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November 7, 2011

Secretary of the Commission,
Ontario Securities Commission,
20 Queen Street West,
Toronto, Ontario, M5H 3S8
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Dear Sir,

MAPLE GROUP ACQUISITION CORPORATION – Notice and Request for Comment

I write to share with the Commission my 25 plus years of experience in exchange regulation. I must however inform the Commission at the outset that I am currently engaged as a consultant by CNSX Markets Inc., which operates a recognised stock exchange that competes with TMX Group and Alpha Trading today. I have been engaged by CNSX, at least in part, because of my international experience with stock exchanges, but this letter represents my personal views and not necessarily those of CNSX.

I have been the in-house lawyer at the Stock Exchange of Hong Kong (HKEx) – at a time of tremendous reform and re-organisation. I have advised the Indian Government on the design and creation of the National Stock Exchange of India, which was created as a direct response to the particularly egregious abuses carried out by the broker-owned Bombay Stock Exchange. I have been the CEO of the Bermuda Stock Exchange and helped to de-mutualize the exchange (one of the first exchanges to do so in 1992), and I have advised the World Bank and IMF on capital market development in various countries.

Governance Issues – International Experience

Maple Group Acquisition Corporation's application to acquire TMX Group Inc. highlights the conflicts of interest that exist between a stock exchange's public interest responsibilities and its business activities. All stock exchanges, including publicly-owned and listed exchanges, face conflicts of interest, of course. However, Maple Group's potential ownership of the Toronto Stock Exchange (TSX) and the TSX Venture Exchange (TSXV), raises particularly difficult issues.

Based on the critical functions they perform, most jurisdictions regard the proper functioning of their stock exchanges as critical to the efficient operation of their capital markets. They therefore see a strong public interest in exchanges operating those markets in a way that promotes market efficiency and commands market confidence. The biggest issue facing

regulators today is how to ensure what IOSCO calls "...the maintenance of a proper balance between an exchange's public interest obligations and its commercial interests".

The Commission well knows what history has taught us, that broker-owned exchanges have not, in the main, been able to deal appropriately with that conflict of interest.

Lest we forget, I repeat again what the "Buttonwood Tree" Agreement, that formally constituted the New York Stock Exchange on 17 May 1792 (it was named after a Buttonwood tree at 68 Wall Street under which the brokers used to meet), states:

"We the subscribers, brokers for the purchase and sale of public stock do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day on for any persons what-so-ever any kind of public stock at less rate than one-quarter percent commission on the specie value of, and that we give preference to each other in our negotiations."

In other words, the brokers sought to exclude other traders and to control the prices at which stocks were bought and sold by fixing the commissions charged by the brokers for trading on behalf of a client.

Fixing the commissions is just one of the many forms of restrictive practices that broker-owned exchanges can (and have) adopted, in direct contravention of their public interest responsibilities. Other forms of restrictive practice that have been commonly carried on by broker-owned exchanges include:

- a closed system, not allowing new, innovative or remote brokers to have access (e.g., in the old days, preventing remote memberships, ie non-members who are given access to trade on the exchange. In the modern era an equivalent issue would be restricting direct access to the market to new high frequency traders);
- anti-competitive restrictions on the business practices of new traders (e.g., in the old days, restricting the number of offices a member could have and in the modern era an equivalent issue would be imposing restrictions on high frequency trading strategies);
- anti-competitive actions that prevent fair access to competing exchanges (e.g., in the old days, preventing members from joining other markets and in the modern era an equivalent issue would be online brokers providing electronic order-entry to their own exchange but not to other competing markets or charging investors more to access a rival market than they charge for access to their own market);
- Discriminatory pricing practices that favour the owner-members;
- Being slow to innovate with new products that might effect members' existing business practices;
- Introducing order types that benefit their members to the disadvantage of retail investors or other more transparent markets;
- Directing client order flow to their own exchange – even when better execution may be available on a rival market;

- Giving preferential treatment to owner-members in new listing IPO allocations (e.g., the corruption that was exposed within the Listing Committee of the HKEx after the 1987 crash); and
- shutting the exchange down periodically as a tactic to advance the business interests of its owners – like the old Bombay Stock Exchange (frequently) and the HKEx in 1987.

As the anti-competitive features of broker-owned stock exchanges became increasingly unacceptable and contrary to the public interest, governments all over the world have sought to make broker-owned stock exchanges more representative of the wider public interest. As with the NYSE, the most common approach has been to require the governing body of the exchange to include a majority of non-broker "independent" representatives. Sometimes, the government insists on appointing a number of government representatives. The above is only a brief summary of some of the issues raised by member-owned exchanges in the International context and help to remind us why the Commission must be particularly careful when approving a takeover of a public stock exchange by a Bank-controlled, private club which includes a group of Canada's largest brokers.

