Chapter 13

SROs, Marketplaces and Clearing Agencies

13.2 Marketplaces

13.2.1 Maple Group Acquisition Corporation – Notice and Request for Comment

MAPLE GROUP ACQUISITION CORPORATION

NOTICE AND REQUEST FOR COMMENT

I. INTRODUCTION

On May 15, 2011, Maple Group Acquisition Corporation (Maple), a consortium of Canadian investment dealers, pension funds and other institutional investors (collectively, the Investors[1]), announced their intention to acquire TMX Group Inc. (TMX Group), which, through its wholly-owned subsidiary, TSX Inc. (TSX), operates the Toronto Stock Exchange. Following its proposed acquisition of TMX Group, Maple also proposes to acquire Alpha Trading Systems Limited Partnership (Alpha LP) and Alpha Trading Systems Inc. (collectively, Alpha) and The Canadian Depository for Securities Limited (CDS Ltd.) and, indirectly, CDS Clearing and Depository Services Inc. (CDS Clearing and, collectively, CDS) (collectively, the Maple Proposal).

In connection with the Maple Proposal, Maple has applied (the Application) to the Commission, requesting that it issue orders to:

(i) recognize Maple as an exchange, including applying to Maple a limitation restricting beneficial ownership of more than ten percent of the voting securities of Maple without the prior approval of the Commission;

(ii) approve the beneficial ownership by Maple of all the common shares of each of TMX Group and TSX;

(iii) amend and restate the recognition order of TMX Group and TSX;

(iv) approve the Investors and Maple acting jointly or in concert as beneficial owners of voting securities of TMX Group in connection with the Subsequent Arrangement (as defined below) and the Alpha and CDS acquisitions;

(v) approve the beneficial ownership by the Investors, individually, as applicable, of more than ten percent of the voting securities of Maple for a transitional period relating to the Subsequent Arrangement; and

(vi) amend and restate the recognition order of CDS.

Maple is also seeking amendments to the exemption orders previously granted by the Commission to TSX Venture Exchange (TSXV) and the Bourse de Montréal (MX).

In order to assist the Commission in assessing the Maple Proposal, staff of the Commission (Staff or we) are publishing this notice (Notice), together with the Application, to request public comment on all aspects of the Maple Proposal and the Application. In addition, we are also requesting comment on certain key issues relating to the Application, as identified in this Notice. There are certain specific instances where we request suggestions as well as comments. We also welcome suggestions on all of the issues raised, or any other issues brought to our attention through the comment process.

The purpose of this Notice is to:

- summarize the Maple Proposal (Section II);
- discuss the types of issues that can arise from changes in ownership, consolidation and governance of market infrastructure entities and outline issues for comment specifically related to the Maple Proposal (Section III); and
- provide information on the Commission's comment process (Section IV)

[1] The Investors in Maple consist of Alberta Investment Management Corporation, Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, CIBC World Markets Inc., Desjardins Financial Corporation, Dundee Capital Markets Inc., Fonds de solidarité des travailleurs du Québec, GMP Capital Inc., The Manufacturers Life Insurance Company, National Bank Financial Inc., Ontario Teachers' Pension Plan Board, Scotia Capital Inc. and TD Securities Inc.

We have also included in Appendix A some background information on the regulation of exchanges and clearing agencies in Ontario.

The Commission will review the Maple Proposal and the Application to consider the implications for the capital markets. In determining whether it is in the public interest to make the requested orders, the Commission will consider all available information and the public comments received and will also refer to the criteria for recognition and exemption for exchanges and clearing agencies (attached at Schedules A-1 and A-2 to Appendix A of this notice, respectively). In the context of exchange and clearing agency recognition, these criteria form the basis upon which the Commission considers how to fulfil its mandate to protect investors and foster fair and efficient capital markets and confidence in those markets.

In addition, if the Commission determines that the Maple Proposal is in the public interest, the Commission may impose terms and conditions on any orders issued that are necessary to address regulatory concerns arising from the Application and to ensure that there continues to be appropriate regulatory oversight over Maple, TMX Group, TSX, CDS and Alpha going forward.

The Maple Proposal raises complex and novel issues for the capital markets. The structure that would result from the Maple Proposal exists in some other jurisdictions, and we understand that there is no determinative evidence that suggests one structure is superior to another in all contexts. Our objective is to gather information to assist us and the Commission in evaluating whether the Maple Proposal is in the public interest.

We are publishing this Notice and the Application for a 30-day comment period. Please refer to Section IV of this Notice for information on how to submit written comments. Please note that in assessing the merits of any submissions made to us by commenters, we will take into account the extent to which the submissions are supported by relevant evidence.

The Commission will also hold an in-person consultation (Policy Hearing) to give members of the public who have submitted written comments an opportunity to clarify or expand on their written submissions and respond to any questions the Commission may have. Information on the Policy Hearing is set out in Section IV of this Notice.

II. THE MAPLE PROPOSAL

Maple is proposing to create an integrated group of businesses that provide trading, clearing, settlement and depository services for a broad array of financial instruments traded in Canada. In order to achieve this, Maple proposes to take the following steps:

(a) acquire TMX Group;

(b) acquire CDS Ltd., and indirectly CDS Clearing, and integrate their operations with the Canadian Derivatives Clearing Corporation (CDCC); and

(c) acquire Alpha.

Full details of the Maple Proposal can be found in Maple's Application. The following is a high level summary of certain key aspects of the Maple Proposal.

(a) TMX Group Acquisition

TMX Group is a holding company that, through its key subsidiaries, operates cash and derivatives markets trading products in the equities, fixed income, derivatives and energy asset classes. TSX, its wholly-owned subsidiary, operates the Toronto Stock Exchange and TSXV. Additional subsidiaries include MX, which owns CDCC, and Natural Gas Exchange Inc.

TMX Group is a publicly traded company, listed on the TSX. The shares of TMX Group are subject to a share ownership restriction, pursuant to which no person or company may beneficially own or exercise control or direction over more than ten percent of the voting shares of TMX Group, without the Commission's prior approval.[2]

TMX Group and TSX are regulated by the Commission pursuant to a Commission order recognizing each as an exchange (TSX Recognition Order). The TSX Recognition Order specifies the terms and conditions that both TMX Group and TSX must comply with on an ongoing basis.

Maple has commenced a two-step integrated transaction to acquire 100% of the outstanding shares of TMX Group. The first step is a take-over bid to acquire a minimum of 70% and a maximum of 80% of the TMX Group shares for $50.00 in cash per share (Offer). The second step is a plan of arrangement that provides TMX Group shareholders (other than Maple) with Maple shares in exchange for their remaining TMX Group shares (Subsequent Arrangement). Upon completion of the Subsequent

[2] Section 21.11 of the Act imposes a share ownership restriction of five percent on the shares of TSX. The five percent restriction was increased to ten percent by Ontario Regulation 261/02, September 3, 2002. The share ownership restriction was imposed on TMX Group as a condition of the Commission's approval for TMX Group to acquire all of TSX's shares in 2002.

Arrangement, TMX Group will be a wholly-owned subsidiary of Maple. Current TMX shareholders will own between 27.8% and 41.7% of the shares of Maple, with the Investors owning the remaining shares. The final percentages depend on how many TMX Group shares are tendered as part of the Offer. Upon completion of the TMX Group acquisition, no one shareholder will own more than ten percent of the voting securities of Maple.

Of the Investors, each of CIBC World Markets Inc., National Bank Financial Inc., Scotia Capital Inc. and TD Securities Inc. have agreed to hold a certain percentage of Maple shares for a period of five years following completion of the acquisition of TMX Group. The remaining Investors will be free to dispose of their Maple shares at their discretion.

Upon completion of the acquisition, Maple will become the parent holding company for TMX Group and its exchanges and related businesses. Maple will be the continuing public company, listed on TSX, and TMX Group will cease to be a reporting issuer. Maple is proposing to be recognized by the Commission as an exchange, along with TMX Group and TSX.

Maple is proposing to adopt the TMX Group's governance framework, including existing board and committee mandates and TMX Group's present board code of conduct. The Application also provides that Maple's governance arrangements are intended to ensure fair, meaningful and diverse representation on the Maple Board and its committees including representation of independent directors and a balance among the interests of the different persons and companies using TMX Group's services and facilities. The Application indicates that the composition of the Maple Board will respect the board composition requirements imposed by the recognition orders of TMX Group, TSX, TSXV and MX on a consolidated basis (which refers to the minimum representation requirements with respect to independent directors, directors that are residents of Québec, directors with Canadian public venture capital markets expertise and directors with derivatives expertise). Maple will also commit to having at least one member of the Maple board who is from Canada's independent investment dealer community (i.e. participants who are not affiliated with Canadian Schedule I banks). The Maple Board will be replicated at each of TMX Group, TSX, TSXV and MX to ensure consistency of governance at each of these exchanges.

Maple intends to enter into a nomination agreement (Nomination Agreement) with eight of the Investors, pursuant to which each of the eight Investors (or, in each case, an affiliate thereof) will have the right to nominate one director for election to the Maple Board. The Nomination Agreements will terminate in respect of an Investor at the earlier of (i) the sixth anniversary of the completion of the acquisition of TMX Group and (ii) such time as such Investor ceases to own a specified number of Maple shares. Each nominee will be subject to the approval of the Governance Committee of the Maple Board. Further details on the Nomination Agreement are set out below in item 1(c) of Section III.

Maple is proposing that the ten percent share ownership restriction be imposed on Maple, such that no person or company could own ten percent or more of Maple voting shares without the prior approval of the Commission. The Application states that Maple and its Investors support the rationale for the share ownership restriction, that no one shareholder or group of shareholders acting jointly or in concert should exercise substantial influence over an operating exchange without prior approval of the Commission.

In connection with Maple's acquisition of TMX Group, Maple is applying for an amended and restated recognition order for TMX Group and TSX, as well as a recognition order for Maple, to reflect the acquisition. Maple proposes to adhere to substantially the same terms and conditions currently applicable to TMX Group.

(b) CDS Acquisition

CDS Ltd. is a holding company that, through its subsidiary, CDS Clearing, operates the depository and the clearing and settlement system for equities and fixed income securities in Canada. Other subsidiaries include CDS Inc., CDS Innovations Inc. and CDS Securities Management Solutions Inc. CDS Ltd. is a privately owned company. Its shareholders are six Schedule I banks, the TMX Group and the Investment Industry Regulatory Organization of Canada (IIROC).[3] CDS Ltd. and CDS Clearing are regulated by the Commission pursuant to a Commission order recognizing each as a clearing agency (CDS Recognition Order).

Contemporaneously with, or following the completion of the acquisition of TMX Group, Maple intends to acquire CDS Ltd. Each of the Investors has agreed with Maple to use its commercially reasonable efforts to pursue and effect the acquisition of CDS Ltd. and to support the transaction. Affiliates of four of the Investors, namely, CIBC World Markets Inc., National Bank Financial Inc., Scotia Capital Inc. and TD Securities Inc., currently directly or indirectly hold shares of CDS Ltd.

