PRESENTATION BY IIROC INDUSTRY COMMITTEE.

--- On resuming at 1:37 p.m..

CHAIR: I think we are ready to begin the afternoon session once we are finished with the BlackBerrys and other such items in the hearing room. Thank you so much. Who is goes to going to speak? Yourself?

MR. VIRVILIS: We're all going to speak we'll start with Mr. Palumbo, Mr. Kennedy and myself.

CHAIR: Go ahead, please.

PRESENTATION BY IIROC INDUSTRY COMMITTEE:

MR. PALUMBO: Thank you very much. We are here today as representatives of a committee of 18 investment dealers formed by IIROC in July --

CHAIR: Who are you with?

MS. PALUMBO: Octagon Capital Corporation, Chairman and CEO of that company.

CHAIR: Thank you.

MR. PALUMBO: The concern of IIROC is that an informed group of representatives of a cross-section of investment dealers have gathered to discuss the various attributes and concerns regarding the bid. And after five or six meetings since July the group

came to a consensus as to what our position is and we submitted a letter in that regard to the OSC. A complete list of participants is attached. We are here today to further elaborate on the that position and I will go through some of our main concerns before turning it over to Jeff and Peter to elaborate further.

Let me start by saying the Committee was unanimous in rejecting the view put forth by Maple that a for-profit model would on balance provide enhanced benefit to most capital markets' participants especially the independent dealer community which we are all part of.

The committee was of the view that on the contrary the unrestricted for-profit monopoly would lead to increased costs for many investment dealers and also increased settlement cost for our clients both in the institutional market and in the retail market.

The ultimate effect of going to a for-profit model from the current cost-recovery model would likely have the effect of driving some independent investment dealers out of the business and in the process hurt capital formation and hurt services to investors, large and small.

Overall we questioned why allowing such a concentration of services would ultimately be a

benefit to the system when it works so well today.

Turning to a key objective stated in the Maple proposal the committee disagreed with Maple and continues to disagree that a vertically integrated model would ultimately enhance system integrity and efficiency and we came to that conclusion after discussion for several key reasons.

Firstly, the concentration of clearing and settlement will create a barrier to entry, making it difficult for new competition to emerge in a key area of securities clearing.

At the moment, Canada has the second lowest clearing cost per trade in the world according to recent studies. Recent estimates put us at 2.4 cents per trade. And that figure is only bested by DTCC in the United States at approximately one cent per trade. Under the current cost-recovery model our marketplace is very well positioned globally and to provide low cost services to investors in our capital market.

Basic economic theory would suggest a monopoly that is for-profit and vertically integrated will stifle competition and inevitably drive prices higher. We certainly are of that view.

When the committee turned its attention

to governance, we are especially concerned that the for-profit model proposed by Maple does not sufficiently address the many conflicts of interest among investors of Maple who are also large users of CDS services and information.

We note in that regard Maple's proposed board of eleven directors of which only five are independent directors with no economic interests in Maple, though when we look at the composition of the board and how they define independence, leads us to question just how truly independent of the board of CDS will ultimately be.

We do not believe the potential for conflict is eliminated by the way the board is currently constituted and by the recommendation coming out of the Maple and we would very much like to see full independence on the board.

We acknowledge that Maple has agreed to at least one director from IIROC though with the proviso that they would choose from a list of candidates put forward by IIROC. We would suggest that if it came to that, that the IIROC representative would be chosen without question.

We are also concerned all the board committees should also contain a majority of

independent directors and reading through the proposal we fail to see how that assurance has been provided.

Ensuring that the committees at least contain a majority of truly independent directors, would ensure all that the interests of Maple investors do not overly influence what's necessarily in the best interests of all users of CDS and what's in the best interests of the Canadian capital markets.

When we turned our attention to access the committee was also concerned that Maple will eventually change CDS guidelines, and restrict service to some CDS users whose operations did not necessarily fit with existing risk parameters.

Our concern was that a shift to more restrictive requirements would likely force independent dealers to change from being self-clearing organizations to clearing through carrying brokers. We believe such a development would actually increase systemic risk in the Canadian capital market by further concentrating clearing services and carrying brokers. And create other organizations which as the jargon goes today: Already too big to fail.

At a minimum, if Maple's for-profit model is granted approval there should be safeguards to ensure access to all registered investment firms on a

continuous basis. We would also suggest any change to CDS risk policies would need the approval of outside body or regulator to ensure that continues.

A fundamental concern has been the area of fees and pricing. I'll touch on some of those aspects before turning it over to my colleagues. It appears to us to date Maple has offered no clear framework on how it intends to set prices other than using a single price which it continues to say will be fair, reasonable and benchmarked. We do not understand what that means though we have asked the question in writing and they gave us the opportunity to meet with them, but still we have no clarification what they intend to do.

What we do surmise a for-profit model means increases in prices and costs to other capital markets participants from what is currently the second lowest clearing price for trades in the world. We note any benefits or cost savings will no longer accrue to users of CDS. And in turn such savings will no longer passed on to individuals and other investors, the ultimate beneficiaries of CDS's current low cost of cost-recovery model.

Historically as CDS has become more efficient, fair pricing has often met a declining

schedule of clearing fees, particularly as volumes continue to increase. Under Maple's for-profit proposal this benefit to the capital markets will undoubtedly come to an end.

Our committee was not satisfied that there are adequate safeguards that Maple will not use its monopoly power to increase prices. Without those safeguards it would affect the smooth function of our current system.

Therefore the committee requests that restrictions and safeguards be put in place to prevent abuse of pricing if Maple succeeds in changing the current model from a cost-recovery model to a for-profit model.

In that regard we have three suggestions: Firstly, that consideration be given to a utility type model for setting fees based on costs of CDS and return on capital requirements.

Secondly, that there be a requirement that CDS publish its fees and price schedule for public comment prior to being granted approvals.

Thirdly, the establishment of an independent body separate from Maple charged with revising and approving those fees.

