

## ANNEXE A

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Subject- application (the Application) by Maple Group Acquisition Corporation  
(Maple)

### **Introduction**

Maple has filed an application for approval by the AMF of its acquisition of TMX Group Inc. and its stock exchange TSX Inc., Alpha Trading Systems Limited Partnership and Alpha Trading Systems Inc. (collectively Alpha), and of The Canadian Depository for Securities Limited and its subsidiary CDS Clearing and Depository Services Inc. (collectively CDS).

We are making this submission to ensure that the interests of small investors are protected in the transaction resulting from a change in the business model (non-profit to for-profit) and in the shareholders of CDS.

We submit:

- in response to Question 1 of the consultation document, that there are other aspects of the transaction that the AMF should consider in the public interest, including how to ensure equitable treatment of public investors, with respect to custody/safekeeping charges, commissions and other charges, following the changes in CDS.
- in response to Question 21, that there are objections to be considered in the change of business model of CDS; and
- we therefore answer NO to Question 29.

We propose that the AMF include the following conditions in its approval:

1) require the banks and their business associates in CDS, and their affiliates (including their dealers, both full service and discount), to treat small investors equitably, with respect to custody/safekeeping charges, commissions, or other charges, following the change in business model and in shareholders of CDS;

2) provide the AMF with a right of oversight and of intervention with respect to the impact of the change in business model and of shareholders of CDS on publicly-traded index products (ETFs and mutual funds) that have become essential investment products for small investors.

3) verify and ensure that the changes in the business model and shareholders of CDS will not interfere with the possible establishment of a system in Canada (similar to the US Treasury Direct in the United States) <http://www.treasurydirect.gov/> enabling small investors to buy directly (without going through a broker) Government of Canada bonds.

Subject to availability, we would propose to present our observations orally at the public hearings on the Proposed Transactions.

## **Who are we?**

The mission of **Cyber InfoInvest enr.** is to promote the creation and dissemination of objective, independent and disinterested information for the use of self-managed or do-it-yourself (DIY) investors.

Our site (in French InvestisseurAutonome.info <http://investisseurautonome.info/> and in English IndependentInvestor.info <http://independentinvestor.info/> ) (hereinafter, the Website) has thousands of subscribers who access the information on our Website and receive our free newsletters on the financial markets and on investing, all written from the perspective of the individual investor. The Website does not accept funding, advertising or other financial assistance from banks, insurance companies, securities dealers or financial advisors.

The Website has been described as:

- *one of the few educational websites that offer the unbiased, clearly written material that busy investors need* (The Globe & Mail 30 05 2008);

- a site *dedicated to providing individual investors with independent, objective, free advice and information* (The Gazette, Montreal 31 03 2008).
- The most comprehensive of all French-language sites in Quebec for the independent investor (Affaires Plus magazine, May 1, 2008);
- For more media references to our Website, see *In the media* on the English version of the Website <http://independentinvestor.info/content/blogcategory/52/85/> and *Médiathèque* on the French version. <http://investisseurautonome.info/content/blogcategory/52/85/>

Our founder and publisher, Marc J. Ryan

<http://www.linkedin.com/in/independentinvestor> worked for several years for a regulator of the securities market and for more than a quarter century for two major issuers of securities

### **Stock exchange merger**

The acquisition of TMX Group Inc. contemplates the merger of the TSX and of Alpha. This merger raises important issues under competition law. Canada already has one of the least competitive financial systems in the world ; see on our Website *Financial system*.

<http://independentinvestor.info/content/category/5/17/171/> In the Application (p. 14) Maple recognizes that the transactions envisaged will effect an even greater concentration. We share the general reaction of the author of the site PrefBlog (see <http://www.prefblog.com/?p=15469> and <http://www.prefblog.com/?p=15416> ) that *In any other country, of course, a proposal to merge the #1 exchange with the #2 wouldn't even get the time of day at the Competition Bureau*. This said, the purpose of our letter is not to comment on the issues under competition legislation.

In addition, in accordance with the *philosophy*

<http://independentinvestor.info/content/view/49/77/> of our Website, we do not recommend that DIY investors deal in options, which are speculative, short-term, high commission products. Therefore we do not comment on that part of the application involving the Montreal Exchange Inc. (MX Exchange and the Canadian Derivatives Clearing Corporation or CDCC).