Subsequent to completing the acquisition, the objective is to align more closely the products and services offered by TMX Group, in particular by its indirect subsidiary CDCC, and those offered by CDS, to create an efficient trading and clearing platform for all asset classes whether exchange-traded or over-the-counter (OTC). The clearing infrastructure of CDS and CDCC is intended to be integrated, but the clearing operations of each will remain in separate legal entities, albeit with overlap in personnel, resources and board membership. In addition, the settlement and depository functions of CDS will be operated

[3] The Schedule I banks own 66.7%, TMX Group 18.1% and IIROC 15.2% of CDS Ltd.

through a separate legal entity. The separation of the legal entities is intended to isolate financial risk. The clearing, settlement and depository functions would remain open to other ATSs and exchanges operating in Canada.

Pending any integration of the infrastructure of CDS and CDCC, Maple intends to implement boards of directors at each of CDS and CDCC (the "Clearing Boards"), which will include a number of directors in common, and also a number of directors unique to each board. The Clearing Boards will be comprised of eleven directors; five independent directors, five directors appointed by the Maple Board and one director who will the chief executive officer of CDS and CDCC, respectively. It is also intended that at least four of the directors of each of the Clearing Boards will be representatives of users. For CDCC, Maple has committed that at least 25% of the directors will have derivatives experience. In addition, Maple is proposing that at least 25% of the directors be residents of Quebec.

Three board committees will be established, all chaired by independent directors, to assist the Clearing Boards to discharge their duties: the Risk Management Committee, Finance and Audit Committee and Governance Committee.

The Clearing Boards and management will establish external Market Participant Advisory Committees to continue to seek input from industry participants. It is currently anticipated that the Market Participant Advisory Committees will include a strategic development committee, a risk advisory committee and specific committees for each of the derivatives, equities and fixed income industries.

In connection with Maple's acquisition of CDS Ltd., Maple is applying for an amended and restated recognition order for CDS Ltd and CDS Clearing, to reflect a "for-profit" business model, the governance structure described in the Application, and the Market Participant Advisory Committees.

(c) Alpha Acquisition

Alpha currently operates as an alternative trading system (ATS) under National Instrument 21-101 *Marketplace Operation* (NI 21-101). Alpha facilitates the trading of equity securities listed on the TSX and TSXV through a transparent, continuous matching platform. Eight of the nine current limited partners of Alpha LP are investment dealers or entities that wholly own an investment dealer. Alpha has applied to the Commission for recognition as an exchange and its application was published for comment on April 15, 2011.[4]

Following the acquisition of TMX Group, Maple intends to acquire Alpha. The Application indicates that Maple envisions maintaining multiple trading platforms. They intend to consult with market participants prior to making any decision with respect to the best course of action for the platforms and services of Alpha and TMX Select, TMX Group's new ATS. Maple also indicates that the Maple board of directors will consider whether Alpha should withdraw or continue to pursue its application to be recognized as an exchange.

(d) Investor Agreements and Undertakings

The Application indicates that, other than in connection with facilitating the Alpha and CDS acquisitions, after completion of the acquisition of TMX Group, there will be no agreements, commitments or understandings between the Investors with respect to the voting of Maple's shares (other than the commitment by the bank-owned dealers to continue to own a percentage of Maple shares for a period of five years).

The Application, however, describes two agreements that the Investors have already entered into or have agreed to enter into. The first is a non-competition agreement (Non-Competition Agreement) that each Investor has agreed to enter into with Maple and the other Investors or their Parents. The Investors or their Parents (other than the pension fund Investors and Manulife Financial Corporation) will agree not to, and to cause their subsidiaries not to, engage in any business in Canada that competes with the business of TMX Group, CDS or Alpha, subject to certain exceptions. Further, each Investor or Parent (including the pension fund Investors and Manulife Financial Corporation) will agree not to, and to cause its subsidiaries for which it controls decision making authority not to, invest in any person engaged in establishing or operating an alternative trading system or recognized exchange in Canada, or in any person primarily engaged in the settlement and clearing of securities or derivatives trading transactions in Canada, subject to certain exceptions. The non-competition agreement will run for a term of five years from closing of the Maple Acquisition. The second agreement is a non-preferencing agreement (Non-Preferencing Agreement). In the event that the acquisition of Alpha does not occur, then CIBC World Markets Inc., Desjardins Securities Inc., National Bank Financial Inc., Scotia Capital Inc., and TD Securities Inc. (collectively, the Alpha Dealers) have agreed not to preference the trading on the facilities of Alpha, subject to complying with applicable regulatory requirements. The non-preferencing obligation of each Alpha Dealer would survive the sale by such Alpha Dealer of its shares in Maple and would continue to run in perpetuity.

[4] (2011) 34 OSCB 4555, April 15, 2011.

The Application also describes various undertakings that Maple will be making in other jurisdictions. The details of these undertakings can be found in section 7 of the Application.

III. ISSUES RAISED BY THE MAPLE PROPOSAL

The Maple Proposal raises a number of issues that the Commission will examine when considering the Application. This section highlights some key issues and raises some questions on which we wish to solicit public comment. These key issues relate to:

- exchange and clearing agency governance, particularly with respect to fair and meaningful representation of different stakeholders and the definition of independent directors;
- conflicts of interest at the exchange and clearing agency levels;
- concentrated exchange ownership, including the concentrated ownership by bank-owned dealer users and the potential resulting order flow concentration, and agreements among Investors;
- the acquisition of Alpha;
- vertical vs. horizontal model for clearing services;
- ownership structure of CDS;
- for-profit vs. cost recovery model for clearing agencies;
- fees;
- fair access;
- integration of CDS and CDCC; and
- market structure changes.

For each of these issues, we have provided some context and highlighted our observations based on research that we have conducted to date. We note that some of these issues are related, therefore some of the discussion in certain sections is also relevant to other sections. In addition to the issues and questions identified in this Notice, we also welcome comment on any other issues not discussed here, as well as suggestions to address these issues. In providing comments, Staff expressly request that commenters support their comments with available evidence.

Before discussing the specific issues, we wish to ask a question regarding Maple's requested Commission approvals.

Question 1: In the Introduction above, we outline the approvals requested by Maple. Do you believe that the Commission should consider the requested approvals all at the same time, or should the requested approvals be considered in stages?

1. Exchange Governance

Directors of a corporation owe a duty to act in the corporation's best interests. Given the key role exchanges play in the capital markets, directors of an exchange must operate the exchange in a manner that is in the public interest and cause the exchange to properly discharge its regulatory responsibilities. The Commission has recognized the important role that the board of directors plays by requiring exchanges to meet certain criteria relating to corporate governance. Currently, the recognition criteria for exchanges includes the requirement that an exchange's governance structure provide for fair and meaningful representation of different stakeholders and appropriate representation of independent directors. The precedent in Canada is currently to require a minimum of 50% independent directors. Several specific issues concerning board composition are discussed below, but we would like to solicit comments more generally.

Question 2: What is the optimal composition of Maple's board, and why?

(a) Fair and meaningful representation of different stakeholders

Exchanges have many different stakeholder interests. In the case of TMX Group these include shareholder interests. There are also several different types of users that are interested stakeholders; in particular listed issuers and market participants who trade on the exchange. There is also the broader public interest in ensuring that exchanges operate in a fair and efficient manner, given their role in the capital raising function and overall importance in the capital markets.

Fair representation of stakeholder interests on the board of an exchange may be an important tool to link board decision-making with the interests of the stakeholders affected by the exchange's operations. Fair representation of stakeholder interests on the board helps to ensure that the board, when fulfilling its fiduciary duties and its statutory duties to act in the best interest of the corporation and discharging its public interest mandate, has knowledge of and considers different interests in its decision making. As a result, the board may be better positioned to ensure that the exchange is properly managed and is operating in the public interest.

Yet there are also difficulties associated with having stakeholders represented on the boards of exchanges and the effectiveness of that representation. Nominees of institutional stakeholders may bring to the board a perspective that arises from their own institution, which may not align with the interests of the exchange.[5] This may give rise to a perception of conflict of interest. Conflicts between different stakeholder interests on the board may create difficulties with respect to effective board decision-making and supervision of management. There is also the need to ensure that the board has the requisite mix of skills needed to oversee effectively the management of an exchange.

Pursuant to the Maple Proposal, nine of the 15 directors of the board are proposed to be nominated by the Investors. This raises a concern that the board of directors may not have fair and meaningful representation of all stakeholders but will be dominated by shareholder interests and in particular a subset of shareholder interests, i.e. the Investors. Other shareholders could end up acquiring similar shareholdings to the Investors', through the public trading of Maple shares, but would not have a right to nominate a director to the Maple Board. We recognize that shareholder considerations are important, but we question whether the Maple board has an excessive focus on the shareholders' interests, and Investors' interests in particular, and we are concerned about the large number of nominees of the Investors on the board of directors, both in terms of absolute number and relative to the size of the board.

The Maple Proposal also raises a concern with respect to the representation of non-owner users on the board of directors. Fair representation of stakeholders includes representation of users of the exchange. In Maple's case, there will be dealer representation on the board, but they will all be nominees of the Investors.[6] The four bank-owned dealers that are shareholders in Maple are each entitled to nominate one director to the Maple Board. Maple has committed that at least one member of the Maple Board will be chosen from Canada's independent investment dealer community. However, it is proposed that a representative from an Investor that is a non-bank-owned dealer fill that position.[7]

Question 3: **Is fair and meaningful representation on the board of directors being achieved in the Maple Proposal or is the proportion of shareholder representation under the proposed nomination agreements too large?**

Question 4: **Is it appropriate that the shareholder representatives are nominated by only a certain subset of the shareholders, i.e. the Investors?**

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

(b) Independent directors

(i) Importance of Independent Representation

An appropriate representation of independent directors on an exchange's board is important, in our view, for various reasons. Independent directors can be objective and evaluate the performance and interests of the company without any conflicts of interest or undue influence by interested parties. This objectivity helps to provide effective oversight of management. We also believe that independent directors are an important tool to ensure that the public interest is considered in exchange governance and decision-making – although we note that all directors are responsible for operating the exchange in the public interest and in a manner that fulfills its regulatory role.

We are of the view that an exchange should have directors that are not only independent of management but also from significant shareholders who may be able to exercise control. An appropriate governance structure may assist in mitigating potential conflicts of interest between the dealer-owners, or other shareholders, and the exchange's operations. In particular, a governance structure with a board of directors independent of both management and certain ownership interests may be better positioned to supervise management, free from any incentive to see that the exchange's operations primarily benefit its owners, to the possible detriment of other stakeholders, end users, or the public interest.

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5 We recognize that a director's fiduciary duty is to act in the best interests of the corporation for which he or she is a director, however, there may still remain a perception of a conflict of interest.

