



November 7, 2011

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

By e-mail to: consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

RE: Maple Group Acquisition Corporation – Notice and Request for Comment

The Investment Industry Regulatory Organization of Canada (IIROC) has formed an industry committee (the Committee) to advise the board of directors of IIROC (the Board) on the proposed acquisition by Maple Group Acquisition Corporation (Maple) of The Canadian Depository for Securities Limited (CDS Ltd.). The Committee appreciates this opportunity to respond to the Notice and Request for Comment (the Notice) issued by the Autorité des marchés financiers (the Autorité) on the proposed acquisition by Maple (the Maple Proposal) of TMX Group Inc. (TMX), Alpha Trading Systems Limited Partnership (Alpha LP), Alpha Trading Systems Inc. (and together with Alpha LP, Alpha), CDS Ltd., and indirectly, CDS Clearing and Depository Services Inc. (CDS Clearing, and together with CDS Ltd., CDS) and the application of Maple (the Application) to the Autorité for the issuance of certain orders required in connection with the Maple *Proposal*.

As a general proposition, and as you will see from our comments below, the Committee believes that CDS' current business model (i.e. "cost-recovery") has delivered efficient and cost-effective clearing and settlement services to all market participants, has served the Canadian capital markets well and has been a factor in the high degree of confidence shown by the international community in the Canadian financial system. The Committee's preference would be to maintain the *status quo* with respect to CDS' operations going forward as the Committee believes that uncontrolled monopoly powers exercised by dominant marketplace participants could undermine the fair, effective and low risk system currently in place.

About IIROC

IIROC is the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. IIROC is the current holder of 15.2% of the outstanding common shares of CDS Ltd.

About CDS

CDS, as Canada's national clearing and settlement agency and depository for equity and debt securities, plays a systemically important role in Canada's capital markets. Formed by the investment industry in 1970, CDS operates on a "cost-recovery" model under which profits are not distributed to shareholders but applied directly to lower costs for all market participants in Canada. Maple's proposed acquisition of CDS and the Canadian Derivatives Clearing Corporation (CDCC) (a wholly owned subsidiary of the TMX to be indirectly acquired as part of the Maple Proposal) would result in a "for-profit" monopoly for all clearing and settlement services in Canada.

About the Committee

The Committee was created as part of IIROC's efforts to solicit industry views on the strategic, operational and public policy considerations arising from the proposed acquisition of CDS by Maple. Further, the Committee's views with respect to the terms of Maple's offer for those shares of CDS Ltd. held by IIROC will inform the Board's consideration of such offer. The Committee is comprised of CEOs and other senior representatives of eighteen dealer member firms (investment dealers regulated by IIROC) that are not investors in or advisors to Maple or advisors in connection with the prior competing transaction between TMX and the London Stock Exchange Group plc. The Committee reflects a cross-section of large, medium and small firms with regional representation across Canada (a member list is attached).

The Canadian Securities Administrators relies on IIROC to set and enforce high quality regulatory and investment industry standards, protect investors and strengthen market integrity while maintaining efficient and competitive capital markets. An efficient and cost-effective clearing and settlement process is of significant importance to all market participants including issuers, investment dealers and investors and the Canadian capital markets generally. As such, the Committee has determined that it would be appropriate to provide a general response outlining the Committee's views on (a) the governance of CDS, (b) access to clearing and settlement services, and (c) the cost of clearing and settlement services, without reference to the specific questions set out in the Autorité's request for comments.

Below is our response. All of the capitalized terms used in this letter have the meanings given to them in the Notice unless otherwise defined.