### **The situation today**

CDS is owned by the major Canadian chartered banks, the Investment Industry Regulatory Organization of Canada (IIROC) and by the TSX Inc. CDS has its head office in Toronto and operates regional offices in Vancouver, Calgary and

Montreal; see the website of CDS. <http://www.cdsltd-cdsltee.ca/cdsltdhome.nsf/Pages/-EN-Ownershipandgovernance?Open>

Here's how CDS describes its mission:

The principal objective of the corporation is to contribute to the improved efficiency of the financial sector of the Canadian economy through the provision of automated facilities for clearing of securities transactions and custody of securities. CDS Annual Report 2010, p.24.

Approximately 100 organizations (see list here <http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-Participantlinks?Open> ) are CDS participants, they must meet the eligibility criteria of one of four categories of members:

- Regulated financial institutions
- Foreign Institutions
- Public bodies
- The Bank of Canada.

In addition to clearing services CDS provides custodial/safekeeping services for its participants or customers:

As Canada's national securities depository, CDS manages the safekeeping of depository-eligible domestic and international securities in both electronic and physical certificate form for its participants. CDS-eligible securities are held by CDS or transfer agents and registered in CDS's nominee name (CDS & Co). Once the electronic or physical securities are deposited with CDS, CDS enters them into a ledger and they trade electronically. More than 88,000 equity and debt security issues are eligible for deposit at CDS. See the CDS site. <http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-Custodianservices?Open>

In practice, no financial intermediary can carry on business in Canada without using, directly or indirectly, the services of CDS, including the discount and full service brokers used by retail investors. CDS calculates that its price per exchange or trade (there were on average 1.2 million trades per day in 2010) is steadily declining and in 2010 was about 2 cents before discounts; see Annual Report, p. 16.

CDS costs are initially borne by participants, and ultimately by public investors.

CDS has been recognized by the AMF as a clearing house, and exempt from the

requirement for recognition as a regulatory body; see decision 2006 - 0180 PDG of the AMF dated 11 January 2006 (Recognition) in Schedule 3 of the consultation document. Sections 16, 22 and 23 of the Recognition regulate the allocation of CDS's fees and costs (frais et coûts) and the custody of securities deposited with CDS. It is clear that these provisions do not regulate the absolute level of fees and costs nor their impact on the public, it is the impact on the CDS participants that are protected.

### **The acquisition of CDS and the change of business model**

The proposed transactions involve the acquisition of CDS. It involves not only a change of the shareholders of CDS, but also a fundamental change in the CDS business model: from the traditional cost recovery model of a self-regulatory organization to a profit-making model. The obligation of the CDS directors and officers has always been to act in the best interests of CDS and its shareholders. With the change of business model, this will now mean in practice seeking to maximize CDS shareholder value.

Schedule C of the Application proposes to modify the terms of the CDS Recognition, and includes an amended and restated section 16 on fees and costs. Nothing in the amended text changes the principle that the interests of participants are protected.

In the Application (p. 31) Maple envisages that 4 out of 11 members of the CDS board will be representatives of users of clearing services of CDS, and that the securities industry association IIAC <http://www.iiac.ca/welcome-to-iiac/about-us/> and securities dealer regulator IIROC <http://www.iiroc.ca/English/Pages/home.aspx> may both offer to the CDS board a list of potential independent candidates as nominees for election to the Board of CDS, and the nominating committee of the board will select one person of these two lists to the extent that the committee believes that the candidate is a fit and proper person.

The Application indicates that Maple intends to establish external Market Participant Advisory Committees with the participation of industry executives to advise CDS on, among other things, matters of service development. Participation on the Market Participant Advisory Committees would be open to all interested parties within the industry, including members of IIROC and IIAC. The Bank of Canada, the OSC and the Autorité would be entitled to participate in committee meetings.

## The relevant principles

Our submission is based on the following principles:

- Fraud and theft, for obvious reasons, sell newspapers. And it is no different in the fields of securities and investing. And the recent tragic events, such as the Bernie Madoff affair, may give the public and even regulators, the impression that this is where investors typically lose their hard earned money. But Canadian market participants know better. Far and away the biggest source of loss for Canadian retail investors are the excessive, routine, day-to-day costs in the system. By far the largest source of losses for Canadian investors in retail excessive fees imposed on them daily by the Canadian financial system. Excessive management fees of actively managed mutual funds are the prime example. The federal attempt to assume jurisdiction in securities was justified in part by reduced costs of investors that would result. See on our Website *Proposed Canadian Securities Act and investor protection: a failing grade.* <http://independentinvestor.info/content/view/955/236/>

-These excessive fees are due to a lack of competition in the Canadian financial system, and the absence of legislation encouraging (or requiring) government agencies to propose measures addressing the problem. See on our Website *The Financial System* <http://independentinvestor.info/content/category/5/17/171/> .