The Canadian Context

In addition to the international experience of broker-owned exchanges, the Commission must assess the Maple Group acquisiton in the light of the specific Canadian elements at play here.

The Maple Group comprises not just be the largest brokers in Canada, but also a group of Schedule I Banks that are widely acknowledged to operate as a classic oligopoly in Canada. In addition, the banks that are part of the Maple Group also own a significant percentage of CDS, the monopoly clearing system for debt and equities, in Canada. Together, the bank-owned brokers now control the majority of total daily order flow in Canada. Together, the bank-owned brokers are responsible for the syndication of many underwritten IPOs. The banks in the Maple Group are also the primary source of early stage loan funding for small and medium size Canadian companies that may someday seek a public listing on an exchange in Canada. Finally, the Maple Group banks own the majority of the mutual fund industry and, together with the pension fund members, they are the majority of the buy side investors in Canada.

If the Maple Group acquisition is approved, the TSX and TSXV will not just be owned and controlled by the largest brokers in Canada, they will be owned and controlled by a group that either owns or has a dominant position in the vast majority of Canada's financial services sector.

This fact alone should require the Commission to impose the highest international governance standards on Maple Group Acquisition Corporation, to ensure that it fulfils it public interest obligations and properly manages the inherent conflicts of interest that will exist. In addition though, the prior business practices of some members of the Maple Group (e.g., as demonstrated in their operation of Alpha ATS), emphasises the need for the Commission to put very serious checks and balances in place.

In particular, I suggest that the Commission should bear in mind the following prior or existing business practices of some members of the Maple Group when reviewing Maple Group Acquisition Corporations's application:

- a closed system. Some of the bank-owned brokers, as Alpha owners, have actively lobbied to restrict direct access to the Canadian market for new high frequency traders;
- anti-competitive actions that prevent fair access to competing exchanges. Several of the bank-owned discount brokerage firms still do not offer their clients electronic order-entry to CNSX, some seven years after CNSX was granted stock exchange status;
- Discriminatory pricing practices that favour the owner-members. When the Banks were the majority owners of the TSE they instituted tiered/bulk discount pricing that disproportionately benefited their brokerages. It is instructive to note that the TSX Group dropped that pricing model after it became a for-profit company with wider ownership;
- Refusing to innovate with new products that effect members' existing business practices. It is interesting to note that Maple Group Acquisition Corporation does not propose to launch a retail debt market in Canada – even though other exchanges around the world are doing so – see for example the LSE initiative here http://www.londonstockexchange.com/about-the-exchange/media-relations/press-releases/2010/londonstockexchangesnewretailbondmarketgoeslive.htm. Maybe the Maple Group is not introducing exchange trading of debt products because it will adversely effect the owners OTC dealing desk business?;
- Introducing order types that benefit their members to the disadvantage of retail investors or other markets. The IntraSpread facility on Alpha is a clear example of an order type that benefits the owners' brokerages while disadvantaging other markets in Canada;
- Directing client order flow to their own exchange – even when better execution may be available on a rival market. The so-called "Momentum" initiative, which rewarded the broker owners with greater equity in Alpha Trading based on the amount of client order flow that they could direct to Alpha ATS, looks like a recent example of this right here in Canada. Please note, that when some of the Maple Group members state that they will or will not "preference" their order flow to TMX or Alpha, they are including their clients' order flow, and they have a fiduciary duty to direct their client's orders to the market that provides best execution – whichever market that may be at that time.

Question 5: Should there be representation of non-owner users on the board of directors?

Question 6: How should independence be defined for purposes of the Maple Proposal?

Question 7: Should founding non-dealer shareholders of Maple be excluded from the definition of independent director?

Question 8: Should listed issuers be excluded from the definition of independent director?

As the Commission indicates, independence on the board is a key component in ensuring that adequate consideration is given to a stock exchange's general public interest mandate. International standards now dictate that more than 50% of the board of a stock exchange should be independent – and I believe that this is even more important in the case of a broker-owned stock exchange. The following quote from a recent World Bank report highlights this:

"Following several decades of evolution, international best practice in developed markets is for independent directors to comprise at least 50% of SRO boards, if not a majority of the directors. This practice applies to both independent SROs and exchanges that remain mutual organizations. It also applies to regulation subsidiaries established by public exchanges. If independent directors make up half or more of the directors, it is more likely that the board will reflect the interests of all stakeholders and that conflicts of interest will be managed well, because members do not control the board."