Summary

In summary, the Committee submits that:

- its preference would be to maintain the *status quo*, as an unrestricted "for-profit" monopoly for all clearing and settlement services in Canada would not be in the interests of the Canadian capital markets;

- high barriers to entry in clearing and settlement services makes new entrants, and thus, competition, challenging if not unlikely (in contrast to alternative trading venues where barriers to entry are comparatively much lower);
- it is imperative that CDS' governance structure take into account CDS' responsibilities to a broad range of constituencies (not only to its shareholders but also to issuers, investors, investment dealers, regulators, government and other market participants);
- the access of investment dealers to CDS' clearing and settlement services needs to be assured as a "for-profit" CDS could lead to the implementation of more restrictive capital and collateral requirements that would force smaller firms to change their business models to clear trades through carrying brokers; and
- concerns in respect of CDS' future fee structure are not limited to potential future increases in price but also include the status of CDS' current rebate structure and the potential that benefits of anticipated future trading volume increases and future synergies/cost efficiencies will no longer accrue to market participants including, indirectly, individual investors.

Governance of CDS

With its systematic importance to the Canadian capital markets, CDS serves a broad range of constituencies including issuers, investment dealers, investors, regulators, government and other market participants. If Maple were to proceed to acquire TMX and CDS, it is imperative that CDS' governance structure takes into account the legitimate interests of all stakeholders (and not only the interests of Maple's shareholders) in an efficient and cost-effective clearing and settlement process.

Maple has indicated that it intends to seek full ownership of CDS and presumably, if required, squeeze-out IIROC's minority shareholding. If this were to occur, IIROC would lose its current legal right to nominate a director to the CDS board. However, we note that the Application indicates that Maple proposes a process for an industry group and self-regulatory organization representing the industry to put forward candidates, at least one of whom will be selected for the CDS board. The Committee submits that, at least one member of the CDS board should be nominated by IIROC to simplify matters and so as to ensure and preserve broader industry user representation on the CDS board going forward.

The Application proposes that the CDS board will be comprised of eleven directors: five independent directors, five directors appointed by the Maple board of directors and one management director. The Committee recommends that a majority of the directors on the CDS board should be independent of Maple and/or the Maple shareholders.

Although the Application specifies that the Finance and Audit Committee and Governance Committee will contain a certain percentage/number of independent directors, the Committee recommends that each committee of the CDS board (i.e. including the Risk

Management Committee) contain a requirement to include a specified percentage/number of independent directors. Additionally, the Committee recommends that any committee of the CDS board with a mandate to review fees and access (i.e. not just the Risk Management Committee but also the Finance and Audit Committee) should contain a requirement for independent industry/user representation to ensure that their perspective is formally considered.

Access to Clearing and Settlement Services

The Committee is concerned that a "for-profit" CDS may look to modify its risk policies to restrict the availability of its service offerings to the exclusion of certain current CDS participants. As participants in CDS, investment dealers have certain capital and collateral requirements that must be maintained. The Committee believes that a shift to more restrictive requirements, without a corresponding reduction of overall risk, may cause smaller firms that are currently self-clearing (with direct access to CDS services) to be forced to change their business models to access CDS services through a correspondent arrangement with a carrying broker. Currently, a majority of IIROC's dealer members (greater than 60%) are clearing through arrangements with carrying brokers. Further consolidation of clearing and settlement services raises significant operational and public interest concerns, such as increased systemic vulnerability to any financial adversity experienced by the carrying brokers. As such, the Committee submits that there should be an express requirement in any recognition order that CDS should be required to maintain broad direct access to its clearing and settlement services for various models of investment firms and that changes to the risk model be independently reviewed to ensure overall risk remains at an appropriate level.

Cost of Clearing and Settlement Services

The subsequent planned integration of CDS with CDCC following the acquisition of TMX and CDS by Maple would result in a "for-profit" monopoly for all clearing and settlement services in Canada, which when coupled with high barriers to entry make new entrants unlikely and could have the effect of hindering innovation.

The only details that Maple provides with respect to proposed fees is that CDS Clearing "shall equitably allocate its fees for Settlement Services", that "[t]he fees shall not have the effect of unreasonably creating barriers to access such Settlement Services and shall be balanced with the criterion that CDS Clearing has sufficient revenues to satisfy its responsibilities" and that "[t]he fees, costs or expenses borne by participants in the Settlement Services shall not reflect any cost or expense incurred by CDS Clearing in connection with an activity carried on by CDS Clearing that is not related to the Settlement Services".

