



November 7, 2011

Secretary of the Commission
Ontario Securities Commission
20 Queen Street West
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Toronto, Ontario M5H 3S8
e-mail: jstevenson@osc.gov.on.ca

Re: Maple Group Acquisition Corporation Notice and Request for Comment (“Notice”)

Dear Sirs/Mesdames:

Chi-X Canada ATS Limited (“Chi-X Canada” or “we”) welcomes the opportunity to provide comments on the Ontario Securities Commission’s (“OSC”) Maple Group Acquisition Corporation Notice and Request for Comment.

We commend the OSC on its very thorough and thoughtful analysis of the Maple Group Acquisition Corporation (“Maple”) proposed acquisition of TMX Group (“Acquisition”). Recognizing the significant changes that the Acquisition will introduce to the Canadian capital market, it is important that the necessary time is taken to consider the implications of these changes, as it will be impossible to turn back the clock once an approval has been granted.

Recognizing the broad scope of the Notice, we have focused our comments to the following areas: governance, conflicts of interest, the Alpha acquisition and CDS ownership. Our specific answers to questions asked in the Notice are provided below.

Answers to Specific Questions

Is it appropriate that eight of the Investors be entitled to nominate one director for a period of six years?

We believe that governance standards adopted by Maple should follow best practices and not deviate from current TMX Group policies and practices. Although Maple has proposed to adopt TMX Group’s governance framework including existing board and committee mandates to ensure that there is fair, meaningful and diverse representation on the Maple Board and its committees, several proposals differ from existing practice today.

It is the mandate of the TMX Governance Committee to make recommendations for candidates to be Directors on the Board. No shareholder or other stakeholder enjoys the entitlement to nominate a candidate. The nomination agreement referenced in the Maple application that will give eight Maple Investors the right to nominate one Board member not only deviates from current practice but may undermine the objective of fair, meaningful and diverse representation. It is important that the interests of all Maple Group users are represented on the Board so that advocacy for these interests is ensured. The ability of the Investors to nominate directors, introduces potential bias in the selection process. It also undermines the perception of fairness. In addition, as currently proposed, Maple would be able to influence the selection of 9 of 15 Directors, more than a majority. Also, given the six-year term of the nomination agreement, this influence will be exercised over more than one election period. Given the potential conflicts of interest and perception of conflicts outlined in the notice, we recommend at the very

least that current best practices continue. However, if a deviation is permitted, we suggest that only five of the Maple investors be given the entitlement to nominate a Board member so that the total Maple influence is less than a majority and that the term of the agreement only apply to the first election period.

Are Maple's proposed measures to mitigate potential conflicts of interest sufficient or are additional measures needed? If additional measures should be implemented, please indicate which ones and why?

Maple's proposed measures to mitigate potential conflicts of interests heavily rely on governance standards intended to ensure fair, meaningful and diverse representation on Maple's Board and committees. As noted in the question above, the nomination agreement calls into question this objective being achieved. Consequently, we support many of the additional suggestions made by OSC in the Notice to better handle both the identification of conflicts and how they are managed.

Requiring enhanced conflict of interest policies not only at the exchange level but also at the individual dealer level will encourage both interests groups to prioritize the identification of conflicts within their organization, which in turn will help build investor confidence that these conflicts are being addressed. We suggest that both exchange and dealer policies and procedures for conflicts be required and that they are posted on the exchange and dealer websites. A similar requirement has been proposed requirement for marketplaces in proposed amendments to National Instrument 21-101.

Requiring dealer-owners to provide transparency to their clients regarding the dealers routing decisions not only will assist in addressing the potential conflict of interest, but will assist clients in assessing best execution. A similar requirement is already in place today in the US where reporting of routing decisions are required a part of the best execution reporting set out in the 605 and 606 reports of Reg NMS.