6 Five directors will be representatives of dealer-owners. A sixth director will be from an independent Participating Organization, but that director is a nominee of one of the pension fund Investors.

7 We note that the non-bank owned dealer's share ownership level will only be between 0.5% and 0.7% of Maple shares.

It is also necessary to ensure that there is a sufficient number of directors that are independent of the users of the exchange, as exchanges exercise regulatory responsibilities over their users.

Having directors that are independent of the owners (as well as management) of the exchange is potentially more important when the owners of the exchange are themselves users. In such a case, additional provisions may be required to ensure that the interests of non-owner users are taken into account, as their interests may differ from the dealer owners. The separation between ownership and governance through independent representation also helps to ensure that a non-industry perspective that reflects the broader stakeholder group is considered. It is important to have representation that can speak for and represent non-industry stakeholders, investors and the public interest. We believe this is more likely to be achieved when independent representation is at least fifty percent.

(ii) Definition of "Independent"

Achieving the appropriate definition of "independence" for directors is important in light of the exchange's different stakeholders, its decision-making processes, and its regulatory responsibilities. In addition to the required independence standards that apply to directors of a public company, we have historically focused on the need for an exchange's board to have an appropriate degree of independence from the dealers who use its facilities, since the exchange has regulatory responsibilities over those dealers. However, to the extent that an exchange also exercises regulatory responsibilities over its listed issuers, it should be considered whether an appropriate definition of independence for the board of an exchange should also provide for independence from listed issuers.[8] Finally, where an exchange has one or more large shareholders, or where a group of shareholders may act jointly or in concert, the independence standards need to reflect an appropriate degree of independence from those shareholders who, together, could be in a position to exercise disproportionate influence or control over the exchange's decision-making and operations.

Despite this, there may be some challenges to the effectiveness of independent directors on a board of an exchange. If there are too many parties excluded from being "independent", it may be difficult to find individuals that are both independent and have the requisite skills or experience to participate in the decision-making of the board of the exchange in an informed way. In addition, there may be too much reliance by independent directors on management or industry directors for information to inform their decision-making. As a result, the need to ensure there is sufficient consideration of the public interest must be balanced with the need to ensure it is possible to find and appoint a sufficient number of members to the exchange's board that have the knowledge and expertise to make effective decisions.

TMX Group and TSX are currently required, pursuant to the TSX Recognition Order, to ensure that at least fifty percent of their directors are independent. For purposes of the TSX Recognition Order, a director is independent if he or she is independent within the meaning of section 1.4 of Multilateral Instrument 52-110 *Audit Committees* (NI 52-110).[9] The board of directors has also adopted standards, which may be amended with prior approval of the Commission, setting out criteria to determine whether individuals are independent. Representatives of dealer participants are not considered to be independent, on the basis that they are users of the exchange.

In the Application, Maple has stated that at least fifty percent of the directors will be "independent" within the meaning of section 1.4 of NI 52-110 and the currently existing independence standards adopted by the board of directors of TMX Group.

Staff are considering the current definition of independent director in light of the Maple Proposal, particularly the proposed ownership structure. We are considering whether, in addition to marketplace participants, the definition should exclude:

a. the founding non-dealer shareholders of Maple; and

b. issuers listed on any Maple owned exchange.

With respect to issuers, we note this is not a Maple specific concern, but rather reflects an opportunity to review which users of an exchange should be excluded from the definition of independent director.

Two specific questions relating to the definition of independence are set out below; however, we also want to obtain more general comment on the definition.

[8] This exclusion is not currently imposed on recognized exchanges in Ontario to date.

[9] Pursuant to s.1.4 of NI 52-110, a director is independent if he or she has no direct or indirect material relationship with the issuer. A "material relationship" is a relationship which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of the member's independent judgement. In addition to the general guidance on the meaning of "material relationship", section 1.4 of NI 52-110 sets out some specific material relationships.

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

a. Founding shareholders of Maple

Currently, individuals from the dealer Investors are excluded from being independent directors by virtue of their firms' being Participating Organizations of the exchange. However, the non-dealer Investors of Maple would be considered to be independent under the current definition of "independent director", as applied to the exchanges currently recognized by the Commission. The non-dealer Investors that are part of a group that have created a common vision and strategy for Maple will hold a significant percent of the shares of Maple[10], and they will, after the acquisitions of CDS and Alpha, continue to have a material interest in Maple in order to see their vision and strategy implemented. As a result, we question whether they should be considered independent.

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

b. Listed Issuers

When exchanges began to demutualize, the focus of the independent director definition was on the exclusion of directors representing dealer participants of the exchange, given that they were users of the exchange and subject to regulation by the exchange with respect to their trading activities. Representatives of listed issuers were not excluded from the definition of independent director; yet they are also users of the exchange and are also subject to regulation by the exchange, in terms of the initial and on-going listings requirements. This raises the question of whether representatives of listed issuers should be excluded from the definition of independent director, similar to dealer representatives. However, as discussed above, we recognize that excluding too many individuals from the definition of independent director can also cause difficulties in establishing an appropriate board composition.

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

(c) Duration of Nomination Agreements

Maple intends to enter into a Nomination Agreement with eight of the Investors, pursuant to which each of the eight Investors will have the right to nominate one director for election to the Maple Board. This means that the eight Investors hold eight out of the fifteen seats on the board, a majority, for the period of the Nomination Agreement. The eight Investors entering into the Nomination Agreement are: Alberta Investment Management Corporation, Caisse de depot et placement du Québec, Canada Pension Plan Investment Board, CIBC World Markets Inc., National Bank Financial Inc., Ontario Teacher's Pension Plan Board, Scotia Capital Inc. and TD Securities Inc.. The Nomination Agreements will terminate in respect of an Investor at the earlier of (i) the sixth anniversary of the completion of the acquisition of TMX Group; and (ii) such time as such Investor ceases to own a specified number of Maple shares.

In Maple's view, the directors nominated pursuant to the Nomination Agreement are representatives of participants of the exchange or organizations that are active in the capital markets industry, and therefore bring important expertise and skills to the Maple Board. Maple has also indicated that it is important to the Investors to have representation on the board of directors, in return for their significant investment in Maple.

Question 9: Is it appropriate that eight of the Investors be entitled to nominate one director each for a period of six years?

2. Conflicts of interest at the exchange level

Numerous conflicts of interest may arise in the context of an exchange's ownership and governance structure.[11] The potential conflicts associated with a specific ownership structure may impact how an exchange discharges its regulatory responsibilities. A key consideration in examining conflicts is whether an exchange's private incentives are aligned with its public interest regulatory responsibilities. We discuss two specific elements, below, that give rise to potential conflicts of interest: (a) an exchange's for-profit status and its regulatory mandate; and (b) the ownership of the exchange. In part (c), below, we discuss possible measures to address potential conflicts of interest.

[10] The non-dealer Investors will hold, collectively, up to 45% of the shares of Maple. The individual shareholdings of each non-dealer Investor will vary, with a range between approximately 3% up to potentially 8.5% each.

[11] See Lee, Ruben, *Running the World's Markets: The Governance of Financial Infrastructure*, Princeton University Press, 2011, pp.308-14 and Carson, J.W. *Conflicts of interest in self-regulation: Can demutualized exchanges successfully manage them?* World Bank Policy Research Working paper 3183 12/2003.

(a) Conflicts associated with an exchange's for-profit status and its regulatory mandate

An exchange that operates on a for-profit basis has a potential conflict of interest between its profit-making objectives and its regulatory role.[12] The exchange may focus excessive resources on profit-making areas, such as attracting listings business, as opposed to regulatory areas, such as developing and enforcing compliance with listing standards. For-profit exchanges have a direct incentive to maximize profits. They may also have an incentive to decrease regulatory requirements in order to do that.[13] For an exchange, the loss of revenue from fees may be a more immediate and tangible outcome than any lessening of reputation that may result from relaxing regulatory standards.

As demutualized exchanges tend also to be listed companies, the conflict between business and regulatory objectives may be exacerbated. As a listed company, an exchange may be under pressure from shareholders to deliver short-term financial results. Longer term regulatory objectives or programs may consequently not be a priority.

TMX Group and TSX currently operate on a for-profit basis, while also carrying out regulatory functions. In light of the potential for conflicts of interest, the Commission has imposed certain terms and conditions in the TSX Recognition Order. We also monitor for any potential conflicts of interest through our on-going oversight of TMX Group and TSX. Recently, there has been some public discussion of the issue of conflicts in the context of listings regulation, and concerns with the status quo have been raised.[14] Therefore, while the Maple Proposal does not change this particular conflict of interest, as TMX Group and TSX will continue to operate on a for-profit basis under Maple, we wish to raise this issue for public comment.

(b) Conflicts with respect to ownership

The ownership of an exchange can also give rise to various conflict of interest issues. Where an exchange is owned in part or completely by dealers that are also users of the exchange, there is a risk that the dealers will exercise a degree of control over the operations of the exchange, such that the exchange is operated primarily in the dealers' interest rather than in the public interest. This creates the potential for conflicts of interest where the dealers' interest may not be aligned with the public interest. These potential conflicts include:

- Dealer-owners may use the exchange to facilitate a trading strategy consistent with their own business objectives but detrimental to other dealers that are not owners (i.e. through the creation of new order types or new trading facilities designed to provide maximum benefit to the dealer-owner's order flow relative to other non-owner dealers).

- Dealer-owners may influence the development of trading or listing rules and policies or pressure staff of the exchange to exercise discretion in the application of trading or listing rules and policies for their own benefit.

- Dealer representatives on the exchange's board may have access to confidential information about the exchange's operations that could be used inappropriately for the benefit of the dealer.

- Dealer representatives may bring to the board a perspective that arises from their work at the dealer, which may not align with the interests of the exchange. This may give rise to a perception of conflict of interest.

- Dealer-owners may favour routing their clients' orders to their exchange, subject to best execution and order protection obligations.

Non-dealer owners of an exchange may also generate potential conflicts of interest in how a for-profit exchange is operated. Shareholders with a significant ownership interest in an exchange may have an interest in maximizing profitability of the exchange to provide for the greatest return on their investment. Depending on the extent of its investment, a shareholder could also bring pressure to bear on management of the exchange to deliver short term financial results at the potential expense of the exchange's regulatory responsibilities.

With respect to Maple, six of the Investors are investment dealers who are users of the exchange. Four of those investment dealers are each entitled to nominate one director for election to the Maple Board. Four of the non-dealer Investors are also entitled to nominate one director for election to the Maple Board. These four non-dealer owners will each own between 6.9 to 8.7% of the shares of Maple.

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12 We recognize that conflicts of interest may also arise with exchanges that operate on a non-profit basis as member-owned mutual companies. Conflicts arising from ownership are discussed in section (b). Given that TMX Group and TSX currently operate on a for-profit basis and the Maple Proposal will not change this, our focus in this section is on the for-profit status.