The Committee understands from the Application that, in seeking to vertically integrate the TSX with CDS, Maple hopes to achieve synergies, improve overall profitability and attract a

higher stock multiple (as evidenced by other vertically integrated exchanges such as Deutsche Börse). While the Committee acknowledges that certain benefits of such vertical integration (as noted in the Application) may accrue to market participants, such as the ability to cross-margin across asset classes, the Committee believes that once integrated, Maple will have a strong incentive to extract revenues and value from CDS' operations, by raising prices to users, as the Maple Proposal is highly leveraged and servicing the resultant debt may be a priority. The Committee's concern on CDS' future fee structure relates not only to potential future increases in price, but also to the status of CDS' current rebate structure and the potential that benefits of anticipated future trading volume increases and future synergies/cost efficiencies will no longer accrue to market participants including, indirectly, individual investors.

Maple has indicated that it will commit to not having two-tiered discriminatory pricing. While the Committee would expect this to mean that CDS would continue to have one fee schedule for all of its participants, it remains concerned that Maple may set fees in a manner that advantages high volume users and would like to see an express prohibition against two-tiered pricing in any recognition order. The commitment also does not address other aspects of CDS' fee model that impact market participants. Even if CDS chooses not to raise clearing and settlement fees in the future, it could change and/or eliminate its current rebate structure. In fiscal 2010, CDS returned over \$14.2 million to its participants by way of price reductions in the amount of \$4.6 million, volume related discounts in the amount of \$2.6 million and \$7.0 million in year-end rebates¹. As such, any reductions in CDS' rebate policies would, in effect, increase the cost of clearing and settlement services and could negatively impact market participants and investors, as a whole. Between 2005 and 2011, the daily average volume of equity exchange trades processed by CDS increased by approximately 6 times but the prices for equity exchange trades decreased by approximately 18 times². Going forward, cost reductions associated with future volume increases may accrue solely to the benefit of Maple shareholders at the expense of other CDS stakeholders including, indirectly, investors. The implementation of any such policies or practices would, in essence, have the same effect as two-tiered discriminatory pricing. As such, Maple's commitment not to have two-tiered pricing provides no assurances that the cost of clearing and settlement services will not, in fact, be discriminatory towards CDS stakeholders not affiliated or associated with Maple.

Maple has suggested that the inter-listing of stocks in Canada and the United States (US) and the dealers' ability to shift the trading of such stocks to the US should the Canadian landscape no longer be cost competitive is a constraint that will address industry concerns. The Committee does not believe that this would act as an effective discipline on clearing and settlement fees. As of August 31, 2011, only 164 listed securities of Canadian-based issuers on

¹ CDS Annual Report 2010 (for the year ending October 31st, 2010).

² CSD Pricing Analysis: A comparative study of service pricing across global central securities depositories and clearing organizations released by CDS on April 20, 2011.

the TSX (of 2,144 total listings) and 12 listed securities of Canadian-based issuers on the TSX Venture Exchange (of 2,424 total listings) are inter-listed on a US marketplace. In addition, Canadian trading rules require an investment dealer to trade at the best price (regardless of clearing and settlement costs) if displayed on a protected Canadian marketplace before executing on a non-Canadian marketplace, and there are foreign currency exchange and other transaction costs associated with trading on a foreign marketplace.

It is the Committee's view that an unrestricted "for-profit" model is not in the interests of the Canadian capital markets given the monopolistic position that CDS will enjoy in Canada for clearing and settlement services. In general, the Committee believes that CDS has served the Canadian capital markets well and that preserving the strengths of the current CDS "cost-recovery" model would be the preferred approach. A recent study commissioned by CDS showed that its clearing and settlement pricing was ranked 2nd for global competitiveness (behind The Depository Trust & Clearing Corporation (DTCC) in the US which also operates on a "cost-recovery" basis)³. With respect to equity clearing and settlement (exchange markets), CDS charges US\$0.024 per trade (before discounts), compared to US\$0.01 for DTCC and US\$0.78 for European central securities depositories⁴.