In conclusion, the committee believes

current cost-recovery model served Canada well and contributed to our economic stability, fostering one of the most efficient settlement systems in the world. Consolidation of clearing and settlement services under Maple's control would create very high barriers to entry for new competitors which would undoubtedly affect the functioning of the marketplace.

Furthermore the inherent conflicts of interest have not been adequately addressed in the Maple proposals and greater independence and oversight is necessary.

Finally, let me just say the consolidation of clearing and settlement services would result in a monopoly in Canada which will undermine what is currently an open, fair and effective and competitive system of clearing and settlement. That concludes my remarks.

I'll pass it along to Jeff who will probably elaborate.

CHAIR: Thanks.

MR. KENNEDY: My name is Jeff Kennedy the Chief Financial Officer of Cormark Securities Inc. I started in the investment industry in December of 1987. As the Chief Financial Officer I deal with clearing and settlement operations through the CDS.

Through most of my career I have worked with firms that are self-clearers and direct participants of CDS, although for a period of five years, my former firm was an introducing broker through TD Waterhouse. I am a member of the Industry Committee advising the board of IIROC on the proposed takeover.

In the past I was a Chair with the committee that reviews and approves and implements capital rules for investment dealers and Chair of the Executive Committee of IIROC and advisory board to IIROC on policy matters affecting capital rules, compilation rules, including those involving CDS.

Cormark is a leading institutional investment dealer in Canada, number one small cap and mid-cap research in Canada, eighth overall for research, and in investment banking, we are one of the top ten underwriters in Canada.

Although our main business which is that of an institutional boutique, we also have an operation where we are the prime broker for a small number of hedge funds. We are a self-clearer and direct participant and if we were not so, our prime brokerage business would not be possible.

In my experience, being a direct participant of CDS provides better service to our

clients in North America and Europe and we have consistently met the threshold of compliance with national instrument 4101.

The committee discussions over the previous five meetings have centred around three areas: Access, fees and governance. I'll go briefly through some of the points in our letter. Under access, the committee is concerned that a clearing system controlled by a group that already dominates the marketplace may have a desire to restrict direct access to the clearing system by non-Maple related investment dealers.

We are concerned that this restriction could be implemented through changes and manipulations of the risk model. While there are legitimate concerns to ensure that the nation's central counterparties for debt, equity and derivatives clearance is not exposed to undue risks. The fear is Maple related dealers may prefer to limit the number of counterparties they are exposed to and ring fence default risks to just amongst themselves.

This could be accomplished by increasing capital collateral requirements to such a level that other investment dealers, particularly small and mid-sized firms, could no longer afford to have

direct access and therefore must enter into clearing arrangements with Maple members. In fact, the two largest carrying brokers in the country are part of Maple. This would have the effect of increasing profit margins to Maple members at the expense of non-Maple members with no reduction in central counterparty risk.

The committee wishes to further caution that a situation such as this could lead not to a reduction in overall risk, but actually increase overall risk and introduce new or heightened current risks in relation to the concentration of the securities industry.

We believe an unregulated CDS controlled by investment dealers, affiliates of Maple members, would tend to a model where they were only exposed to each other as counterparties which could result in a system where certain counterparties could become too important to fail due their size and influence over the financial system.

This could lead to a contagion effect should one or more of them experience financial difficulties or liquidity concerns due to the other lines of business or world events. In other countries, exposures to such risks require government intervention to defend the financial system.

This concern of possible reduced access is heightened in my view when you consider the rationale for the integrated trading and clearing model.

Certain financial participants of Maple have stated their expectation that the integration of CDS and CDCC and TMX will result in a higher stock market valuation for the integrated entities as compared to TMX as a standalone entity. This rational indicates that certain members of Maple may not be long-term holders of their position wishing to liquidate once the revaluation is captured. My concern here is that allowing a for-profit monopoly to be formed that can result in reduced direct access may not be easily reversible at a future time should Maple members no longer be holders of the integrated TMX. Simply, firms will have changed their business models in the interim creating an inertia that is not easily overcome.

In addition, a future TMX which is more widely held could still have a clearance system that remains highly concentrated as the incumbent policy setters while remaining investment dealers affiliated with Maple with the disincentive to broaden access to the system.

Moving to pricing, the concern here for the committee is that there is no current alternative to CDS for clearing and settlement of all Canadian securities and it is not feasible or desirable for a competing clearing system to be created.

Therefore, this will put tremendous monopoly pricing power in the hands of a small number but already dominant marketplace participant. The Maple proposal has not to date provided detail of how future pricing will be determined, changed or be fair and equitable. Therefore, the committee believes that retaining the current cost-recovery model is the best alternative.

If that is not possible, then like other utility corporations in Canada, pricing should be strictly controlled and subject to a high degree of oversight. A few suggestions we have made include international benchmarking within the top quartile or decile of clearing and settlement fees, pricing restrictions on the basis of a return on invested capital model, a rate review board with power to review rate applications but also to review prices in light of technological innovations.

Finally, turning to governance, the Canadian financial system has received many accolades

around the world and is a major stakeholder in the clearing and settlement system. This utility is too important to be driven solely by a profit motive and therefore must be operated for the protection of all participants in the financial system, including the dynamic innovative and highly productive operation. Qualities not often found in monopolies.

The committee believes the governance of the board of CDS, an important committee, i.e. those that establish price, risk tolerances and operating procedures must be made up of a majority of independent directors and those directors should be independent of material conflicts of interest. Such independent directors must have knowledge of the system and at least some of them should be industry participants.

That concludes my remarks and I pass them on to Peter.

CHAIR: Thank you.

MR. VIRVILIS: Thank you for the opportunity expand on our concerns with respect to this transaction. My name is Peter Virvilis and I am the executive vice-president of operations for Genuity Corp and a member of an IIROC industry committee.