Finally, we find the OSC suggestion to require Maple to create an independent subsidiary or affiliate to conduct its regulatory mandate and clearly separate the management of its public interest from its business objectives very interesting. We would encourage the OSC to call a task force to assess its value proposition.

Will the Alpha acquisition impact competition in the Canadian market or concentrate market power with respect to trading?

In order to understand the impact on competition with respect to the Alpha acquisition, we require more detail regarding how Alpha will be re-purposed by Maple after the transaction. The impact on competition from the acquisition will largely depend on whether or not Alpha will continue to operate as a marketplace or will be closed for business.

Should Maple decide to continue to operate Alpha as a trading venue, the Maple consortium will control three marketplaces in Canada and fifty percent of all lit marketplaces that trade TSX-listed securities. By operating three medallions, they would be able to implement three different pricing models and different matching allocation methodologies at each venue, making it difficult for existing marketplaces with a single medallion to compete. Whereas existing markets would be limited to targeting only one market segment, Maple would be able to target three. We have been proponents since entering Canada in 2008 that innovation from competition creates benefits for investors. Consistent with this believe, we are not concerned about Maple owning three marketplaces as long as other existing marketplaces are not restricted from also operating more than one venue.

If Maple decides to discontinue operations at Alpha we do not see a significant impact on competition in Canada. Although market forces would normally suggest that the merger of a company that controls 60% of the market with another which controls 20% would lead to unfair pricing power, we do not see this happening as there is still demand for competition in Canada. The Maple transaction includes a non-preferencing agreement by those Maple Investors who are also Alpha shareholders. Such an agreement implies that order preferencing is determined by ownership interest and not based on pricing or services. If this is the case, the only economic explanation for such decisions must be that shareholder profits are greater than the higher trading fees associated with the transaction. Why else would a rational dealer send flow to a venue not based on cost, product offering and speed?

When considering shareholder interests, the Maple transaction may actually lead to greater competition. Currently, the interest of the Alpha owners are more focused on lowering trading costs than generating profits. Because the Pension fund owners of Maple have a fiduciary duty to their pensioners, the desire to increase profits by the Consortium may outweigh the objective to lower fees. In turn, this should lead to a more vibrant competitive environment where all marketplaces will be competing for the same goal.

What are the implications of the vertical integration of TSX and CDS, the monopoly clearing agency, to the capital markets, market participants and the provision of depository, clearing and settlement services? Please explain both positive and negative implications for Canada.

Maple will become a single monopoly for clearing and settlement services in Canada and will shift CDS ownership from a horizontally integrated organization to a vertically integrated ownership model. We believe that the optimal structure for the provision of clearing and settlement services is a horizontal integrated model for both services and that competition should be fostered for clearing services, where possible. However, under certain conditions, we recognize that with the right controls in place that a vertical model may also be able to bring about similar benefits to participants.

We believe that the depository for settlement services is a national asset and should be operated for the benefit of all market participants and protected from being operated in the interests of a few. Settlement is a critical function of a well-functioning capital market and therefore should be able to be accessed by all participants and used at low cost. A single depository also minimizes risk to the settlement process and systematic risk in general.

For clearing services we believe that, where possible, competition can create efficiencies, which include lower costs and better service. This is witnessed in Europe, where many clearing agencies compete for business whereas most countries operate only one central depository.

A main issue and key risk cited by the European Commission in their review and subsequent denial of the proposed merger between the Deutsche Bourse and LSE in 2005 was that Deutsche Bourse could force all clearing done on the LSE exchange to go through a single clearing agency. Should CDS be acquired by Maple we believe it will ensure that competition for clearing services in Canada will be unlikely going forward. Because of Canada's size, and the concentration of order flow controlled by Maple's owners, CDS's largest customers will also be its owners. Given that there is not a regulatory obligation for participants to use a cheaper or more efficient clearing solution, a new entrant will be unable to compete even if a superior product is offered. Clearing fees have already decreased significantly under current CDS ownership and is generally recognized to be lower than most other marketplaces globally.