13 This issue was raised in a report by the Standing Committee on Government Agencies: Report on Agencies, Boards and Commissions, Ontario Securities Commission, March 2010, 2nd Session, 39th Parliament, 59 Elizabeth II. FAIR also issued a report studying this issue and making recommendations. See John W. Carson, *Managing Conflicts of Interest in TSX Listed Company Regulation*, July 23, 2010.

14 Ibid.

(c) Possible Measures to address conflicts of interest

With respect to addressing the potential for conflicts of interest, the Maple Application indicates that Maple will adopt TMX Group's present board code of conduct. Maple also submits that the possibility of perceived conflicts of interest is mitigated through the composition and mandate of Maple's board committees, in particular through the inclusion of independent directors on those committees.

As discussed above, we have concerns with the current definition of "independent" directors due to the potential conflicts of interest. We are also concerned that reliance on the board code of conduct and independent directors may not be sufficient to mitigate the potential conflicts of interest that may exist given the proposed structure. In addition to considering the appropriate definition of "independent" director, we are also considering what other measures may be necessary. We have identified a range of measures that could be considered, including the five set out below. We note that a decision to implement some of these measures may affect other recognized exchanges operating in Ontario that face similar conflicts.

(i) Enhanced conflicts of interest policies and procedures not only at the exchange level but also at the individual dealer shareholder level

This measure would require Maple to establish, maintain and ensure compliance with enhanced policies and procedures that would, among others things:

- identify and manage any conflicts of interest arising from the operation of the exchange or the services it provides, including those that may arise from the involvement of any dealer-owner or other significant shareholder in the management or oversight of the exchange operations or regulatory functions of the exchange and the services it provides; and

- require that information regarding exchange operations, regulatory functions or a participating organization or issuer that is obtained by a dealer-owner or other significant shareholder through their involvement in the management or oversight of exchange operations or regulatory functions be kept separate and confidential from the business or other operations of the dealer-owner or other significant shareholder and not be used to provide an advantage to the dealer-owner or other significant shareholder.

We are also considering whether policies and procedures dealing with confidentiality and conflicts of interest are required to be imposed on the individual dealer shareholders.

(ii) Requiring dealer-owners to provide transparency to their clients regarding the dealers' routing decisions and ownership in the exchange

As discussed above, a dealer with an ownership interest in a particular exchange may favour routing orders to that exchange, subject to any regulatory requirements. It is important to ensure that clients are aware of the potential conflict of interest and that there is transparency regarding the dealer's order routing decisions. One way to achieve transparency is through disclosure on the trade confirmations sent to clients. We will be considering whether there are other methods of transparency as well.

(iii) A regulatory oversight committee (ROC) at the board level

A ROC is a board committee responsible for overseeing the regulatory functions of the exchange. The duties of a ROC can range from overseeing conflicts of interest, hearing appeals from any regulatory decisions of exchange staff, overseeing the exchange's rule-making function, overseeing the exchange's regulatory and compliance programs, and setting a regulatory budget. The usefulness of a ROC depends in part on what activities it oversees. However, the value of a ROC also depends on whether its role is advisory in nature or whether it has decision making capabilities and to whom it reports, i.e. the board of the exchange or directly to the Commission. The composition of a ROC is also important, including whether it should be comprised entirely of directors that are independent of shareholders and users and whether it should have non-director representatives.

(iv) The establishment of a separate regulatory division or subsidiary

An option for dealing with these types of conflicts of interest is to place all regulatory functions of the exchange into a separate division or subsidiary of the exchange. This would ensure that regulatory functions are kept separate from the business functions of the exchange and are performed by different staff. With a separate division, it would be important to establish distinct reporting lines; however, a separate division would ultimately report to the same board of directors. A separate subsidiary could have a different board of directors. A direct reporting line to the Commission could be established in either case.

(v) Longer term, the outsourcing of the listings regulatory function

Equities exchanges in Canada already outsource the majority of the trading regulation function to IIROC. In theory, the exchange's listing regulatory function could be similarly outsourced to a self-regulatory organization or other entity. However, this would have to be more fully considered as a long term solution and cannot be imposed as part of our review of the Maple Application.

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.

3. Concentrated Exchange Ownership and Investor Agreements

Historically exchanges were owned and governed by their dealer users. It has only been over the last 15 to 20 years that we have seen a shift to demutualized and widely held, publicly traded, exchanges. Although Maple will continue to be publicly traded, and somewhat widely held, the Maple Proposal results in a movement back to more concentrated ownership and governance, including by dealer owners who are also users of the exchange. The dealer-owners also include four bank-owned dealers who control a majority of order flow in Canada. Pursuant to the Maple Proposal, eight of the Investors will be able to each nominate a director to the board and the four bank-owned dealers have made a commitment to hold their Maple shares for a period of 5 years. As noted above in Section II, the Investors have also entered into, or intend to enter into, two agreements: the Non-Competition and the Non-Preferencing Agreements.

Pursuant to section 21.11 of the *Securities Act* (Ontario) (Act), no person or company may beneficially own or exercise control or direction over more than ten percent of the voting shares of Toronto Stock Exchange Inc., without the Commission's prior approval.[15] Maple is seeking the Commission's approval to own 100% of the voting shares of TMX Group and TSX, and is proposing that the share ownership restriction be placed on Maple. No individual Investor will own ten percent or more of Maple's voting shares. However, combined, the Investors will own between 58% and 72% and the bank-owned dealer Investors together will own between 21.5% and 26.6%.

Staff believe there are some important questions that need to be considered with respect to these aspects.

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?

Question 14: Notwithstanding the percentage set out in section 21.11 of the Act, should the degree of ownership by each Investor be capped at the level proposed by Maple (or should it be capped at a lower level)?

Question 15: Do you have any concerns with the Non-Competition Agreement or the Non-Preferencing Agreement?

4. Alpha Acquisition

As described above, in Section II, Maple intends to acquire Alpha. In the Application, Maple indicates that it has not made any decisions regarding the operations of Alpha.

Question 16: Will the Alpha acquisition impact competition in the Canadian market or concentrate market power with respect to trading?

Question 17: More generally, what are other implications, both positive and negative, of the Alpha acquisition?

[15] Section 21.11 prescribes a five percent restriction but this has been increased to ten percent by regulation (Ont. Reg. 261/02, September 3, 2002). The restriction was also placed on TMX Group by Commission order.

5. Vertical vs. Horizontal Model for Clearing Services

Maple's vision is to create an integrated group of businesses that provides trading, clearing, settlement and depository services in Canada. It will mark a move to a vertical model for clearing services and integration of exchange and clearing agency that have not been seen in the Canadian cash market.

Vertical integration refers to the consolidation of the various functions associated with trading, clearing and settlement of a transaction under common ownership. These primary functions are comprised of a number of activities including: price discovery, trade execution, trade matching, affirmation and confirmation, reporting to a trade repository, securities position and fund netting, novation, collateral management, depository, and funds and securities delivery or settlement. In various markets these functions may be carried out by separate legal entities, or by an entity or a few entities providing multiple functions. In its simplest form, in a vertical organisation, a trade executed on a marketplace would be processed through to final settlement by affiliates of the marketplace. Often, in a vertical model, the clearing and settlement services are conducted through wholly-owned subsidiaries of a marketplace, giving the marketplace full control over these services, although the clearing and settlement services may be made available to other trading platforms or for bilateral OTC transactions.

A horizontal model of clearing, on the other hand, refers to the provision of clearing and settlement services, across different marketplaces and/or products. Horizontal organisations are typically owned by the participants or users of the services. In the case of a clearing agency, that could be the banks and dealers with obligations to settle or the marketplaces on which the trades are executed.

Both vertical and horizontal models exist in many jurisdictions and various markets. For example, the vertical model is seen in Europe, South America and Asia and the horizontal model is seen in both North America and Europe; the vertical model is also very common for futures markets. Currently in Canada, CDS operates as a horizontal organisation providing its services to all market participants and all marketplaces operating in Canada. CDS is considered a user-owned and user-governed entity, as it is largely owned by the banks and IIROC that represents the independent dealer community.

As between a vertical and a horizontal model, we understand that there is little evidence to show that one is inherently superior to the other in all environments. Benefits of vertical models may include: economies of scale (such as shared information technology facilities or enhanced opportunities for straight through processing) that could help reduce costs; easier monitoring of participants' risk exposure from improved information flow between the trade and post trade functions; easier harmonisation of rules and procedures between affiliates of the corporate group; and greater ease in introducing new products and services due to easier coordination between the marketplace and the clearing agency.

Potential risks of vertical models include: the possibility that loss/risk in one affiliate within the corporate group could negatively impact other entities within the group; the creation of a large vertically integrated organisation may give rise to a "too big to fail" mindset that may reduce the incentive to manage risks and potentially increase systemic risk; inadequate governance procedures to ensure the independence of risk management of the clearing agency from marketplace decisions, especially where the marketplace is operated on a for-profit basis; and a large vertically integrated organisation using its market power to engage in anti-competitive behaviour by, as is often argued, restricting access to clearing services by unaffiliated marketplaces and thus affecting competition among marketplaces. To the extent that different vertical marketplace/clearing agency silos remain separate from each other and do not interoperate in any form, participants' efficiency in managing their collateral obligations may be reduced and the settlement process may be delayed and made more complex due to the need to transfer collateral/assets between vertical silos.

On the other hand, the benefits of a horizontal model may include: economies of scale and scope for the clearing agency; reduced costs to markets and participants in only having to join a single clearing agency; greater benefits from netting of a larger number of transactions and a corresponding reduction in credit exposure for the clearing agency and participants; and improved transparency of participants' aggregate exposure allowing better monitoring by the clearing agency and regulators.

The risks that can arise from a horizontal model may include: increased complexity in risk management, including default procedures, if the model involves bringing together different markets with different products; the creation of a large horizontal organisation giving rise to a "too big to fail" mindset that may reduce the incentive to manage risks and potentially increase systemic risk; and if the organisation is a user-owned entity, existing user-owners setting eligibility requirements or limiting access from participants who do not operate similar businesses or deal in similar assets.

Both models can potentially benefit from economies of scale and/or scope and provide certain efficiencies to its participants and provide potential risk reduction and greater transparency either to its corporate affiliates or regulators for monitoring purposes. Both can also raise potential concerns from increases in size that may raise operational risks, from a reduced incentive to manage systemic risk properly, and from exacerbated conflicts of interest from varied objectives or goals. There is also a concern that either type of organisation as it grows in size may become a dominant entity in a particular market and may exploit its position by engaging in anti-competitive behaviour.

The Maple Proposal would transform CDS from a horizontal model of clearing to a vertical model. Maple commits that CDS will continue to maintain its open architecture and permit all market participants that satisfy applicable access criteria to become members, and permit all Canadian trading venues equal access to its clearing and settlement services. As such, even though CDS will become a vertically owned clearing agency, from a functional perspective it will continue to be horizontal in nature by providing open access to all marketplaces.