I would like to expand on two specific

issues raised by my colleague. The first relates to access. We believe the risk model can and likely will be used to limit access to CDS services and therefore require serious external oversight. As the sole independent investment dealer on CDS's risk advisory committee since its inception in 2002, I have experienced first-hand the concerns of the committee participants who are primarily the banks.

In the OSC's notice and request for comment, the Commission raised the concern that a 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.

We do not share this concern for two reasons. First, the CDS model operates with extenders of credit and receivers of credit. The extenders, the banks, and not CDS, effectively guarantee the default in the system that cannot be satisfied by the defaulter or the collateral pool created for the particular service.

Inevitably, the extenders want to ensure that there is no flow through risk to them as final guarantor or as participants in the collateral pools that their investment dealer's subsidiary

participate in. Without their buy in to underwrite the risk the system does not operate.

The second reason we do not believe this scenario will materialize is because we don't expect the economics from a CDS perspective to change in any way. We do not believe there is a strong correlation between the strictness in the risk model and the volume of business that passes through CDS.

As Jeff points out the stricter model and greater collateral requirements are more likely to concentrate the business amongst fewer, larger financial institutions but ultimately will not disappear.

Again, it is for this reason exactly that we believe left unchecked, the risk model will be used to further limit access to CDS services to an even larger and therefore fewer financial institutions.

The second issue I'd like to comment on is pricing. As with the issue of access, we strongly endorse the position that an independent third party must review and approval CDS's pricing on an annual basis. I was on the CDS board until 2009 as the IDA and now IIROC designate. For part of my term on the CDS board I was also on the finance committee, and, in fact, chaired it for a year.

Part of our mandate was to review the annual business plan and recommend it to the board. The business plan included a review of their pricing strategy and any pricing changes. CDS has a very high fixed cost infrastructure with little variability to volumes. Year over year costs vary little. Volumes in some areas like trading increased substantially. During my tenure on the CDS board, substantially means in excess of 12 times.

In large part, this is how they've been able to annually reduce transaction pricing to participants. The greatest challenge CDS has with this kind of cost structure is to fairly allocate its largely fixed costs to the various products and services so as to reasonably assign a price. Because their participant base varies in the use of their services there was always a genuine effort to allocate costs equitably so as not to be seen favouring one participant base by cross-subsidizing another.

As I'm sure you are aware, fixed cost allocations are more of an art than a science.

CDS management and the board are so preoccupied by these issues that most pricing changes require an analysis by industry sub-group, for example, dealers and custodians, so as to understand the

individual impacts.

Because total costs varied little year over year so did the total cost by participant unless there were material changes to the allocation methodology. In a Maple environment, the issue of fair allocation will become even more critical and frankly, open to significant abuse as people and systems get integrated into a larger more diverse organization.

An organization that suffers competition in some business lines and monopoly dominance in others will need an impartial third party to scrutinize and approve many of these decisions.

Hence, as stated before, we recommend an independent annual price review. We are not simply referring, however, to an approval of price changes. We expect all prices to be reviewed annually for pricing policy and transaction volume changes as well as cost allocation methodologies.

Finally, I would like to point out that over its 40 years existence as a non-profit industry utility, we have collectively developed and accepted conservative financial management policies. In large part because it's understood that we as its shareholders and users will be responsible for any operating or funding shortfall. These policies will

likely make little sense in a commercial for-profit monopoly that is owned by a disparate shareholder base and not its users. To that end, we need to consider what happens to volume volatility premiums and the annual rebates generated from excess revenues. How will capital investments for new systems or new services be funded? Is it still appropriate to charge an initial initiation fee to become a member and ultimately who is responsible for funding shortfalls?

Without being overly melodramatic, this is a very different paradigm we are considering. We must proceed with an overabundance of caution as we look to destroy 40 years of exemplary service to the financial services industry. Thank you.

CHAIR: So we're going to ask a few questions and I take it you've completed your comments. You were in Montreal?

MR. VIRVILIS: I was not.

MR. KENNEDY: I was in Montreal.

CHAIR: Were the same representations made in Montreal?

MR. KENNEDY: You and I read from the same remarks.

THE CHAIR: We are trying to use the benefits of the comments in Quebec and here to assist

us in the consideration of the issues which is fine. So a number of questions obviously.

I guess you don't like the transaction.

MR. VIRVILIS: No.

CHAIR: So why do you like the status quo so much? Let me ask you this about the status quo. How do you know the status quo is the best thing for Canada's markets? You seem very persuaded that that's the case. How do you know that?

Let me help you a bit. Markets are changing, very international in scope, very much Canadian in scope. The pressures that exist on regulators to accommodate the G20 requirements around derivatives, trading, CCPs, trade repositories is an example of the need for regulators to respond to this environment. CDS is a systemically risky organization as so declared by the Bank of Canada under their legislation.

So step away from that a bit and ask a very general question: How do you know that status quo is the best for Canada's markets today and into the future?

MR. VIRVILIS: I guess to start with, I would suggest that our experiences are not simply focused domestically. As an organization, we have

operations in London, we have operations in the United States, and we have operations in Australia. So we have exposure to foreign markets, and we have seen how some of those function.

Our system is based on that wealth of information, if you will, and believe that the model that has been chosen by the Americans in DTC which is similar to what we have today is the most appropriate and does address the issues of not only efficient pricing but does change or offers the opportunity for change as market conditions change as well.

CHAIR: Let me just ask you this, and I know my colleagues and fellow commissioners will have questions here. The whole focus on this is we realize the North American market is a bit unique in the way in bring it deals with the vertical integration as between exchanges and clearing and settlement. I think you would agree with me that the CDS has operated in this way for 40 years as I think you've described it and you don't look to me like you've been doing it for 40 years but I may be wrong. You're very well pre-served if you have.

But some non-profit entities, the cost-recovery entities are often described as just not having poured enough money into innovation not keeping

up with what is required and they require greater investment in order to that particularly in a more complex environment particularly as products become more complex and volumes increase and I think you are so well aware of that in your business.