While Maple has indicated that "CDS Clearing's process for setting fees for Settlement Services shall be fair, appropriate and transparent", the Committee is not satisfied that the Maple Proposal provides adequate safeguards to ensure equitable pricing for all CDS users and recommends that, in the event that the "cost-recovery" model was considered no longer feasible, restrictions be put in place with respect to CDS' clearing and settlement fees (i.e. a utility model) and that structural protections be considered, including the following:

- fees be set in a manner that limits the return on capital and/or be based on DTCC/global benchmarks for fees for such services (e.g. ranked within top quartile for price competitiveness);
- the composition of the CDS board and any committee of the CDS board with a mandate to consider fees should contain representation from industry (as further elaborated in our response above);
- a requirement for CDS to publish its proposed fee model and any amendments thereto for public comment; and
- the establishment of an independent body, similar to the oversight bodies that currently exist in other regulated industries, charged with the mandate of reviewing and approving the fees levied by CDS on users.

³ *Ibid.*

⁴ *Ibid.* For the purposes of this comparison, the costs included both sides of the transaction as well as volume discounts provided by the entity and excluded any fixed monthly fees, central counterparty (CCP) charges and communications charges.

The acquisition of CDS by Maple and the subsequent planned integration of CDS with CDCC will result in the consolidation of all clearing and settlement services in Canada. This differs from the resultant Canadian landscape for alternative trading venues where Maple's proposed acquisition of Alpha would leave some viable competition. Further, unlike alternative trading venues, where the barriers to entry are comparatively quite low, the same cannot be said for clearing and settlement services. As a result, the Committee believes that this non-competitive environment could continue indefinitely as it is doubtful that new competitors could easily gain a viable foothold in the Canadian market. To ensure that the resulting framework does not constrain even the possibility of competition, certain measures should be considered, such as enshrining the authority to determine where trades are directed for clearing and settlement services with the parties to the trade (as opposed to the trading venue) and prohibiting any restrictions on parties accessing clearing services and settlement services from different providers.

We thank you for this opportunity to provide comments regarding the proposed acquisition of CDS by Maple and its potential impact on Canadian capital markets. Please do not hesitate to contact us if you require further information.

Yours truly,

A handwritten signature in black ink, appearing to be 'David ...', with a long horizontal flourish extending to the right.

On behalf of the Committee

MEMBERS OF THE COMMITTEE

Name and Title	Firm
Brian Parker President & CEO	Acumen Capital Finance Partners Limited
Sheila Murray Executive Vice President, General Counsel and Secretary	Assante Capital Management Ltd.
Mario Frankovich President & CEO	Burgeonvest Bick Securities Limited
Peter Virvilis EVP, Treasury and Operations	Canaccord Genuity Corp.
John Hanrahan President & CEO	Citadel Securities Inc.
Jeffrey Kennedy Chief Financial Officer	Cormark Securities Inc.
Gary Reamey Managing Principal, Canada	Edward Jones
Todd Monaghan President	Global Maxfin Capital Inc.
Nicholas Thadaney Chief Executive Officer	ITG Canada Corp.
Mark Redcliffe President & CEO	Jordan Capital Markets Inc.
Yves Ruest Chief Financial Officer	Laurentian Bank Securities, Inc.
Geoff Whitlam President	Mackie Research Capital Corporation
Georges Paulez Managing Director and CEO	Mirabaud Canada Inc.
John Palumbo Chief Executive Officer	Octagon Capital Corporation
John Skain President & CEO	Penson Financial Services Canada Inc.
Christopher Potter President & CEO	Peters & Co. Limited
Jean-Paul Bachelier President & COO	PI Financial Corp.
Paul Allison Chairman & CEO	Raymond James Ltd.