In response to the concern that interests of unaffiliated marketplaces may not be taken into account by CDS, Maple indicates that the Clearing Boards would establish (a) a Governance Committee, whose mandate would include ensuring fair and equitable resources are dedicated to development projects for competing ATSs and exchanges; and (b) various Market Participant Advisory Committees (MPACs), whose membership is open and on which unaffiliated marketplaces could participate. In addition, CDS would annually report to the Commission the recommendations made by the MPACs and whether and why any of the recommendations were rejected or only partially implemented; and the MPACs would advise the Commission whether and why they agree or disagree with CDS' report.

In their proposal, Maple noted that, other than TMX Group, none of the other marketplaces are currently represented on the CDS board of directors, and indicated that it is not proposing any changes in this regard. Staff, however, note that TMX Group currently has only two representatives on the CDS board of 15 directors, and subsequent to the Proposed Transaction TMX Group's parent company, Maple, would be able to appoint five of the 11 directors on Clearing Boards. Notwithstanding Maple's commitment regarding open architecture, staff question whether access to CDS by unaffiliated marketplaces would be an issue and whether additional measures are necessary.

Question 18: **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.**

Question 19: **Is the answer to question 18 above affected by the fact that the TSX currently has a dominant position in the market for trading systems? Please explain.**

Question 20: **Do you have any concerns with the move from a horizontal model of clearing to a vertical model of clearing? If so, please explain the issues and how they may be addressed through appropriate regulatory measures or why the concerns could not be mitigated.**

Question 21: **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?**

Question 22: **If you are of the view that unaffiliated marketplaces should be represented on Clearing Boards, what is the appropriate percentage representation? What should the nomination process be to ensure that different unaffiliated marketplaces are well represented on the Clearing Boards?**

6. Ownership Structure of CDS

In general, a clearing agency can be owned by the users of its services, by an exchange, by other private interests, by governmental entities, or by some combination of these different types of users or entities. The ownership structures currently in Canada are user-owned and non-user privately owned. CDS is currently a user-owned, user-governed clearing agency. Other clearing agencies in Canada (such as CDCC) are privately owned by an exchange.

In a user-owned entity, control rests with the users and thus, generally, the clearing agency's business and the clearing and settlement system are designed and operated to meet their needs. This would include the functionality of the system and the underlying risk model for the system. Users of clearing agencies have a vested interest in ensuring that they are adequately protected against the loss arising from default by another user especially when losses are mutualised among the surviving users. They therefore generally have a strong incentive to ensure that the risk model for the clearing and settlement system is appropriate and risks are managed properly. Users of clearing and settlement services would also look to the clearing agency to provide those services in the most efficient and cost-effective way possible, so as to keep clearing and settlement costs low.

To the extent that the owners of a clearing agency are different from the users of its services, there may be a divergence in their interests, which may result in conflicts between their objectives. The owners may seek to increase profit by setting risk standards that are less than optimal from the perspective of either the users or the regulators, but which may serve to attract more business.[16] They may choose to divert resources to other ventures instead of maintaining the core clearing agency functions. This may be especially so where the organisation does not face competition in the provision of clearing services but

[16] This is discussed below in *For-Profit vs. Cost Recovery Model for Clearing Agency - Risk management by the clearing agency*.

does in the trading sphere. There may be greater incentive to deploy more resources to business lines facing competition than to maintaining or improving the clearing services. The owners may also favour a certain group of participants (such as affiliated participants) by setting different access and on-going requirements.

Although a user owned model would not have the conflict of interest resulting from differences between the motives of the owners and the users, other potential conflicts could result. Indeed, conflicts could arise any time that the users are not a homogeneous group since the interests of the different constituencies may not be the same on certain matters. For example, different users (e.g. those who provide liquidity/credit to the system and those who do not) may have different risk appetites and, therefore, may have different views on the clearing agency's operations and its risk model; end users (e.g. investors) who require intermediated access to a clearing system, and direct participants in the clearing system, may have different views on the clearing agency's access standards and fees.

Under the Maple Proposal, CDS would change from a user-owned user-governed entity to one that could be owned ultimately by shareholders who may not be users. In addition, the composition of the CDS board would change. The CDS board currently has 15 directors: six represent banks or their affiliates, one represents independent dealers, two represent TMX Group, five are independent directors and one represents management. Directors who represent the banks and dealers would be considered user representatives. Under the Maple Proposal, the Clearing Board, which is different than the Maple Board, would be comprised of five independent directors, five directors appointed by the Maple Board and one management director.

Maple is proposing that a person be considered an independent director if the person is not an associate, partner, director, officer or employee of a shareholder of Maple (where the shareholder owns or controls more than 5% of the outstanding shares), or an officer or employee of Maple or its affiliates. This definition for an independent director is different from that under the CDS Recognition Order. Maple's proposed definition does not exclude persons connected with a participant. Maple proposes that at least two of the independent directors will not be an associate, partner, director, officer or employee of a participant. Only these two directors (18% of the total number of directors) would be considered independent if the existing definition of independent were applied.

Similar to exchanges, clearing agencies play a key role in the capital markets, and directors of a clearing agency must operate the clearing agency in a manner that is in the public interest and in a way that addresses the needs of various stakeholders. CDS' recognition order therefore includes a term and condition that the governance arrangements shall be designed to fulfill public interest requirements and promote the objectives of its shareholders and users of its services. The proposed Clearing Board will have reduced representation by users, which are arguably the most directly affected stakeholders, as well as a different mandate to maximise profit. This raises concerns about the ability of CDS to fulfill its public interest responsibility and promote the objectives of its users.

In order to address this concern, Maple proposes the following:

- it would commit that at least four of the 11 directors be representatives of users of CDS services;
- the Clearing Boards would include at least one director who would be nominated by an industry group or a self-regulatory organization to represent the industry;
- CDS would continue to utilize MPACs to obtain user input into their clearing operations; and
- CDS would annually report to the Commission the recommendations made by the MPACs and whether and why any of the recommendations were rejected or only partially implemented; the MPACs would also advise the Commission whether and why they agree or disagree with CDS' report.

Staff acknowledges that the above measures mitigate the risks caused by conflicts of interest between owners and non-owner users, and the annual reporting by CDS and the MPACs could increase CDS' accountability to consider users' points of view. Staff also note that Maple's commitment to include a minimum number of user representatives on the board is also consistent with existing requirement on CDS, which is for its governance arrangements to be designed to fulfill its public interest requirements and to promote the interests of CDS' shareholders and the users of its services. Nonetheless, we are considering whether these measures would be sufficient to address the concerns raised by reduced user representation and potential conflicts of interest between users and owners, and whether additional measures, are necessary. These measures could include:

(i) Requiring a higher percentage of user representation on the Clearing Boards; and

(ii) Imposing ownership restriction on CDS such that no one shareholder, or a group of shareholders acting jointly, have significant control over the entity.

Question 23: **What are your views on the user-owned and the non-user owned model for clearing agencies, including the pros and cons of each model?**

Question 24: **What criteria should be used to determine which model would be more appropriate for our capital markets?**

Question 25: **In your view, is one model preferable for our capital markets and why? If you believe that both models could work for Canada, please explain.**

Question 26: **Are there concerns related to the divergence of the interests of the users of CDS services and the interests of the owners of CDS and Maple? Why?**

Question 27: **Are requirements ensuring a minimum number of directors representing users on Clearing Boards effective to ensure that CDS services are appropriately designed and operated to meet the needs of users? If so, what would be the appropriate number of user representatives?**

Question 28: **Is the definition of independent director under the Maple Proposal appropriate? If not, how should an independent director be defined and why?**

Question 29: **What is the optimal composition of CDS' board and why?**

Question 30: **Are there other measures that should be considered to ensure that CDS services are appropriately designed and operated to meet the needs of market participants and the industry generally?**

7. For-Profit vs. Cost Recovery Model for Clearing Agencies

CDS currently operates as a cost recovery entity. Once it is acquired by Maple, it will be part of a for-profit corporate group and will operate on a for-profit basis. The issue of cost recovery vs. for-profit business model is closely tied to the issue of ownership (i.e. user-owned vs. non-user owned). Where a clearing agency is user-owned, it is likely to be operated as a cost recovery utility, as seen in CDS. Clearing agencies that are held by non-users are usually operated on a for-profit basis (including where a for-profit exchange acquires a clearing agency and creates a vertically integrated organisation), for example with CDCC.

We note that the business model of a clearing agency could have implications in the following areas: (a) capital markets development, (b) innovation, (c) clearing and settlement costs to users, and (d) risk management by the clearing agency. Each is discussed below.

(a) Capital market development

In a vertically integrated organisation where a marketplace, especially a dominant marketplace, acquires ownership of a monopoly clearing agency, there may be concerns that the resulting entity will attempt to exploit its dominant position through its control over the utility clearing services, and engage in anti-competitive behaviour to the detriment of competing marketplaces. For that reason there is a view that a horizontally integrated clearing agency operating on a non-profit or cost recovery basis may be beneficial to the development of financial markets in general. Such a clearing agency performs the role of a utility offering low cost clearing services. In addition, it would offer access to any marketplace on a equal basis without concerns as to the conflict of interest that may arise for a vertically integrated organisation in favouring its own trading facility. The advantage of a utility clearing agency is the creation of an environment to foster competition among marketplaces, which in turn benefits issuers and investors, and generally makes the financial markets more attractive to all market participants, domestic and foreign.

(b) Innovation

For-profit clearing agencies may have strong incentives to expand their products and services wherever there may be adequate demand and possibility for profit. Their focus on maximising returns for shareholders might make them willing to provide new and more innovative products and services, beyond core clearing and settlement services. In addition, where they operate in a competitive environment, they also have the incentive to continually invest and improve their systems and services in order to maintain their business.

However, for user-owned clearing agencies, their user-owners may prefer to maintain the existing functionality and risk tolerance of the clearing and settlement system, by not venturing into other areas (such as clearing different assets or accepting other participants with whom they do not share any common activities). The reluctance to expand may be due to concerns about increased risk from these activities that they may not fully understand or be prepared to accept. This could hinder innovation by the clearing agency. A cost-recovery model may also raise concerns about availability of resources to upgrade and maintain systems and other resources.

(b) Clearing and settlement costs to users

As noted earlier, for-profit clearing agencies are typically owned by non-users whose main objective would be to maximise profit, which may be achieved either by raising the fees for services or reducing costs. In a competitive environment, profits would likely be maximised by reducing costs because raising prices would be difficult to do. However, in a monopoly situation, it may be more expedient to raise prices to users at the expense and detriment of market participants and the markets in general.

User-owned clearing agencies, on the other hand, would likely operate in the most cost effective manner. The user-owners would have the control necessary to ensure that the clearing agency does not charge monopolistic prices. If a clearing agency is operating on a cost recovery basis, the fees for clearing services may be less than they would be in a for-profit environment even if there is competition. In addition, cost recovery clearing agencies generally provide open access to anyone who seeks access, which results in greater transactional volumes for the clearing agencies, which in turn provides greater economies of scale; both scenarios contribute to lower costs to the users. However, it can be argued that a cost recovery entity does not need to maximize profit, and so does not have the incentive to lower costs, and therefore clearing and settlement costs to users may not necessarily be lower.