Do you have a concern for CDS, which is currently run as a not for-profit, being able to achieve those requirements in a so-called not for-profit environment? I'm happy for any of you --

MR. PALUMBO: Where there's some hesitation, you have to ask what is the objective of the clearing settlement system to begin if a core objective is to maintain a very stable capital market that is open and creates capital formation for young businesses and mature businesses. I would suggest the current system has worked very effectively. I think to characterize it as a situation where it perhaps is lacking in innovation or funds aren't available to come up with new research or new products I think is maybe shortchanging what CDS actually does. From my experience it takes a hard look at new computer systems required, new infrastructure, new software. There's a lot of discussion to stay at the forefront and is not going to exceed what is currently in the industry.

I mean, if the objective is to go in a

novel direction and what we fear it will actually destabilize the system from something which has been very smoothly operating for many, many years. We continue to believe that if you take a look at the history it supports the notion it has been a big contributor to this system we have today which is probably the envy of the world as we look across.

Take a look what's what happened with for-profit models and the Deutsche experience is a good one, the cost of clearing there is somewhere in the area of about 75 cents a trade compared to our 2.4 cents a trade. While we are not suggesting we would end up there, certainly that's the direction that the market would go and that would create a lot of inefficiencies in the marketplace.

CHAIR: I know that we'll have more questions, but I think I really appreciate your comment which goes to what is the purpose of the clearing. So is it about stability or about something else?

Regardless of the cost and we realize how important the cost of clearing is and how much that affects the market across the whole market from the investor right through to the CCP, do you think that the for-profit model today leads to instability in clearing in those markets?

MR. PALUMBO: To the effect it will cause dislocation among some capital market participants which we believe it will, there will be some instability.

I think if concentration in the industry is something which will promote those values then obviously some of our assumptions are incorrect but we do believe in creating a monopoly in this area is going to cause inefficiencies to prevail in the marketplace which we don't have today.

CHAIR: I'm sure you want to jump in, but it's a monopoly now, it's going to be a monopoly later. What's the difference?

MR. KENNEDY: It's a monopoly now where all of us have a say particularly us that are users of it and one of the things that maybe to your first question one of the things CDS has been able to do over 40 years as problems become important we have been able to get together as a community and settle those. And CDS has been extremely helpful in those, really been a lead of implementing those. I think what we're worried about is there won't that be that free flow of information in the future between users who are not Maple and users who are.

MR. VIRVILIS: If I could, to weigh in

on this as well. The CDS model is not simply CDS looking at the marketplace and deciding for themselves what in fact is important both for the domestic market and potentially internationally.

I think as Canadians we can pride ourselves on the fact we have a very global view of the economic environment, and as such we bring to the CDS board, to the CDS committees, and even to the line staff, an opportunity to exchange and direct where CDS goes with its new services, with its developments and ensure that it does stay current. So as participants in the global financial marketplace we are familiar with whether it being myself or another organization, somewhere along the line the Canadian marketplace understands what's going on globally and those expectations are imparted on CDS as our central organization to facilitate and provide the necessary change that we require.

CHAIR: So if you look at the for-profit model which exists between the MX and CDCC and look at the cost-recovery model between CDS and market, are you detecting anything in that situation which would suggest that the for-profit model is creating some instability or inefficiency or inappropriate behaviour or pricing behaviour that would

cause you to suggest, well, that greater concern might occur in the event that this transaction were to proceed?

MR. VIRVILIS: My first comment is to challenge the comparison that CDCC and CDS are equivalents and that they are in the same market. As I will comment later, I believe it's an unfair comparison. CDS is much, much more to the Canadian capital markets than CDCC is. CDCC's role is very specific and very narrow in its nature. CDS has a much larger, broader mandate and provides significantly greater service offerings to the Canadian financial services marketplace. It also has a much more complex participant base.

COMMISSIONER CONDON: I would like to ask a question about governance which is a likely different topic from the questions that the chair has been pursuing.

In the event that the Commission were to approve the acquisition of CDS by Maple, Mr. Kennedy, you mentioned that one of the changes of the way things work today is you all have your say in the way CDS functions.

Are there modifications to the governance proposals that have been made for CDS by

Maple that would continue to achieve some of those objectives from your point of view? You mention in your letter the idea of the IIROC member continuing to be on the board.

MR. KENNEDY: Yes.

COMMISSIONER CONDON: Would that ultimately be the best way from a governance point of view of achieving a continued voice for independent dealers in CDS.

MR. KENNEDY: I think that's part of it. I think what we were looking for which is not really what Maple has presented was that IIROC had a permanent member as they do now because they're a shareholder. And that's their current governance model.

We would like that to continue, but I think in my remarks I was going further and in that the board, and particularly the committees of that board that set pricing, access or the risk model in particular have much broader user base or people who are users be part of that rather than just relying on those that are Maple members. Certainly the Maple members they cover most of the types of products ending up going through CDS, but I think there is still a conflict of interest between them doing the clearing

and settling not only for themselves but for all of the other dealers, concentrating the clearing and settlement function and the profit that would then go that not only in what they would be charging but what they would then be able to charge as the carrying broker to all the introducing brokers, doubling up or increasing the level of profit.

I think from our perspective we think that the people who are setting those policies should represent much broader all of the users rather than just the Maple members. In my view they should be at least equal.

COMMISSIONER CONDON: Have you given any of thought though how to implement this? Would you want to have a separate nominating committee to nominate users, not Maple shareholders.

MR. KENNEDY: I think it should be just the general undertaking they should provide especially not so much for the board at CDS level but with the committees. I haven't given thought as to how they would be written down on paper but that being the general concept.

CHAIR: But would you see that as a governance issue?

MR. KENNEDY: Yes.

CHAIR: Or is it a conflict of interest or both.

MR. KENNEDY: It's both.

CHAIR: Let me ask you about this. There's a lot of discussion obviously about the sort of scope of regulation and involvement. I know on the pricing side you've talked about it considerably as to what you would expect should this transaction proceed. On the access side I'm not exactly clear.