Self-Regulation in Securities Markets: Working Paper for World Bank Financial Sector Policy Group written by John Carson, August 2010.

The Commission might want to consider the example of the HKEx – where the government reacted to many examples of egregious behavior by broker-owners. Accordingly, there are several features of HKEx's constitutional arrangements which are designed to ensure that the public interest is not subordinated to HKEx's commercial interests, including:

1. half the Board (including the Chairman) is appointed by the Government;
2. HKEx has a statutory duty to give precedence to the public interest over its other interests[1]; and
3. All rule amendments, new products, fees or tariffs of HKEx are subject to vetting and approval by the Securities and Futures Commission (SFC). HKEx cannot act unilaterally in any of these areas. The SFC also has powers to give directions to the exchange and to approve key appointments. SFC oversight of HKEx includes an annual audit of the way listing regulation is performed.

I do not propose that the independent members of the board of Maple Group Acquisition Corporation should be appointed by the Federal or Provincial Governments in Canada (although the Commission may determine that is appropriate), but I do recommend that Maple Group Acquisition Corporation should have a majority of independent directors and that the Chairman should be independent.

Given the wide scope of the business interests of the members of the Maple Group in Canada, I believe the independence definition for Maple Group Acquisition Corporation should be much wider than for other market places in Canada. I believe that directors, officers or employees of

[1] Section 21 (2) (b) of the Securities and Futures Ordinance.

any of the Banks (even if they hold less than 10% of Maple Group Acquisition Corp) should not be seen as independent for this purpose. Similarly, the partners, officers and employees of the main service providers to the banks (e.g., auditors, legal counsel, etc) should be excluded. I recommend that the Commission look at the definition of "Independent" in NI 81-107 (Independent Review Committees for Investment Funds) as a suitably wide definition, since it would exclude people that have a commercial, charitable, banking, legal, accounting or consultancy relationship with any of the members of the Maple Group. In my opinion, the CEO of Maple Group Acquisition Corporation should be an ex officio member of the board but should not be counted as one of the independent directors.

Question 10: 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.

Question 11: Do you have any concerns with a shift to a more concentrated ownership of the exchange, in particular by dealer users?

Question 12: Are the concerns exacerbated by the fact that the same dealers control the majority of order flow in Canada?

Question 13: Does this shift to a more concentrated ownership of the exchange raise other market structure issues in addition to the ones already identified in this Notice?

Again, given the wide scope of the Banks' interests in Canada and the extent of the conflicts of interest that will exist, Maple Group Acquisition Corporation should be subject to a duty to give precedence to the public interest over its other interests. This obligation could be imposed in the Recognition Order of the Maple Group Acquisition Corporation. See Schedule 1 for the wording of Section 21 (2) (b) of the Securities and Futures Ordinance in Hong Kong, by way of example.

Given the prior practices detailed above and the owners' dominant position in the financial markets in Canada, I believe that the Commission should impose an obligation on the members of Maple Group that requires them not to give preference to Maple Group owned exchanges.

For example, in my opinion, it would be entirely inappropriate for brokers that are part of the Maple Group to provide electronic order-entry to their own Maple Group owned exchanges, unless and until they have granted fair access to the rival markets in Canada. Similarly, some of the bank-owned brokers charge investors higher commission rates to trade on CNSX than TSX or TSXV. It would be entirely inappropriate for those same brokers to provide lower fees for order-entry to their own Maple Group owned exchanges, unless and until they have granted fair price access to the rival markets in Canada.

Accordingly, I recommend that the Commission should impose an obligation on the Maple Group members that requires them not to give an unfair preference to Maple Group owned

exchanges. This must be closely monitored by the Commission and IIROC. So, for example, IIROC would check that those brokerage operations are providing their clients with access to rival markets in Canada that is at least equal to the access provided to their own Maple Group owned exchanges.

Questions 18-33: Clearing and Settlement

It would be virtually impossible to set-up a new securities clearing and settlement system in Canada today. The Canadian Depository for Securities Limited (CDS) operates a monopoly and will remain a monopoly in the clearing and settlement of equities and bonds, while CDCC has a monopoly in clearing derivatives.

Right now we have an "hourglass" model in Canada for equities and bonds – as does the US – under which CDS is the common clearing and settlement organization for the multiple trading markets in Canada. In my opinion, this is the best model. On the other hand, CDCC represents a "silo" model, under which one exchange owns the derivatives clearing house and no other competing exchanges have access to CDCC.