(c) Risk management by the clearing agency

A key objective for a clearing agency is to manage the risks arising from the clearing and settlement activities it engages in, especially when it also provides central counterparty services. As noted above, in a user owned clearing agency, and in particular, when the risk model employed involves mutualising the risk of default among the surviving users of the service, users will bear the risk of loss not only through their ownership interest in the clearing agency but also through the loss sharing mechanism. The owners who are also users thus have strong incentives to ensure that the risk model adequately addresses the potential loss from a participant default notwithstanding the costs that the risk mitigation may entail such as, for example, the costs of higher collateral requirements.

When a clearing agency has a for-profit business model there can be concerns that the profit making goal may cause the clearing agency to compromise its risk management function resulting in a settlement system that does not adequately control risk in the clearing and settlement activities. In a for-profit model where the owners of the clearing agency are not the same as the users of the services, the incentives for risk management might be different. In this case, neither the shareholders of the clearing agency, nor its management, would want to see the entity fail due to inadequate management of risks. However, the value at risk for the shareholders may be limited to their equity investment in the clearing agency and may not include risk of loss from defaulting participants, which could be significant. Coupled with the profit maximizing goal of the shareholders, they may have higher risk tolerance than a similarly situated user-owner and this difference in risk tolerance may be reflected in the robustness of the risk management measures undertaken by the clearing agency. (It should be noted, however, that even user-owners may not have the same view of risk management as a regulator. Regulators have as one of their responsibilities the control of systemic risk. While users are concerned with the risk of a counterparty default, their focus may not extend to ensuring that the consequences from a participant default does not have a systemic effect on other participants or the capital markets in general. Thus regulators may take an even more conservative approach to risk management than a user-owner.)

Under the Maple Proposal, CDS will become a for-profit entity. Staff are concerned about the implication of this change to user costs and CDS' risk management. The issue on user costs is further examined in section 8 below. The remainder of this section focuses on the concern about the potential conflicts between profit-maximization and proper risk management.

Maple submits that conflicts can be managed, and proposes the following to address this issue:

- The Clearing Boards will establish a Governance Committee and a Risk Management Committee, both chaired by independent directors. The Governance Committee will be comprised of a majority of independent directors and will be responsible for dealing with conflicts of interest, among other things; the Risk Management Committee will be responsible for assisting the board in fulfilling its risk management responsibilities; and

- The Risk Management Committee will be advised by a MPAC that focuses on risk; and both MPAC and CDS would have an annual reporting obligation to the Commission as discussed earlier in this Notice.

Maple indicates that the risk management function of CDS will not change as a result of the Proposed Transaction; risk management decisions will continue to be made by the board with input from the industry through a MPAC.

Staff are considering whether it is necessary to impose additional measures such as the following:

(i) Requiring a higher percentage of user representation on Clearing Boards;

(ii) Requiring periodic independent assessment of the CDS risk model; and

(iii) Requiring Maple to provide additional equity to cover any liquidity shortfall in a crisis or stressed scenario to better align the interests of users and non-user shareholders.

Question 31: What are the implications of 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 capital market developments, innovation, costs of clearing and settlement services, risk management or other areas affecting the public interest.

Question 32: Are the measures proposed by Maple adequate to address the conflicts that may arise, or are there other measures or specific requirements that are needed?

Question 33: What are your views on the additional measures outlined above? Should any other measures be considered, and if so, why?

8. Fees

There is a concern that the Maple Proposal could lead to a decrease in competition among marketplaces and an increase in exchange fees (trading, listings and/or data fees). Given that CDS is a monopoly there is also a concern that with the move from a cost-recovery model to a for-profit model, and from a user-owned model to a non-user-owned model, CDS would seek to charge monopolistic prices resulting in higher clearing and settlement fees for the market.

Maple, in its Application, indicates that it intends to maintain a competitive fee structure for TSX, and that its fees will not discriminate against any particular user or category of users. Maple commits that all fees that are imposed by TSX on its participating organizations will be equitably allocated, will not have the effect of creating barriers to access and will be balanced.

With respect to clearing, settlement and depository functions, Maple commits that all fees related to these services will be equitably allocated in relation to product types and volumes, and there will be unit pricing for each of these services such that all users will pay the same price for the same service. Maple represents that these fees will not have the effect of unreasonably creating barriers to access to such services and will be balanced with the need to have sufficient resources to operate the services effectively. Maple also commits that the fees, costs and expenses borne by users of the clearing, settlement and depository services will not reflect any cost or expense incurred by CDS in connection with any activity that is not related to such services.

Maple submits that fair and equitable pricing for clearing, settlement and depository services will be achieved through a combination of the following:

- Composition of the Clearing Boards would provide assurance that any fee setting decisions will take into account both users' needs and the public interest;
- The Finance and Audit Committee of the board would be composed of all independent directors and would be responsible for advising the board on the equitableness of CDS pricing and fees;
- User input into clearing and settlement would be obtained through the use of MPACs and annual reporting to the Commission (as discussed in previous sections of this Notice); and
- Benchmarking of fees for various products and services against relevant domestic and international counterparts.

While these mechanisms can assist with fair and equitable pricing, there are challenges. For example, benchmarking is often difficult because different entities provide different products and services and they often bundle them differently, making comparisons sometimes impossible. We also note that even when benchmarking is performed diligently, an entity can justify price changes as long as their pricing is comparable to other entities, which can make benchmarking less meaningful.[17]

More generally, there is also a concern not just with the setting of fees but the allocation of costs. In a vertically integrated organisation with more diverse businesses under common ownership there will likely be greater sharing of resources such as staffing and information technology systems. The fair allocation of costs becomes increasingly more difficult since allocations

[17] CDS commissioned an independent pricing analysis and the results were published in the spring of 2011. CDS pricing was benchmarked against eight central securities depositories and clearing organizations in markets with profiles similar to Canada. Costs used for comparison included both sides of a transaction and any volume discounts provided, but did not include any fixed monthly fees, central counterparty or communication charges. The study found that overall North America (i.e. CDS and DTCC) offers the lowest fees for clearing and settlement, and CDS ranked second just behind DTCC; and in the exchange trade category, the closest entity in the comparison group had fees many times higher than CDS or DTCC. The findings of this study suggest that it would be difficult to refute any potential price increases as current prices are relatively low compared to those of other clearing agencies.

are no longer just within the marketplace services or the clearing agency services but also between trading and clearing services. Improper allocation of costs could result in unfair pricing, especially where there is competition. For example, if the exchange is not bearing a fair allocation of costs it may be able to offer trading services at a level that competing marketplaces cannot.

For marketplaces, including exchanges, we currently review fee models and fee changes but primarily for the purposes of ensuring that fees do not unreasonably condition or limit access to services, and to ensure that fees are transparent. Since CDS is currently operating on a cost-recovery basis, our current regulatory approach does not involve fee review or approval, although CDS is subject to the general requirement that it equitably allocate its fees and costs for its services, and that its fees should not have the effect of unreasonably creating barriers to access to such services and should balance the need for sufficient revenues to satisfy its responsibilities. We are considering whether increased fee regulation for exchanges and clearing agencies by the Commission is required in light of the Maple Proposal.

Possible measures that could be introduced include:

(i) requiring any increases in clearing fees to be sufficiently explained and justified;

(ii) requiring proposals to change fees or to charge new fees to include a comparison to fees charged by other marketplaces or clearing agencies, as applicable (domestically and internationally);

(iii) requiring periodic fee benchmarking by Maple of fees and services offered;

(iv) requiring unbundling of fees for all services offered by Maple, i.e. trading, clearing, settlement, depository, data, etc.;

(v) imposing a cost-plus model for the services that are considered essential for the capital markets, i.e. clearing, settlement and depository; and

(vi) requiring that Maple justify and support the allocation of costs charged to the various clearing agencies and trading platforms for services shared by multiple affiliates.

Question 34: Are the measures proposed by Maple sufficient to prevent anti-competitive or monopolistic pricing? If not, what other measures should be put in place?

Question 35: Is increased fee regulation by the Commission warranted and, if so, what specific measures should be adopted and why?

9. Fair Access

NI 21-101 and National Instrument 23-101 *Trading Rules* (together, the Marketplace Rules) include a number of provisions designed to ensure fair access by market participants to the services of an exchange. Specifically, a marketplace, including an exchange, must not unreasonably prohibit, condition, or limit access by a person or company to services offered by the marketplace and it must not impose any burden on competition that is not reasonably necessary and appropriate.[18] Marketplaces in particular are responsible for ensuring that their fees for the services they offer do not unreasonably condition or limit access to those services.[19]

Where an exchange has dealer-owners that are also users of the exchange, it may be necessary to take steps to ensure that there is fair access for all users to all services offered by the exchange, including its trading facilities and listing services. Structures and processes or requirements must be closely examined to ensure that there are no additional benefits or different standards for access or fees applicable to dealer-owners and that there is compliance with the Marketplace Rules.

In the Application, Maple states that it is not proposing any changes to the recognition order of the TSX with respect to access. TSX's current recognition order contains terms and conditions relating to access, including that TSX establish written standards for access, that TSX not unreasonably prohibit or limit access and that the exchange keep records of decisions to grant, deny or limit access. The Application states that under Maple ownership, TSX will continue to permit all properly registered dealers that are members of a recognized self-regulatory organization and that satisfy TSX's criteria, to access the trading facilities of the TSX. Maple also states that it does not propose any changes to the TSX's criteria for access, which will continue to apply consistent with current practice.

Similar concerns also arise for a clearing agency when it has users that are its owners and some that are not. There is a possibility that user-owners may attempt to implement standards, whether it is initial or on-going standards, that are

[18] NI 21-101 *Marketplace Operation*, ss. 5.1(1) and (3), as amended
[19] Companion Policy 21-101CP to NI 21-101 *Marketplace Operation*, s.7.1(5), as amended.

discriminatory to those users that are not owners. An additional concern with a vertically integrated clearing agency is that the clearing agency may not provide equal access to unaffiliated marketplaces to its clearing and settlement platform.

CDS is currently subject to terms and conditions of recognition that require it to provide reasonable access to any person or company that meets the eligibility requirements for access to its services, and that prohibit CDS from setting rules (which cover eligibility requirements) that unreasonably discriminate among participants. Maple indicates in the Application that it is not proposing any changes to CDS' recognition order. It further indicates that it is not proposing any changes to the existing eligibility requirements of CDS.

In light of the requirements currently in place under the recognition orders of TSX and CDS and NI 21-101, and Maple's commitments, we believe that there are controls in place to address fair access by participants/users to the exchange and clearing agency services, although we believe this is an area that will require monitoring, as we currently do through our on-going oversight. In order to ensure that clearing services are not offered on a different basis depending on the marketplace on which the transaction was executed, we believe it is appropriate to include a term and condition in the CDS recognition order that requires open and fair access to all marketplaces.