Where do you remember envisage relative to the model, I don't think you were here this morning but there was more elaboration of it when others appeared. Where do you see the regulatory oversight role when it comes to access? Do you see an important role there or something that's significant to any conditions associated with a recognition order.

COMMISSIONER KELLY: I might take that a step further. You mentioned that the risk model could potentially be used to impair access. I was looking for an example or two of how that might actually occur from --

MR. KENNEDY: How they could restrict access? Well, at the moment things like equity securities receive collateral which collateral which you need to post each day for clearing trades settling

trades that day. Changing the risk model and taking equities out of that equation and having equities at zero value for purposes of collateral would certainly hurt those firms who deal primarily in equities, such as small and mid-sized firms.

We would therefore not have our own collateral, we would have to get collateral in the Canadian marketplace who is likely going to the banks, who are Maple. There's definitely a disincentive for them to increase our borrowing capacity to meet collateral when they could capture some of the profit.

COMMISSIONER KELLY: But surely there are precedents in the industry for what's acceptable collateral and what can be used.

MR. KENNEDY: Peter can probably talk more specifically about that.

MR. VIRVILIS: Certainly, I think if we go back to 2002 --

COMMISSIONER KELLY: My question is if Canada becomes an anomaly regarding this surely that would be something that we would need to address.

MR. VIRVILIS: Certainly we do. And so certainly in my remarks I've suggested that access is a primary concern to us as well. So when we narrow it down really the issues of pricing and access are

material. And we are not comfortable that the structure proposed will provide sufficient independent oversight or sufficiently appropriate solutions to addressing those and look to an external third party to provide some of that independence.

MR. KENNEDY: And the access or the provision of collateral is a bit of a continuum. There are different rates you can apply to equity and it doesn't have to be all or none, but if it falls somewhere in between that can be manipulated to the point where that's not feasible for other dealers to be members.

COMMISSIONER KELLY: And if that --

MR. KENNEDY: Direct members.

COMMISSIONER KELLY: If that were to occur you talked about the fact that this new world might force or impair the ability of some firms to continue to self-clear. You mentioned in your own business with Cormark you act as prime broker and that's one example of what you might not be able to do. What other consequences are there of not being able to self-clear? What are the costs that might be part of that?

MR. KENNEDY: Well, as I said at the beginning of my remarks, most of the time I've been a

self-clearer, but I've had experience of being an introducing broker as well. In those cases, I found having somebody else settle my trades particularly institutional trades, institutional trades that were cross-border, I found that the carrying broker didn't have the same care to customer service that we would have to our customers.

CHAIR: Why would the carrying broker want to carry that? Is it purely a question of earning something?

MR. KENNEDY: Yes.

CHAIR: Is that the only rationale? Given the risk associated with it why would they want to do it as opposed to saying look you're going --

MR. KENNEDY: Peter is also a carrying broker.

CHAIR: Together then you can do a deal right here.

MR. VIRVILIS: I think to answer your question, the reason is because the services that are provided to start with, are not typically focused exclusively on clearing and settlement so they tend to be much more encompassing. In the case of a capital market boutique, an institutional boutique it's very specific and very limited perhaps to clearing and

settlement.

When you look at a retail organization there's much more that typically comes to play. Many why would a carrier love to take on more of this business? Because ultimately, not dissimilar to what CDS does, but a back office, brokerage back office has had a high fixed cost component, so running more, in terms Mr. Kelly understands, the more volume you run through there, the better economics you make for the organization. So you are absolutely right. There is a trade-off between risk and reward, but certainly there's a number of organizations in this country that make an explicit business from the carrying brokers.

COMMISSIONER KELLY: Is there anything positive you can see, from your chairs, that come out of this transaction for you?

MR. KENNEDY: Well, I think one of the things has been talked about is the cross-margining between the two, CDCC and CDS. I think probably for Canada that is a tremendous benefit that will free up capital particularly from those who do both sides of that. My firm doesn't particularly do that. So maybe I don't get the benefit, but I think the Canadian financial system probably gets a benefit.

I think by combining the two and given

the size of our derivatives market being able to at a policy level drive over the counter derivative transactions through CDCC it provides much better transparency, again a much better benefit to both Canada and probably to the Bank of Canada in terms of being able to assess where risks are when there's a financial meltdown. But I don't know that filters all the way down to a pure equity house that buys and trades all day.

MR. PALUMBO: Safe to say amongst the 18 dealers that are represented on the committee, we struggled with that question over five sessions since July. Outside of the few technical things Jeff just mentioned, the prevailing view is that the detriment of the transaction far outweighs its technical benefits accrue. Because many of the dealers are focused primarily on the equity side of the business, that would impact their business in a more adverse way than possible benefit.

MR. KENNEDY: Although I see those benefits and I think those are very good benefits for the financial system, I don't know that the for-profit model or having it owned by one entity makes that happen any better. If that's really a desire, particularly of the Bank of Canada couldn't that happen

without there having to be a purchase of CDS? And would it have to be a for-profit model? I don't think the stuff I read from Maple's submission really made that clear to me as to why it had to be that way.

MR. KELLY: I just have one question and then I'm done. How in an environment where we have so many interlisted companies, I think 35 percent or so of stocks the on TSX are duly listed, but they represent more of that in terms of total volume and so on. In that environment where as the example I used this morning, where you take a trade in a Canadian stock that's also listed on the New York Stock Exchange, if the trade occurs there, then the trade is cleared by DTCC at one cent.

In that environment, how do you raise clearing fees here, pick a number, 15 cents or whatever number, wouldn't that just effectively drive trades to the New York Stock Exchange, away from the TMX? So isn't there a natural governor here with DTCC as a quasi-competitor?

MR. KENNEDY: I don't think we buy into that because it isn't the clearing and settling that determines where a trade should get executed. It's best execution. If the New York market is more liquid that's where the trade is going to be. If the Canadian

market is more liquid, it is our obligation to do it here. If I'm not correct I apologize, but I think the IIROC rule is you have to get best execution in Canada first.