-Basically, small investors in Canada have two alternatives to minimize their costs: use discount brokers, which currently charge modest commissions, and invest in index products, particularly in exchange-traded funds, which entail low management expense ratios. In general, see *Your choices as an individual investor* on our site. <http://independentinvestor.info/content/view/352/215/>

-One of the biggest gaps in Canada is the lack of a system for the purchase by the individual investor, directly from the federal government, of Canadian government bonds. Such a system in the United States, *Treasury Direct*, <http://www.treasurydirect.gov/> is popular with American retail investors, especially for the reduction of expenses it offers. CDS would be essential for the establishment of such a regime in Canada. See on our Website *Government of Canada Bonds and Minister Flaherty.* <http://independentinvestor.info/content/view/708/236/>

-CDS provides two essential services for the financial system: clearing and custody/safekeeping of securities. CDS has a monopoly and can raise prices with little risk of new competitors. NB- Following the acquisition of TSX the

Application asserts (p. 32) that the exchange business will remain subject to intense competition. No similar statement is made with respect to CDS.

-Maple's Application (p.33) claims that changing the CDS business model will not change the CDS risk profile. What is left unsaid is fundamental: that the effect of this change is likely to be an increase in revenues and profits. A higher level of costs will ultimately have to be absorbed by the public investors who trade in the Canadian capital markets.

- The current cost recovery business model of CDS minimizes risk of run away costs to investors by putting a downward pressure on prices. This reduces the absolute amount of the problem, and reduces the problem of how to fairly allocate these costs. In addition the presence of IIROC as a shareholder of CDS reinforces this tendency to try to minimize costs, rather than to try to increase revenues and profits. See the website of CDS. <http://www.cdsltd-cdsltee.ca/cdsltdhome.nsf/Pages/-EN-Ownershipandgovernance?Open> It is our understanding that IIROC will not be a shareholder and will not have an enforceable right to appoint a representative to the board of CDS.

-The interest of public investors, not of CDS participants, should guide the AMF. Even Maple seeks to justify the transaction by the efficiencies that will result, and that will benefit everyone, including public investors. We agree with this principle. The Application (p.15) states: *We expect that efficiencies will be achieved for the benefit of shareholders, the brokerage community and public investors in two broad categories by virtue of the proposed Transactions.* But without concrete protection measures, it may never happen.

-The current Recognition of CDS by the AMF seeks to ensure an equitable allocation of the costs charged to CDS participants. This may be enough in a cost recovery model, but is totally inadequate if the goal of CDS will be to maximize profits. It is the allocation of costs on the ultimate investors that is important. Custody/safekeeping charges to the average individual investor in Canada can easily become a target of CDS, its shareholders and their affiliates. And this could lead to unfair treatment by discount and full service brokers of their clients.

### **A roadmap for the AMF**

In our view, the AMF must include terms in any approval that will protect investors against unfair treatment at the level of custody/safekeeping fees, commissions and other fees, arising from the change of business model and of the shareholders of CDS.

This raises the following questions:

- Theoretical or real risk?
- Adequacy of current criteria for self-regulatory organization recognition?
- Relying solely on the word of Maple?
- Jurisdiction of the AMF

We examine each of these questions.

### **Theoretical or real risk?**

Custody/safekeeping charges exist in North America, but seem less pervasive than in Europe.

The perception in North America of these charges is very negative for them; see *The Biggest Rip-Off Fees of All-Saying No to Custodial Fees and So-Called Safe Keeping Fees*.

[http://beginnersinvest.about.com/od/choosingabroker/qt/investing\\_fees.htm](http://beginnersinvest.about.com/od/choosingabroker/qt/investing_fees.htm)

We are not familiar with the exact level of these charges in Canada, and whether the decrease in the level of these charges per transaction described in the annual reports of CDS in recent years has benefited equally to individual investors and to institutional investors.