Question 36: Are the current fair access requirements sufficient to mitigate any fair access concerns that arise with dealer-ownership of an exchange and non-user ownership of a clearing agency? Are additional requirements required? If additional measures are required, please provide examples.

Question 37: Are there concerns with access to clearing and settlement services by unaffiliated marketplaces? If so, what measures could be put in place to address the concerns?

10. Integration of CDS and CDCC

Maple has indicated that after the acquisition of CDS, its plan is to integrate the clearing operations and the information technology platforms of CDS and CDCC. Maple noted that such integration would provide meaningful cost synergies. In addition, Maple indicates that such integration would facilitate the current initiative to develop a central counterparty clearing solution for the Canadian dollar-denominated fixed income repo market; and the integrated platform could also be used for central counterparty clearing of other products, such as OTC derivatives on fixed income and equity securities. Maple also adds that volume brought by these additional products would add scale, which would benefit industry participants through reduced costs, improved capital management and the potential for cross-margining across asset classes.

Staff acknowledges that, if successfully implemented, the increased volume could lead to greater netting and increased benefits to market participants, since netting of settlement obligations provides operational efficiencies by reducing the number of payment and delivery obligations, and thus results in a corresponding risk reduction. The lower payment obligations may then result in reduced collateral requirements and lower costs for market participants.

The application by Maple provides only a high level description of the intention to integrate the operations and information technology platforms of CDS and CDCC. Any regulatory approval of the integration would require specific details of the integration plan which would not be available until the Clearing Boards are established and a reorganization plan is developed. Accordingly, there is no approval of the integration being considered in the current application. However, the proposed integration of CDS and CDCC would bring about a significant change in the structure of the post trade industry and staff are seeking the industry's views on the impact that such integration would have on users of the clearing and settlement services and the markets in general.

We are also mindful that information technology projects can be resource intensive, and wonder what the impact of the CDS/CDCC integration would be on market participants, especially existing users of CDS and CDCC.

Question 38: What are the benefits and costs of integrating CDS and CDCC?

Question 39: Would you support the integration of CDS and CDCC and why? If so, what, in your view, would be the optimal degree of integration?

Question 40: What would the impact of integration be to market participants?

11. Market Structure Changes

As the specific issues identified above indicate, the Maple Proposal will lead to significant market structure changes that will impact our capital markets. Should the Commission be of the view that the Maple Proposal and the resulting structure are in the public interest and grant the requested approvals, the Commission will need a mechanism to continue to monitor the impact of these changes on trading, clearing and the market in general. To this end, we are considering whether to impose a requirement

on Maple to carry out regular international benchmarking of its operations to other exchange and clearing agency operations and to provide a report to the Commission. However, as indicated above, we recognize that benchmarking can be difficult because different entities provide different products and services making comparisons sometimes impossible.

Question 41: In addition to the specific issues identified above, do you have any concerns with the changes in market structure that the Maple Proposal introduces? If so, please provide examples of issues not already identified and whether the concerns can be mitigated by some of the measures already mentioned or others.

Question 42: 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 would not be useful.

IV. COMMENT PROCESS

(a) Written comments

We are seeking comment on all aspects of the Maple Proposal and the Application and are also seeking specific comment on the issues and questions identified above.

You are asked to provide your comments in writing, via e-mail and delivered on or before **November 7, 2011,** addressed to the attention of the Secretary of the Commission, Ontario Securities Commission, 20 Queen Street West, Toronto, Ontario, M5H 3S8, e-mail: jstevenson@osc.gov.on.ca.

Confidentiality of submissions will not be maintained and a summary of written comments received during the comment period will be published.

(b) Policy Hearing

The Application raises significant public policy issues that are important to market participants and the capital markets. As a result, the Commission has decided that a Policy Hearing should be held to give members of the public who have submitted written comments an opportunity to provide their views to the Commission in person, and to give the Commission an opportunity to ask questions.

At the Policy Hearing, the Commission will consider the public policy issues described in this notice together with any other public policy issues that are relevant to the Maple Proposal and the Application and that fall within the Commission's mandate. The consideration of these issues will assist the Commission in making its decision whether (1) to approve the acquisition by Maple of all the common shares of TMX Group, and (2) in determining the changes to the TMX Group, TSX and CDS recognition orders that are necessary to ensure that the exchange and CDS can continue to operate in the public interest.

Members of the public wishing to participate in the Policy Hearing must first provide written comments on the Application, following the written comment process set out above. If you are interested in participating in the Policy Hearing, please submit your request, with contact information, as part of your written comments. The Commission will establish the format of the hearing and reasonable time limits for each presentation, considering the time constraints of the hearing, the number of participants, and the complexity of the issues. Please also note that participants in the Policy Hearing will be expected to provide additional insight and detail regarding their comments, rather than repeating the substance of their written comments.

Date(s) for the Policy Hearing have not yet been established, although we anticipate that it will be held in December, 2011. Once the date(s) have been finalized, a notice to the public will be published with additional details, and parties who have expressed an interest in participating in the Policy Hearing will be contacted directly.

Questions on this Notice may be referred to:

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APPENDIX A

BACKGROUND ON REGULATION OF EXCHANGES AND CLEARING AGENCIES IN ONTARIO

(a) Recognition of Exchanges and Clearing Agencies

Both exchanges and clearing agencies play a fundamental role in the efficient operation of capital markets. Exchanges facilitate the efficient raising of capital by providing liquidity and price discovery. Exchanges may also carry out regulatory responsibilities by setting standards for the listing of securities and by imposing ongoing requirements on listed issuers. Clearing agencies, which include entities providing clearing, settlement, and depository services, ensure the safe and efficient clearing and settlement of market participants' obligations and can mitigate risks for market participants.

The (Act mandates the Commission to provide protection to investors and to foster fair and efficient capital markets and confidence in those markets. As part of that mandate, we are responsible for the oversight of marketplaces, including exchanges, and clearing agencies. Before an exchange or clearing agency can carry on business in Ontario, it is required to be recognized by the Commission. Recognition is similar to a licensing process where the Commission considers whether it is in the public interest that an exchange or clearing agency be permitted to operate in Ontario and under what conditions.

Securities regulators oversee exchanges and clearing agencies to ensure that they fulfill their roles in a manner consistent with the public interest. Regulatory oversight is critical to maintain confidence in the operations of an exchange and to support overall market quality, including liquidity, transparency and transaction costs. Clearing agencies provide essential post-trade services to the capital markets, and are viewed as utilities; oversight ensures fair access to these services, the efficiency, accuracy and reliability of the services, and appropriate management of risks in the settlement system. Since clearing agencies concentrate risk and are a source of systemic risk, oversight is an important tool for securities regulators to manage systemic risk. Systemic risk has been identified by the International Organization of Securities Commissions (IOSCO) as one of the three objectives of securities regulation, along with protecting investors and ensuring that markets are fair, efficient, and transparent.[20]

In considering whether or not to recognize an exchange or clearing agency, the Commission will examine the products and services it will offer and how they will be offered, understand its organizational structure and operations, and assess how it meets relevant criteria. Many of the criteria are similar for both exchanges and clearing agencies, while others apply specifically to an exchange t or clearing agency. The criteria that apply to both types of entities include that the exchange or clearing agency:

- has a governance structure with a board of directors that provides for fair and meaningful representation, one of the components of which is appropriate representation of independent directors;
- has policies and procedures to appropriately identify and manage conflicts of interest;
- provides for fair access to the services of the exchange or clearing agency, for example, by not charging fees that unreasonably condition or limit access to any service provided;
- establishes rules to govern and regulate all aspects of its business and affairs;
- has systems with appropriate capacity and integrity that are subject to regular testing and reviews;
- has sufficient financial resources for the proper performance of its functions and to meet its responsibilities; and
- cooperates and shares information with the OSC and other regulators.

Criteria more specific to exchanges include that the exchange:

- has arrangements in place to appropriately regulate listed issuers, for example, by requiring timely disclosure of certain information; and
- regulates the trading of its participants, either directly or indirectly through a regulation services provider.[21]

Recognized exchanges are also subject to the Marketplace Rules. Provisions of NI 21-101 impose requirements on recognized exchanges relating to fair access (fair access provisions)[22], barriers to entry and unreasonable discrimination. [23] In addition,

[20] *Objectives and Principles of Securities Regulation*, International Organization of Securities Commissions, May 2003, section 4.1, p.5.

[21] A Regulation Services Provider is a person or company that provides regulation services and is either a recognized exchange, a recognized quotation and trade reporting system or a recognized self-regulatory entity.

recognized exchanges cannot prohibit, condition or otherwise limit, directly or indirectly, a member from effecting transactions on another exchange or alternative trading system.[24]

Clearing agency specific criteria include that the clearing agency:

- design its clearing and settlement system to minimise systemic risk, including meeting certain objectives related to control of counterparty credit risk, settlement finality, settlement bank risk, default process and cross-border linkages; and

- control the risks that may arise from other non-core clearing and settlement activities that the clearing agency may engage in, to minimise spillover of risk and impact on the clearing and settlement services.

Copies of the current criteria for recognition of exchanges and clearing agencies are attached at Schedules A-1 and A-2, respectively, to this Appendix.

As part of the recognition process, the Commission will impose terms and conditions on the relevant entity. These terms and conditions impose ongoing requirements that reflect the criteria and impose requirements specific to the structure and operations of the exchange or clearing agency. Together with the requirements of Ontario securities law, they form the regulatory framework in which exchanges and clearing agencies operate and the basis for their ongoing oversight by the Commission. This framework is important so that market quality and market integrity are maintained, clearing and settlement services continue to be accessible to market participants and provided in an efficient, accurate and reliable manner, and systemic risk is monitored.

(b) On-going Oversight of Recognized Exchanges and Clearing Agencies

Once an exchange or clearing agency is recognized, the Commission continues to regulate and oversee its operations to ensure that the standards set at the time of recognition continue to be met.

Our ongoing oversight program has three main components:

- the review of information filed regarding operations of the exchange or clearing agency, for example, significant changes in the exchange's operations or any new business activity of the clearing agency;

- the review and approval of changes to the exchange's or clearing agency's rules; and

- periodic oversight reviews of the exchange or clearing agency.

In reviewing significant changes to the operations of an exchange or clearing agency, we consider the impact of the change to the capital markets.

We also have regular and ongoing dialogue with the exchange or clearing agency to identify issues and discuss operational matters that may arise from time to time. Taken together, this approach to ongoing oversight allows the Commission to evaluate, on an on-going basis, whether or not the exchange or clearing agency is complying with the terms and conditions of its recognition and whether or not those terms and conditions continue to be appropriate.