The main advantages cited in favor of vertical integration is that this model creates efficiencies, lowers costs and better adapts the technology of the exchange to the clearing system to create synergies. Although we recognize that vertical integration can bring these benefits, we question why they cannot

also be brought through a horizontally integrated model owned by its users with the right governance structure. Nonetheless, should a vertical integrated model be introduced, there are three principles that we believe are essential to protect the interests of all market participants:

- **Governance** – full representative governance of all stakeholders with reflective voting power should be required so that all interests can be taken into consideration. This principle also supports the OSC suggestion of imposing an ownership restriction on CDS that no one shareholder, or a group of shareholders acting jointly, have significant control over the entity;
- **Transparency** – all fee changes and justification for new costs need to be transparent and require regulatory approval, which should include a public notification;
- **Disclosure** – the operation of critical functions, system utilization and earnings statements need to be regularly disclosed to the regulators and to the public.

Is there a concern that the interests of unaffiliated marketplaces may not be taken into account? If so, are the mechanisms proposed by maple adequate to address the concern? If not, what other mechanisms could be put in place?

Maple's application attempts to address the interests of unaffiliated marketplaces by encouraging them to be members of the market participant advisory committees (MPACs), who in turn will advise the Clearing Boards around several topics including fee setting. However, there is no representation afforded to marketplaces on the Clearing Board of CDS. The proposed Board will consist of five directors nominated by Maple owners, five independent directors, and the CEO of CDS and CDCC. Although marketplaces are not direct users of clearing and settlement services, they act as facilitators of clearing business and play a critical function in the clearing process. In fact, it is important to note that the marketplace with the greatest market share measured by number of trades is the greatest generator of business for CDS.

Recognizing the importance of marketplaces to clearing business, we believe that an unaffiliated marketplace representative should be entitled to hold a seat on the board so that proper representation from this critical stakeholder community will exist. We suggest that the unaffiliated marketplace with the greatest market share measured by number of trades be given Board representation and that other unaffiliated marketplaces continue to be allowed to be representatives on other proposed committees including the Risk Advisory Board and various MPACs.

Having appropriate representation from this community will ensure advocacy will take place to protect marketplaces from being charged new fees for access and that proper controls are in place to protect against client information leakage. Currently marketplaces do not have to pay an access fee to send trade reports to CDS. The only fee that is required is that associated with the connectivity costs of sending an end of day file that is determined by the size of the connection which is the user's discretion. Given that marketplaces are not direct users of CDS there should be an assurance that this costing model does not change as a result of the merger. Any new fee that is placed on a marketplace that is not justified needs to be viewed as an unfair and anti-competitive abuse of monopolistic pricing power. Secondly, the cost for connectivity should reflect industry standards. The TMX recently purchased a connectivity network service provider. Should CDS under Maple direct markets to use this service provider, costing should be comparable to other providers. An example of a monopoly using its pricing power for clearing services is the Australian Securities Exchange. In addition to connectivity costs, our affiliate, Chi-X Australia Pty. Limited, was forced to pay AUD \$275,000 annually with a commitment for five years to gain access to clearing services. We strongly recommend to the Commission to put controls in place that would not permit this kind of fee to be introduced by Maple going forward.

We also highlight the concern that TMX will be able to access information regarding the trading activity on other marketplaces, including client information, because of the CDS acquisition. We would encourage the OSC to place firewalls between the clearing house and the exchange and ensure that they are being followed.

What are the implications for a for profit CDS to the capital markets, market participants and for the provision of clearing and settlement services? Please describe both positive and negative implications; in particular, any implications for the capital market developments, innovation, cost of clearing and settlement services, risk management or other areas affecting the public interest.

