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June 11, 2019

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- and -

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Re: Proposed National Instrument 25-102 *Designated Benchmarks and Benchmark Administrators and Companion Policy* (NI 25-102 and CP 25-102, respectively)

Neo Exchange Inc. (“NEO”) appreciates the opportunity to comment on proposed NI 25-102 and CP 25-102.

Benchmarks are a critical part of the Canadian capital markets and we applaud the regulators for taking the initiative to ensure there is appropriate oversight over benchmarks and those that administer them. As a new stock exchange, we have witnessed first-hand the issues that can occur when a benchmark administrator has commercial interests that conflict with the interests of investors and public companies. It leads to anti-competitive behaviour.

In addition to what is already proposed, we would like to put forward that the S&P/TSX 60 Index and S&P/TSX Composite Index (“S&P/TSX Indices”) should be regulated-data benchmarks, and that Standard & Poor's (“S&P”) and the TMX Group (“TMX”), due to their significant influence on the design, should each be designated as a benchmark administrator. Both indices have become integral to the Canadian equity markets and are frequently utilized by Canadian investors, including millions of retail investors. We estimate that \$150 – 200 billion is invested in products directly tracking these indices (e.g. ETFs, mutual funds, index-linked notes, etc.). In addition to this, asset managers (e.g. pension funds and other active managers) also use the indices as benchmarks and the entire universe of investment advisors commonly use these indices to measure performance for their retail clients. Thus, the total number of assets that utilize these indices in some way is undoubtedly in excess of the \$400 billion threshold to be considered a critical benchmark in the proposed national instrument. Furthermore, it is not only the dollar amount tracked that should lead to such designations for the S&P/TSX Indices, but also the fact that these are key Canadian indices, each viewed as a significant tracker of the performance of Canadian publicly listed securities generally.

Implementing these designations would acknowledge the central role the S&P/TSX Indices play in Canada's capital markets and allow regulators to intervene and manage S&P and TMX accordingly as benchmark administrators.

Contravening the IOSCO Principles for Financial Benchmarks

The IOSCO Principles for Financial Benchmarks¹ and related guidance were put in place to address conflicts of interest in the benchmark-setting process, as well as transparency and openness when considering issues related to transition.

Through an initial analysis of these principles, we have identified a number of conflicts with how the Canadian benchmarks are administrated:

- Principle 3 - Conflicts of Interest for Administrators: *"[addresses] the documentation, implementation and enforcement of policies and procedures for the identification, disclosure, management and avoidance of conflicts of interest, including the disclosure of any material conflicts of interest to Stakeholders and any relevant Regulatory Authority. This framework should be appropriately tailored to the level of existing or potential conflicts of interest identified by the Administrator and should seek to mitigate existing or potential conflicts of interest created by the ownership or control structure or due to other interests arising from the Administrators' staff or wider group in relation to Benchmark determinations. This Principle is intended to address the vulnerabilities that create incentives for Benchmark manipulation."*

It is self-evident that the TMX has substantial influence over the S&P/TSX Indices composition, pricing, voting on constituents, etc. This clearly supports why the TMX should be designated as a benchmark administrator, and also indicates that transparency and mitigating measures are needed to ensure these indices are not subject to inappropriate restrictions, solely to protect the TMX's listing venues.

- Principle 6 - Benchmark Design: *"The design of a Benchmark should take into account generic design factors that are intended to result in a reliable representation of the economic realities of the Interest that the Benchmark seeks to measure and to eliminate factors that might result in a distortion of the price, rate, index or value of that Benchmark. The factors presented are generic and non-exclusive illustrations"*.

The administrators of the S&P/TSX Indices, by mandating that securities have to be listed on a TMX exchange, are clearly not taking into account generic design factors (i.e. non-biased selection of securities), nor respecting the non-exclusive nature of the selection.

- Principles 13 - Transition: *"[addresses] clearly written policies and procedures that address the need for possible cessation of a Benchmark, due to market structure change, product definition changes, or any other condition, which makes the Benchmark no longer representative of its intended function. These policies and procedures should be proportionate to the estimated breadth and depth of contracts and financial instruments that reference a Benchmark and the economic and financial stability impact that might result from the cessation of the Benchmark. The Administrator should take into account the views of Stakeholders and any relevant Regulatory and National Authorities in determining what policies and procedures are appropriate for a particular Benchmark. Administrators should encourage Subscribers and Stakeholders to have robust fall-back provisions in contracts or financial instruments that reference a Benchmark."*

We are not aware of any of the provisions under this principle being addressed within the frame of the S&P/TSX Indices.