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22 Section 5.1(b) of NI 21-101 states that a recognized exchange "shall not unreasonably prohibit, condition or limit access by a person or company to the services offered by it". The services referred to include order entry, trading, execution, routing and data. In addition, it prohibits a recognized exchange from introducing fees that unreasonably condition or limit access to services (NI 21-101 Companion Policy, subsection 7.1(4).)

23 Subsection 5.3(2) of NI 21-101 state that a recognized exchange "shall not (a) permit unreasonable discrimination among clients, issuers and members….or impose any burden on competition that is not reasonably necessary or appropriate".

24 Section 5.2 of NI 21-101.

SCHEDULE A-1

CRITERIA FOR RECOGNITION

PART 1 COMPLIANCE WITH NI 21-101 AND N1 23-101

1.1 Compliance with NI 21-101 and NI 23-101

The exchange complies with the requirements set out in National Instrument 21-101 *Marketplace Operation* and in National Instrument 23-101 *Trading Rules*, each as amended from time to time, including, but not limited to, the requirements relating to:

(a) Access Requirements;

(b) Public Interest Rules;

(c) Compliance Rules;

(d) Information Transparency;

(e) Trading Fees for Marketplaces;

(f) Record Keeping Requirements for Marketplaces; and

(g) Capacity, Integrity and Security of Marketplace Systems.

PART 2 GOVERNANCE

2.1 Governance

The governance structure and governance arrangements of the exchange ensure:

(a) effective oversight of the exchange;

(b) that business and regulatory decisions are in keeping with the exchange's public interest mandate;

(c) fair, meaningful and diverse representation on the governing body (Board) and any committees of the Board, including:

(i) appropriate representation of independent directors, and

(ii) a proper balance among the interests of the different persons or companies using the services and facilities of the exchange;

(d) the exchange has policies and procedures to appropriately identify and manage conflicts of interest, and

(e) there are appropriate qualifications, remuneration, limitation of liability and indemnity provisions for directors, officers and employees of the exchange.

2.2 Fitness

The exchange has policies and procedures under which it will take reasonable steps, and has taken such reasonable steps, to ensure that each director and officer is a fit and proper person.

PART 3 ACCESS

3.1 Fair Access

(a) The exchange has established appropriate written standards for access to its services including requirements to ensure participants are appropriately registered under Ontario securities laws, or exempted from these requirements.

(b) The access standards and the process for obtaining, limiting and denying access are fair, transparent and applied reasonably.

PART 4 REGULATION OF PARTICIPANTS AND ISSUERS ON THE EXCHANGE

4.1 Regulation

The exchange has the authority, resources, capabilities, systems and processes to allow it to perform its regulation functions, whether directly or indirectly through a regulation services provider, including setting requirements governing the conduct of participants and issuers, monitoring their conduct, and appropriately disciplining them for violations of exchange requirements.

PART 5 RULES AND RULEMAKING

5.1 Rules and Rulemaking

(a) The exchange has rules, policies, and other similar instruments (Rules) that are designed to appropriately govern and regulate the operations and activities of participants and issuers.

(b) In addition to meeting the requirements of NI 21-101 relating to Public Interest Rules and Compliance Rules as referred to in paragraphs 1.1(b) and (c), respectively, the Rules are also designed to

(i) ensure a fair and orderly market; and

(ii) provide a framework for disciplinary and enforcement actions.

PART 6 DUE PROCESS

6.1 Due Process

For any decision made by the exchange that affects a participant or issuer, or an applicant to be a participant or issuer, including a decision in relation to access, listing, exemptions, or discipline, the exchange ensures that:

(a) parties are given an opportunity to be heard or make representations, and

(b) it keeps a record of, gives reasons for and provides for appeals or reviews of its decisions.

PART 7 CLEARING AND SETTLEMENT

7.1 Clearing and Settlement

The exchange has appropriate arrangements for the clearing and settlement of trades.

PART 8 SYSTEMS AND TECHNOLOGY

8.1 Information Technology Risk Management Procedures

The exchange has appropriate risk management procedures in place including those that handle trading errors, trading halts and circuit breakers.

PART 9 FINANCIAL VIABILITY

9.1 Financial Viability

The exchange has sufficient financial resources for the proper performance of its functions and to meet its responsibilities.

PART 10 FEES

10.1 Fees

(a) All fees imposed by the exchange are equitably allocated and are consistent with the Access Requirements referred to in paragraph 1.1(a) and the Trading Fees for Marketplaces requirements referred to in paragraph 1.1(e).

(b) The process for setting fees is fair and appropriate, and the fee model is transparent.

PART 11 OUTSOURCING

11.1 Outsourcing

Where the exchange has outsourced any of its key functions, it has appropriate and formal arrangements and processes in place that permit it to meet its obligations and that are in accordance with industry best practices.

PART 12 INFORMATION SHARING AND REGULATORY COOPERATION

12.1 Information Sharing and Regulatory Cooperation

The exchange has mechanisms in place to enable it to share information and otherwise co-operate with the Commission and its staff, recognized self-regulatory organizations, other recognized exchanges, investor protection funds, and other appropriate regulatory bodies, subject to the applicable privacy or other laws about the sharing of information and the protection of personal information.

SCHEDULE A-2

CRITERIA FOR RECOGNITION AND EXEMPTION FROM RECOGNITTION AS A CLEARING AGENCY

PART 1 GOVERNANCE

1.1 The governance structure and governance arrangements of the clearing agency ensures:

(a) effective oversight of the clearing agency;

(b) the clearing agency's activities are in keeping with its public interest mandate;

(c) fair, meaningful and diverse representation on the governing body (Board) and any committees of the Board, including a reasonable proportion of independent directors;

(d) a proper balance among the interests of the owners and the different entities seeking access (participants) to the clearing, settlement and depository services and facilities (settlement services) of the clearing agency;

(e) the clearing agency has policies and procedures to appropriately identify and manage conflicts of interest;

(f) each director or officer of the clearing agency, and each person or company that owns or controls, directly or indirectly, more than 10 percent of the clearing agency is a fit and proper person; and

(g) there are appropriate qualifications, limitation of liability and indemnity provisions for directors and officers of the clearing agency.

PART 2 FEES

2.1 All fees imposed by the clearing agency are equitably allocated. The fees do not have the effect of creating unreasonable barriers to access.

2.2 The process for setting fees is fair and appropriate, and the fee model is transparent.

PART 3 ACCESS

3.1 The clearing agency has appropriate written standards for access to its services.

3.2 The access standards and the process for obtaining, limiting and denying access are fair and transparent. A clearing agency keeps records of

(a) each grant of access including, for each participant, the reasons for granting such access, and

(b) each denial or limitation of access, including the reasons for denying or limiting access to an applicant.

PART 4 RULES AND RULEMAKING

4.1 The clearing agency's rules are designed to govern all aspects of the settlement services offered by the clearing agency, and

(a) are not inconsistent with securities legislation,

(b) do not permit unreasonable discrimination among participants, and

(c) do not impose any burden on competition that is not necessary or appropriate.

4.2 The clearing agency's rules and the process for adopting new rules or amending existing rules should be transparent to participants and the general public.

4.3 The clearing agency monitors participant activities to ensure compliance with the rules.

4.4 The rules set out appropriate sanctions in the event of non-compliance by participants.

PART 5 DUE PROCESS

5.1 For any decision made by the clearing agency that affects an applicant or a participant, including a decision in relation to access, the clearing agency ensures that:

(a) an applicant or a participant is given an opportunity to be heard or make representations; and

(b) the clearing agency keeps a record of, gives reasons for, and provides for appeals or reviews of, its decisions.

PART 6 RISK MANAGEMENT

6.1 The clearing agency's settlement services are designed to minimize systemic risk.

6.2 The clearing agency has appropriate risk management policies and procedures and internal controls in place.

6.3 Without limiting the generality of the foregoing, the clearing agency's services or functions are designed to achieve the following objectives:

1. Where the clearing agency acts as a central counterparty, it rigorously controls the risks it assumes.

2. The clearing agency minimizes principal risk by linking securities transfers to funds transfers in a way that achieves delivery versus payment.

3. Final settlement occurs no later than the end of the settlement day. Intraday or real-time finality is provided where necessary to reduce risks.

4. Where the clearing agency extends intraday credit to participants, including a clearing agency that operates net settlement systems, it institutes risk controls that, at a minimum, ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle.

5. Assets used to settle the ultimate payment obligations arising from securities transactions carry little or no credit or liquidity risk. If central bank money is not used, steps are to be taken to protect participants in settlement services from potential losses and liquidity pressures arising from the failure of the cash settlement agent whose assets are used for that purpose.

6. If the clearing agency establishes links to settle cross-border trades, it designs and operates such links to reduce effectively the risks associated with cross-border settlements.

6.4 The clearing agency engaging in activities not related to settlement services carries on such activities in a manner that prevents the spillover of risk to the clearing agency that might affect its financial viability or negatively impact any of the participants in the settlement service.

PART 7 SYSTEMS AND TECHNOLOGY

7.1 For its settlement services systems, the clearing agency:

(a) develops and maintains,

(i) reasonable business continuity and disaster recovery plans,

(ii) an adequate system of internal control,

(iii) adequate information technology general controls, including controls relating to information systems operations, information security, change management, problem management, network support, and system software support;

(b) on a reasonably frequent basis, and in any event, at least annually, and in a manner that is consistent with prudent business practice,

(i) makes reasonable current and future capacity estimates,

(ii) conducts capacity stress tests to determine the ability of those systems to process transactions in an accurate, timely and efficient manner,

(iii) tests its business continuity and disaster recovery plans; and

(c) promptly notifies the regulator of any material systems failures.

7.2 The clearing agency annually engages a qualified party to conduct an independent systems review and prepare a report in accordance with established audit standards regarding its compliance with section 7.1(a).

PART 8 FINANCIAL VIABILITY AND REPORTING

8.1 The clearing agency has sufficient financial resources for the proper performance of its functions and to meet its responsibilities and allocates sufficient financial and staff resources to carry out its functions as a clearing agency in a manner that is consistent with any regulatory requirements.

PART 9 OPERATIONAL RELIABILITY

9.1 The clearing agency has procedures and processes to ensure the provision of accurate and reliable settlement services to participants.

PART 10 PROTECTION OF ASSETS

10.1 The clearing agency has established accounting practices, internal controls, and safekeeping and segregation procedures to protect the assets that are held by the clearing agency.

PART 11 OUTSOURCING

11.1 Where the clearing agency has outsourced any of its key functions, it has appropriate and formal arrangements and processes in place that permit it to meet its obligations and that are in accordance with industry best practices. The outsourcing arrangement provides regulatory authorities with access to all data, information, and systems maintained by the third party service provider required for the purposes of regulatory oversight of the agency.

PART 12 INFORMATION SHARING AND REGULATORY COOPERATION

12.1 For regulatory purposes, the clearing agency cooperates by sharing information or otherwise with the Commission and its staff, self-regulatory organizations, exchanges, quotation and trade reporting systems, alternative trading systems, other clearing agencies, investor protection funds, and other appropriate regulatory bodies.