wellbeing and development is no greater than that of the TMX Group to Canada's. Material risks and supervisory issues would arise if Canadian regulators did not have full regulatory sovereignty over the holding group of any Canadian exchange. FAIR Canada submits that reforms to strengthen Canada's regulatory framework should be a precondition to any proposed transaction relating to TMX Group. The Requesting Regulators should only provide the requested orders and approvals if they believe that the Proposed Transaction is clearly in the best interest of the Canadian capital markets.

### Enforceability of Undertakings

- 2.9. There have been concerns cited regarding the enforceability of the undertakings provided by the post-transaction LSEG to the Canadian federal government. As noted in the Select Committee's Final Report<sup>10</sup>, witnesses "...observed that there appears to be no remedy when foreign investors renege on commitments they make to our governments." While we recognize that the Requesting Regulators have regulatory oversight and that the federal government could seek remedies for any contractual breaches, the practicality of these remedies is limited. In particular, revocation of an exchange's recognition order would not be a practical remedy, given the importance of the TSX,

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<sup>9</sup> (2011) 34 OSCB 5714-5763.

<sup>10</sup> *Supra* note 3.

the TSX-V and the Bourse de Montréal to the Canadian economy and markets, and ultimately to Canadian investors. Given the central role Canada's stock exchanges play in our financial system, permitting a foreign holding company to have day-to-day control of indispensable Canadian assets presents a real potential risk to the public interest.

#### Transaction Not Clearly in the Public Interest

2.10. The Requesting Regulators need to determine whether it is in the public interest to make the orders and approve the amended recognition orders requested in the notices set out above, including

- an order of the OSC approving the beneficial ownership by LSEG of all the common shares of TMX Group;
- an order of the AMF approving the beneficial ownership by LSEG of all the common shares of TMX Group;
- an amended and restated recognition order for TMX Group and TSX;
- an amended TSX-V recognition order

2.11. FAIR Canada does not believe that the TMX has provided meaningful or probative evidence that the Proposed Transaction is clearly in the public interest. However, if the Requesting Regulators determine that it is in the public interest to make the requested orders, FAIR Canada recommends that additional conditions be imposed before the requests made in applications to the Requesting Regulators are granted in order to protect Canadian investors and ensure the integrity of Canadian's capital markets.

FAIR Canada would like to participate in the OSC's public consultation related to the Proposed Merger that will take place on July 21 and 22, 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 416-572-2282/ [ermanno.pascutto@faircanada.ca](mailto:ermanno.pascutto@faircanada.ca) or Marian Passmore at 416-572-2728/ [marian.passmore@faircanada.ca](mailto:marian.passmore@faircanada.ca).

Sincerely,



Canadian Foundation for Advancement of Investor Rights