Moving from a cost-recovery utility to a for-profit entity will shift shareholder objectives from costs savings to profit generation. Should this new mandate be accomplished, non-Maple participants will surely be the ones to pay. Adopting this new objective may lead to an increase in the overall cost of trading, which in turn may risk Canada's competitive position internationally for equity markets. Recently we have witnessed growth in the Canadian market with the adoption of multiple markets and a robust regulatory framework for trading services. Canada has also captured a greater portion of inter-listed trading, increasing from 43% in Q1 2009 to 54% in Q4 2010 for inter-listed components of the S&P/TSX 60. We believe that one of the main drivers of this expansion is that trading costs in Canada have decreased, making it more advantageous in many instances to execute on Canadian marketplaces.

Even if no explicit fee increases are made by CDS under new ownership, participants may lose out as there may be foregone cost savings not passed onto users. Canada has witnessed a 30% YoY increase in the number of trades in recent years and seen a corresponding eighteen-fold decrease in clearing fees. Even when factoring in that average trade size has decreased over this same period from 1,000 to 300 shares, participants have enjoyed significant cost reduction for clearing services. Should these trends continue, and Maple maintains fees at current rates, what appears to be the same fee may in fact be a hidden fee increase.

Although the benefits of vertical integration are often understood to be lower costs and greater efficiency, these benefits do not always occur. Deutsche Bourse is cited as an example of success in the application, but its clearing costs are opaque, as they do not unbundle fees for trading and clearing services. Spain is an example of how vertical integration has actually led to higher fees. Where regulation does not permit competition (as cited above, the impact of the Maple transaction would effectively also restrict competition), the cost of clearing and settlement in Spain is significantly higher than the rest of Europe.

As an unaffiliated marketplace our greatest concern is the possibility for cross subsidization. Where lost trading margins are unfairly put under pressure because of a compensatory clearing subsidy not enjoyed by other marketplaces. For this reason it is imperative that fees for services are required to be unbundled and made fully transparent. We prefer a more prescriptive, even formulaic, fee setting process being taken. However, where a subjective determination of reasonability is being made on a new fee or an increase to an existing fee, we believe that regulatory approval should be required and that a public comment period be included in the approval process. Any CDS application for a fee increases should lay out the justification and rationale for the new fee with references to international comparisons, alternatives sought, and specific costs incurred. Providing an opportunity for the public to comment will enable the regulators to be more informed and leverage industry experience from non-Maple owners who can assist the Commission in making a determination. A similar process has been adopted for significant changes for marketplace operation, such as new order types, outlined in Staff Notice 23-703. However,

where there may be a need for a faster approval process for marketplace fee changes, this is not the case for CDS as no other competitors exist.

It is also important that each service in the value chain operate as a discrete market with individual and independent pricing. There should never be fee discounts offered for clearing services based on trading activity on a specific marketplace. Even if CDS offers this kind of discount for trading activity on any marketplace, the possibility exists to set volume discount thresholds at levels that can only be reached by the TSX.

With regard to what measures should be put in place to control for unfair fees, as stated earlier we would support the proposal to have MPAC and other committees meet and report to the OSC. Where this has been recommended for risk management purposes, we would also like it to apply to fee setting.

Do you believe it would be useful to require Maple to perform regular international benchmarking of its operations? In answering, please explain why you believe it would or not be useful.

Given the scope of operations that Maple will control, we are in favor of international benchmarking. As stated earlier, the only service in which competition will continue after the merger will be trading services. Consequently there will be no forces other than regulatory approval and intervention to impact changes in operations for listing, clearing and settlement. In order to ensure that operations continue to function and service levels remain high, international benchmarking is recommended to allow for international comparisons where no domestic one exists. This will enhance monitoring and in turn assist Maple in keeping pace with international standards.

Again we would like to commend the OSC on its very thorough and thoughtful analysis of the Maple's application and thank the OSC for this opportunity to respond to the Notice. We would welcome the opportunity to participate in the public hearing that was referred to in the Notice, or to discuss our submission with Staff.

Sincerely,

Chi-X Canada