MR. VIRVILIS: That's my understanding.

MR. KENNEDY: I don't really deal with trades, but it's really the best execution for the client is trade related not clearing cost related.

COMMISSIONER KELLY: All things being equal, you go to the best price clearing environment, if it's either/or...

MR. KENNEDY: Since the clearing costs don't get passed on to the client, customer, the execution cost, where the liquidity is at the best price that forces to you do the trade. Not the clearing costs after the fact. I think I'm answering your question. I just don't think if Germany was cheaper I don't think we would be trading in Germany.

MR. VIRVILIS: While we have one of the most efficient cross-border settlement systems in the world between ourselves and the United States it is more costly.

CHAIR: You mean in Canada.

MR. VIRVILIS: It is more costly to transact cross-border than simply domestically. The

reason I would suggest that is because you not only now have to settle -- take a step back. First off, we need to understand one of the things that CDS does as part of its service offering to its participants is it actually sponsors its members into DTC. None of the Canadian dealers are directly members of DTC. We recall sponsored, CDS is the actual member and we are sponsored in there.

Secondly, CDS sets pricing on cross-border trades, on cross-boarder settlement of trades. So they take an uplift on whatever DTC charges us. So that is open for manipulation, if you will, as well.

Beyond that, not only do we now have to settle the transaction in the United States but ultimately if the transaction is for the Canadian institution that Canadian institution likely wants delivery here in Canada which means we now have to move the securities from the U.S. into Canada, pay CDS their pound of flesh, if you will, and settle the transaction with the financial institution's custodian in Canada.

So I think to Maple's point, I think they've taken an overly simplistic view by what I would suggest are mostly academics on how the clearing and settlement functions actually operate.

MR. PALUMBO: I think I would add as well as a point of clarity, Maple is probably embellishing the importance of interlisted markets a bit too much from our perspective. We know of the 2,144 listed stocks on the Toronto exchange only 164 of them are interlisted as at the end of August. That represents about 7-1/2 percent of the total. Clearly the volume would be higher than 7-1/2 percent. But just to put it into context, the international argument is it pales in significance to what the impact would be in the domestic marketplace if this were to go through.

CHAIR: That's very helpful. Thank you very much.

COMMISSIONER KELLY: Do you have any idea exactly what the cost delta is in the transaction we discussed a moment ago.

MR. VIRVILIS: No.

COMMISSIONER KELLY: Interesting to get that.

COMMISSIONER CONDON: Just one quick question about competition on the trading side. Much of your discussions has been around the issues that would be raised by this transaction on the clearing and settlement side. But we heard this morning from Maple that there is vigourous competition on the trading

side, that there are -- even if we remove Alpha from the equation, that there are markets that are coming forward to offer novel trading strategies, new products and so on.

Would you share that perspective, that there is robust competition with respect to the location of trading? We discussed interlisted, obviously competition with respect to interlisted securities, but more generally?

MR. KENNEDY: I guess first of all the committee here before you was formed solely for the CDS so it's difficult. We are off the reservation in talking about that. But I would certainly say when it comes to trading versus clearing and settling, there are very fewer barriers to entry. Could something develop to be competitive? It is much more likely that can happen in trading. I'm not saying it will. I don't know how deep our Canadian marketplace is; whether it really needs that. Personal view. But in terms of clearing and settling, we believe -- certainly I believe there's little to no chance of a competing clearing and settlement system.

MR. VIRVILIS: Again to Jeff's point, our committee's mandate was focused exclusively on the impacts on CDS. I would suggest that if nothing else

the concern with respect to the non-competition agreement that has been focused in the application does provide concern as it relates to the opportunity for other markets to grow and flourish.

CHAIR: You are aware of the fact that the parties are preparing a pricing policy, it's not just been made available yet. I don't know if you're war of it.

MR. VIRVILIS: We have been hearing that for eight months.

THE CHAIR: I've not been hearing it quite that long. I think this transaction came our wail when, four months ago? September? Well, the application of course. It's only been since that period of time potentially. So the pricing policy would involve, in their view, a role for regulators. And you're recommending even a stronger role on any pricing policy should the transaction proceed as proposed.

As you know, securities regulators are generally not sort of encouraged to do that kind of work. I know you've mentioned something about a review board or some other organization, utility regulator that might look at these kinds of fees. Let's just say short of that, if that were to occur, do you have any

sense of whether a pricing policy, should there be one, would be able to avoid issues of cross-subsidization in in kind of a structure should it go ahead? I think you mentioned something about cross-subsidies. Obviously, you had some worries about that.

MR. VIRVILIS: Right.

CHAIR: Do you have any comments about that?

MR. VIRVILIS: Very significant concerns about cross-subsidization issue. Having spent the time that I did on the finance committee I understand the complexities of what CDS goes through today with its user owners to try and justify to them why the cost allocation model they use are appropriate and that they're fair and that they're not charging more for depository functions than they are for clearing, et cetera. So they do get rather complex.

As I said there's a significant element of judgment that applies to the creation of those policies. Motivation today for CDS is to do the best they can because all of their owners, save one, is a user, and so they have an obligation to all of those shareholders and all of those users similar.

In the model proposed by Maple there are two things that are very dramatically different.

First is the ownership makeup won't be the same so there will be -- there's the possibility that tendencies will be to favour the shareholders in the businesses that the shareholders run at the expense of those that are not.

Secondly, I believe that the larger organization will have a more complex environment with the possibility of management teams that cross boundaries between one business line and another, technology solutions that cross those boundaries and how much do you allocate so much of the cost to the clearing and settlement versus trading, for example.

So I think that if it's complex today it will be significantly more complex going forward.

CHAIR: Thank you for that. I think that concludes our questions. We are most appreciative of you coming and being forthcoming and candid about your views. You should understand the gathering of this information is important for us to be able to consider as part of our review of the transaction from the point of view of whether or not the Commission would be prepared to issue a recognition order under the terms and conditions requested by Maple Acquisition Corp. So thank you very much.