- Principles 15 - Internal Controls over Data Collection: *"[addresses] appropriate internal controls over the Administrator's data collection and transmission processes – when an Administrator collects data directly from a Regulated Market, Exchange or other data aggregator, which address the process for selecting the*

¹ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>

source, collecting the data and protecting the integrity and confidentiality of the data."

By using pricing solely based on data collected from the TMX venues, but volumes from all marketplaces, the S&P/TSX Indices are a partial representation of the interest they represent and are subject to calculation issues as experienced during the TMX outage on April 28, 2018.

Contravening the spirit of the TMX Recognition Order

Under subsections a) and b) of Section 8 - FEES, FEE MODELS AND INCENTIVES of SCHEDULE 2 - TERMS AND CONDITIONS APPLICABLE TO TMX GROUP LIMITED, TMX GROUP INC., TSX INC., ALPHA LP AND ALPHA EXCHANGE, the Recognition Order² states that:

(a) The recognized exchange shall not, through any fee schedule, any fee model or any contract, agreement or other arrangement with any marketplace participant or any other person or company, provide:

(i) any discount, rebate, allowance, price concession or other similar arrangement that is accessible only to, whether as designed or by implication, a particular marketplace participant or any other particular person or company; or

...

(b) Except with the prior approval of the Commission, the recognized exchange shall not, through any fee schedule, any fee model or any contract, agreement or other arrangement with any marketplace participant or any other person or company, provide:

(i) any discount, rebate, allowance, price concession or other similar arrangement on any services or products offered by the recognized exchange that is conditional upon the purchase of any other service or product provided by the recognized exchange or any affiliated entity; or

...

These provisions were put in place to reflect TMX Group's market power to ensure it would not use differential pricing or tied selling to preference its own venues. Preventing the S&P/TSX Indices from including securities listed on other Canadian stock exchanges is clearly not respecting the spirit of these sections of the Recognition Order. And is extremely anti-competitive.

Conclusions

The practice of restricting the constituents of these benchmarks to only those listed on the TSX needs to be urgently addressed. Instead, an objective methodology must be used. The fact that these benchmarks lack any transition policies and procedures is both contravening the IOSCO Principles for Financial Benchmarks and the spirit of the TMX Recognition Order.

Investors choosing to benchmark themselves against a particular index are doing so for a particular exposure, for which the listing exchange should be irrelevant (as is the case, for instance, with similar indices in the United States). Contrary to this principle, the TMX is leveraging its market power and ties eligibility for the S&P/TSX Indices to being listed on a TMX exchange. Therefore, no company currently included in the S&P/TSX Indices is able to list elsewhere than on the TSX without taking the risk of being removed from the S&P/TSX Indices. The result would be a massive sell-off, as the company's securities would be removed from funds and other products tracking the indices. It also becomes a major decision-making factor for any company seeking to be included in an S&P/TSX Index that will have to weigh the pros and cons of not being eligible for a benchmark index versus being listed on what may be a better exchange

² https://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20190221_224_tmx.htm

for its shareholders.

It is our understanding that under the contractual agreement between S&P and the TMX, the TMX has the discretion to approve the inclusion of companies in their indices even if they are listed elsewhere. However, this has yet to be the case and we believe that without appropriate regulatory oversight it will not happen. We also believe that any company that is even considering a listing on another stock exchange will be threatened with exclusion from the S&P/TSX Indices and the conversation will end there.

Designating S&P and TMX as benchmark administrators, and the S&P/TSX Indices as regulated-data benchmarks (or potentially even critical benchmarks) will put checks and balances in place to address some of the existing issues and to minimize the risk going forward that commercial interests are put ahead of the interests of investors and public companies.

These issues are not only of concern to competing exchanges, but have also been raised by the index user community including, as we understand it, the S&P/TSX Indices advisory committee. It appears there is a general view amongst index users that multiple Canadian national indices would not be optimal for the small Canadian securities markets and that requiring a more democratic governance model is the only way, in the foreseeable future, for exchange-agnostic benchmarks and their inherent benefits to be brought to the Canadian markets.

Although one can argue that other exchanges should just start their own “Canadian national indices” to compete with the S&P/TSX Indices, that is not realistic in today’s marketplace. The size of our market and the long-established practices makes it simply unworkable. In other words, the TMX is leveraging a de facto monopoly to enable anti-competitive behaviors similar to those defined under a number of sections of the Competition Act³.

Yours truly,

“Joacim Wiklander”

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³ Part VIII - Matters Reviewable by Tribunal - Restrictive Trades Practices under the Competition Act; in particular the notions of Exclusive Dealing, Tied Selling, Market Restriction and Abuse of Dominant Position, at <https://laws-lois.justice.gc.ca/eng/acts/c-34/page-21.html#docCont>.