The Maple Group wants to create a "silo" model with both CDS and CDCC, which will benefit them - as owners of the monopolistic silo - but will be disastrous for the Canadian capital markets, for the following reasons:

- A clearing and settlement system owned by one exchange is never going to be supportive of new products or ideas that other markets want to launch, and will thus be less open to innovation and will stifle competition in Canada;
- A clearing and settlement system owned and fully controlled by the Canadian banks, within an exchange conglomerate, is less likely to be supportive of the junior issuer markets. Through the risk management system and margin requirements, it will gradually squeeze smaller, independent dealers out of the market and thus weaken the junior issuer markets in Canada;
- A clearing and settlement system which is a monopoly and which is operated on a "for-profit basis", but which is owned and operated by just one exchange, when there are other competing markets, will naturally raise fees to generate profits for its owners, to the disadvantage of the owners and users of the competing markets. **Please note what is currently happening in the UK, where the London Stock Exchange is seeking to buy the clearing and settlement system called LCH – as reported in the Times newspaper, in an ironic reversal of roles, the UK Banks are demanding that the costs of clearing and settlement be fixed for a significant period – to prevent LSE exploiting the monopoly position that it will acquire.**

I suggest that the Commission should revisit the development and funding of CDS back in the 1970's. Back then, CDS was founded and funded by the "four pillars" of Canada's financial system: the Banks, The Trust Companies, The Brokers and the Insurance Companies. Interestingly, the "Brokers" across Canada were represented at that time by the various stock

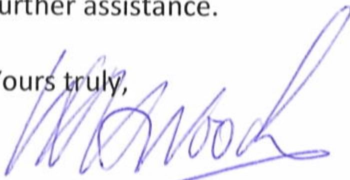
exchanges in Canada. The brokers based in the West, who were then part of the West Canada Depository Trust Company and the West Canada Clearing Corporation, paid their fair share of the development costs, but had their shares held by the regional exchanges (e.g., the Vancouver and Alberta stock exchanges), while the Eastern Broker's shares were given to the Toronto Stock Exchange (as it then was) on their behalf. TMX has consolidated up all of those regional exchanges and now holds all the brokers' CDS interests. But CDS was developed to be a utility for the benefit of ALL the users of the Canadian capital markets, not just a select group. The "dealers" interests in CDS were originally held by the IDA – and are now held by IIROC on behalf of dealers. It would be a cruel irony for the independent brokers' interests in CDS to now be acquired and merged with the Canadian banks' interests in to a monopolistic organization that is owned and controlled by their competitors – the Canadian banks and the bank-owned brokers - and run as a "for-profit" entity, for the benefit only of the owners of TMX Group.

In my experience, there is no effective way to mitigate or alleviate the anti-competitive features of a CDS monopoly that is operated as a "for-profit" business and owned by one exchange, in a silo model. I therefore urge the Commission to reject the Maple Group's proposal to consolidate CDS into TMX and to insist that CDS remains a "not-for-profit" business that is operated for the benefit of all the stakeholders in Canada's capital markets (not just the Maple Group members), which includes all of the marketplaces that use the CDS. In addition, if the Commission approves the Maple Group acquisition of TMX Group, I would urge the Commission to go further and take this opportunity to ensure that CDS is once again owned by, and represents, all of the stakeholders in Canada's capital markets (not just the Maple Group members). This requires that the independent dealers get back their interests in CDS and that rival marketplaces (like CNSX) are given ownership and/or proper representation on the Board of CDS.

Finally, if the Commission approves the Maple Group acquisition of TMX Group, the Commission should take this opportunity to ensure that CDCC is converted into an "hourglass" model under which rival markets have equal access to CDCC, in the same way that rival markets currently have access to CDS. This will ensure that all marketplaces can innovate and create new products, knowing that the common clearing platform will be available to them.

I am grateful for this opportunity to share my international experience and to comment on the Maple Group Acquisition proposal. Please do not hesitate to contact me if I can be of any further assistance.

Yours truly,



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Section 21 (2) (b) of the Securities and Futures Ordinance.

(1) It shall be the duty of a recognized exchange company to ensure-

(a) so far as reasonably practicable, an orderly, informed and fair market-

(i) in the case of a recognized exchange company which operates a stock market, in securities that are traded on that stock market or through the facilities of that company; or

(ii) in the case of a recognized exchange company which operates a futures market, in futures contracts that are traded on that futures market or through the facilities of that company; and

(b) that risks associated with its business and operations are managed prudently.

(2) In discharging its duty under subsection (1), a recognized exchange company shall-

(a) act in the interest of the public, having particular regard to the interest of the investing public; and

(b) ensure that the interest of the public prevails where it conflicts with the interest of the recognized exchange company.