Mr. Virvilis, are you going to hang on

and make another presentation? We are going to be very interested and take careful notes to make sure nothing you say in this presentation is in any way inconsistent with your last presentation.

MR. VIRVILIS: I promise they will at least be consistent if not stronger.

PRESENTATION BY CANACCORD GENUITY CORPORATION

MR. VIRVILIS:

CHAIR: You're here for Canaccord Genuity.

MR. VIRVILIS: I am. Thank you for the time. As mentioned before, my name is Peter Virvilis, Executive Vice-president of Operations for Canada for Genuity. I've been employed in the investment dealer industry for almost 25 years. To your point, Mr. Chairman, it's not been 40. I originally began my career in finance and eventually took an operational focus that expanded over the years.

Canaccord has always been an active industry participant and advocate. Various members of our executive have held a senior advisory role to both the regulatory and the industry association. During my tenure I have held a senior advisory role to West Canada Clearing and West Canada Depository Trust which

was ultimately acquired by CDS in 1996. I currently sit on both the FAS executive and FAS operations sub-committee.

At one time I was the chair of the FAS Executive. For over ten years I sat on the CDS board the IDA/IIROC designate. During that time I was the member of the finance committee and chairperson for a period, audit committee and the executive committee which ultimately became the governance and human resources committee.

In 2006 I was part of a special sub-committee to the board charged with the evaluating an offer from the TMX to acquire CDS. Also I've been a member of a number of CDS participant committees and am currently on the risk advisory committee reporting to the Audit Group of the board, as well as the strategic development review committee.

In my operational capacity at Canaccord I am responsible for 14 departments that employ close to 175 people. Each of these departments and a number that don't report to me are directly affected by the services offered by CDS. Too often we refer to CDS as the clearing and settlement utility as if these two functions explain the breadth of the service provided. In fact, CDS's service offering permeates throughout

the investment dealer back office.

CDS provides a broad range of services to similarly a broad range of clients. For example, we depend on CDS to sponsor us into foreign markets like the U.S. and U.K., they provide technology solutions and specialized reporting to assist investment dealers to meet their trading, clearing and settlement obligations in those foreign markets. They facilitate the efficient movement of securities to and from those foreign depositories. The provide us with reports to help reconcile our market side trades.

CDS provides us with a centralized forum to receive corporate actions notices and acts as the collection re-distribution point for dividend, interest payments, corporate reorganizations and fixed income maturities. They are the centrally authorized agent for the issuance of CUSIPS an integral part of bringing new companies to market. CDS assists in the collection and redistribution of tax notifications. They operate as our intermediary for IRS withholding taxes. They operate an electronic service that allows deal he recalls to efficiently move individual investor accounts from one financial institution to another. In short, CDS is much, much more than a simple clearing and settlement agency. That characterization is more

appropriate of CDCC.

I provide this brief outline of CDS services so we are very clear what we are talking about when we say that we fear the consequences of creating a for-profit monopoly, a monopoly like we have never seen before in the Canadian financial services sector. And we reiterate our recommendation that CDS be left alone and strongly endorse the status quo.

If participants had understood the possibility of CDS becoming something other than an industry owned not for-profit utility it is doubtful that we would have constructed the organization in the same way or directed certain business processes to them. Certainly, some of the fundamental participation rules we have endorsed would not be acceptable in the new paradigm. Would any of us, for example, sign a commercial contract with a service provider where the provider was immune from all legal liability?

The community's relationship with CDS has developed over 40 years and in many ways can be described as the weigh scale with trust as its fulcrum.

For my ten years on the board I can tell you CDS regularly had to balance the expectations of the many to those of the few. The needs of the large to those of the small, the desires of the west to

the east. It's never been perfect and arguably some always have more influence than others. But there was rarely case where the commercial interests of CDS outweighed those of the participant community.

CDS has been there to serve our needs as industry participants not their own. This fundamental difference cannot be mended, and the fulcrum of the weigh scale will forever be damaged. Throughout the written submissions I expect from these hearings and from what you've seen there will be continue to be talk on the pricing concerns. Suffice to say I have reflected our concerns in the written submission and those just previously.

I would not take any more time of the Commission on that issue. Similarly we have presented our concerns with respect to the issue of access both in writing and verbally.

I would therefore like to address our thoughts on the issue of governance. As stated previously, we urge the Commission to accept our recommendation and maintain the status quo. Historically, the CDS board and its shareholders have considered the DTC model of participant ownership and not-for-profit as ideal.

In 2006 the shareholders and board

unanimously turned down the unlisted offer from the TMX to acquire CDS. Why? And what has changed? Certainly all the same stakeholder concerns about monopoly pricing, participant access, controls and oversight were in the forefront of our thinking then. The difference between 2006 and today is that today the banks will continue to be owners.

They recognize the importance of owning this vital central piece of financial infrastructure. It is for just this reason that we strongly believe that before this deal closes, if it closes, both RBC and BMO will accept the standing invitation to participate in the investor group. Any evaluation of this transaction must assume this will occur.

We believe no matter what governance or other constraints are effected, abuse of conflicts are likely outcome.

The best of intentions today will be forgotten in a year or two or five and the commercial interests of this proposed monopoly will prevail. Regardless, the proposed governance structure outlined in the application is seriously lacking. Therefore, if we fail to maintain the status quo, our second recommendation is that the Commission require as a condition of accepting Maple's application, that IIROC

be allowed to maintain its current ownership in CDS.

The 15.2 percent interest in CDS is held by IIROC in trust for the independent, non-bank aligned dealers. This approach ensures a modicum of control and oversight to the dealer community and eliminates concerns about the fair valuation of our shareholdings.

Further, if the Commission was so disposed we would recommend that preferred shares held by CIPF be allowed to convert to common shares and held in trust for the same constituents.