In Europe the custody industry has been the object at least two recent studies: in 2007, for the European Central Bank, <http://www.ecb.int/pub/pdf/scpops/ecbocp68.pdf> and in 2011 for the European Commission.

<http://www.oxera.com/cmsDocuments/Oxera%20report%20on%20trading%20and%20post-trading%20May%202011.pdf> The 2007 study (section 3.1) explains how providing safekeeping services to individual investors can benefit brokers. The 2011 study states (section 6.3.1, p. 101) that large customers have benefited more than small customers from the declines in customer safekeeping costs in Europe. The 2011 study (section 6.5.4, p.107) also indicates that: i) large customers with more assets and high trading are favored by reduced safekeeping expenses on average, and ii) a wide variety was found in the level of safekeeping fees charged to retail investors.

We found that in France these costs are pervasive and involve a level of annual custody/safekeeping fees that Canadian investors would find difficult to accept;

see on our Website *A personal finance book review- combined with a trip to France* <http://independentinvestor.info/content/view/772/236/> .

This brief review indicates to us that the AMF should retain a right of overview and a power to intervene, to ensure that retail customers are treated fairly by the banks and dealers following the changes in CDS.

### **Inadequacy of current criteria for recognition**

The criteria for recognition as a clearing house is set forth in Schedule 9 of the consultation document. Fees must be equitably allocated (Article 2), rules may not unreasonably discriminate between clearing members (Article 4) and safekeeping procedures are employed to protect the assets of participants (Article 10).

These criteria are written to ensure fair treatment of participants in CDS, not of the clients of brokers which are subsidiaries of shareholders of CDS.

### **Rely solely on the words of Maple?**

The headings of the various chapters of the Application are very revealing. The only chapter (p.27-36) relating specifically to CDS is called *Acquisition of CDS and implications for CDCC*. We had hoped to find a chapter entitled *Reorganization of CDS and implications for individual investors*, but there is none.

It is possible that at the hearing of the Application Maple states that CDS will consider the interests of public investors. If so, such a statement, including any expression of Maple, TMX Group Corporation and CDS on the level or allocation of costs following the change of the CDS business model, should be taken with a grain of salt. Broker subsidiaries of the shareholders of Maple are not a party to any commitments or statements to the AMF. They will be the conveyor belt that will ultimately determine how to modify the safekeeping and other fees payable by institutional and individual clients, to reflect the impact of the changes at CDS.

### **Jurisdiction of AMF**

Schedule 7 sets forth the criteria for recognition of a self-regulatory organization. The entity must regulate to serve the public interest in protecting investors and market integrity. It must articulate and ensure it meets a clear public interest mandate for its regulatory functions (Article 2). We believe that the public interest requirement allows the AMF to have an oversight role and a power of

intervention to ensure that individual customers are treated fairly by the Canadian dealers following the change in the CDS business.

The Application (p.43) acknowledges that all aspects of the provision of equities trading services, including fees and access, are subject to regulation by provincial securities authorities, and that mere threat of regulatory activity will continue to be a significant discipline on the activities of TMX/Alpha and a further influence to keep its equity trading fees competitive.

Commissions, custody/safekeeping and other fees charged to investors are part of the traditional mandate of the AMF. In the same way as for the merger component market, AMF approval of the CDS component should be on terms that leave the clear threat of regulatory intervention in the event CDS, its shareholders and their brokers, unfairly treat individual investors.

It is mostly the broker subsidiaries of the shareholders of Maple, who are not party to any commitments in the present process, who will determine how to modify the fees payable by institutional and individual clients, to reflect the impact of the changing CDS business model. These brokers, with their parent companies, are bound by the non-compete clause to be signed at the close of the proposed transactions, a clause which will prevent them from investing in competitors to CDS; see Application, page 43-44. It is normal that in return the authorities retain the authority to regulate the impact of the changing business model on the custody/safekeeping and other fees charged by these brokers to their clients.

## **Conclusion**

For the reasons outlined above we submit:

- in response to Question 1 of the consultation document, that there are other aspects of the transaction that the AMF should consider in the public interest, including how to ensure equitable treatment of public investors, with respect to custody/safekeeping charges, commissions and other charges, following the changes in CDS.
- in response to Question 21, that there are objections to be considered in the change of business model of CDS; and
- we therefore answer NO to Question 29.

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