These shareholders should be afforded two board seats, and the requirement that at least one be on any board committee that is mandated to consider pricing, risk management or participant access issues.

These nominees should be confirmed in the same manner as any Maple nominee and not be required to be selected by the governance committee by a pool of proposed candidates.

As we have said, we find the proposed governance structure seriously lacking. We find their definition of independent director self-serving and we believe that none of the Maple investors should be considered independent for the purposes of the CDS board.

The Maple investors have come together with a single mind, a single vision, all wrapped in a non-competition agreement to create a vertically integrated for-profit model from which they can maximize returns to themselves. There is no altruistic motive regardless of the symbolism represented by their name.

We would now like to address the issue of the non-competition agreement. The details and the actual language has not been provided so we submit our comments based on the limited information provided in their application.

As it stands, we believe this agreement further guarantees Maple's monopoly status and will stifle even the modest possibility that the seeds of competition will take hold. The Maple shareholders will effectively control 85 percent of the financial services industry and are precluded by this agreement from engaging in any business in Canada that competes with the business of the TMX, CDS or Alpha. In addition, it acts as a deterrent to any future third party innovation.

As worded, any business that CDS might engage in today or in the future will restrict 85 percent of the market from participating. It could

also be extrapolated that existing businesses like FundServe or Arrow Services could be displaced if CDS decides that these are businesses that they in the future want to engage in.

The application opens with an outline of key benefits and vague synergies expected to be realized by the transaction. As stated in our submission, we believe the negative impacts of this transaction will far outweigh any potential benefits for the Canadian capital markets.

Maple has argued that with different owners, CDS and CDCC cannot achieve the synergies necessary to keep our capital markets competitive. We disagree. The same argument was made by the TMX in 2006 and the board and the shareholders of CDS disagreed.

I'm sure it's not lost on the Commission that these are some of the same organizations that are now claiming there are significant synergies.

After the TMX bid was turned down, the CDS board instructed management to try and achieve some of these potential synergies. As a result, CDS entered into a joint computing facilities agreement and a data distribution agreement. More was not achieved because,

in part, they were viewed as too capital intensive or too immaterial. As a utility, CDS has proven time and again that they will take direction from their participants and the board has a history of directing management priorities.

If the participants felt that there were material reporting deficiencies or operational limitations between CDS and CDCC, they would have been fixed by now.

We accept, however, there may be business opportunities that CDCC may not have been able to exploit without the assistance of CDS. Again, we submit if they were important to the participants, the current CDS model would allow them for them to be addressed.

There is a delicate balance at work between CDS and its participants and it works because there is a degree of trust that comes from ownership and from a clear understanding that there are no commercial conflicts at play. As stated in their 2010 annual report:

"Rather than provide investment returns CDS shareholders receive value through the efficiencies CDS provides to their operations. This serves the general interest of the Canadian capital markets as

well as all Canadians who depend on efficient, risk conscious, securities clearing organizations."

As an organization CDS is very good at producing reliable repeatable and consistent results. They have done such a good job that we often take them for granted.

I think it would be fair to say, however, that they've never been a great innovator. This is more a symptom of a monopoly though than of CDS specifically.

While this could result in a stagnant and inefficient organization, we submit this is not the case. And it isn't because the participants provide the impetus for innovation. Will they have the same motivation when they are dealing with a commercial monopoly that will capitalize on their ideas?

We must recognize that there is a great and on-going need for a central operational hub and today CDS handsomely satisfies that role.

A good example would be the income tax database. Until about five years ago income trusts mailed a breakdown to each of the registered holders of their annual distribution components. Every year every dealer waited for the mail or checked a variety of web sites to find the data required to prepare our clients'

T4 and T5 statements. As a community we came together and recognized that there was a need for a central repository of this information. The natural choice was CDS. That will not be the case if CDS is transformed into Maple's vision of the future.

What are we to say about an organization that looks to disrupt the equilibrium of our weigh scale with platitudes about fair and equitable pricing but for eight months have refused to provide any detail? What are we to think about an organization that commits to being transparent with all of its users but doesn't want to discuss critical aspects of its repo netting solution with the broader community. How are we to respond to a transaction that offers to purchase critical infrastructure, Alpha and CDS at prices to be negotiated with themselves.

These are not the actions that sow the seeds of trust in partnerships. They are, unfortunately, what we can expect from an organization that will be consistently plagued with conflicts.

We submit we must all tread very carefully because the conflicts of the proposed Maple transaction are everywhere and while we all recognize they exist, like land mines, we can never be certain where they will detonate next. Thank you.

CHAIR: I think we will probably take a break and then come back and then be asking you a few questions. The court reporter could probably use a bit of a break I would think. We will take 15 minutes and come back. Thank you.

--- Recess taken at 2:55 p.m.

--- On resuming at 3:12 p.m.

CHAIR: Mr. Virvilis, we'd like to go back in history a little bit. Since you have all this experience, we may as well tap your experience and memory. TMX wants to buy CDS.

MR. VIRVILIS: Yes.

CHAIR: Couldn't do it.

MR. VIRVILIS: Correct.

CHAIR: Owners said no.

MR. VIRVILIS: Yes.

CHAIR: Many of those owners are part of the Maple Group.

MR. VIRVILIS: Yes.

CHAIR: They say "yes" now.

MR. VIRVILIS: Right.

CHAIR: What's the difference? Why?

MR. VIRVILIS: As I said, my strong belief is they couldn't conceive of a transaction which did not include them as owners of this vital piece of

financial infrastructure.

CHAIR: So is it a control issue.

MR. VIRVILIS: Yes. And their ability to influence it, to ensure that it functions the way that meets their needs. I think it's an integral part of why they're there.

CHAIR: You raised a lot of issues, obviously, in your presentation. There was a part of it that you emphasized when you went down the laundry list of matters which CDS provides to the industry. Some of them are in the regulated entity and some not, as I understand it.

MR. VIRVILIS: Most of them are in the regulated entity.

CHAIR: So is your concern, then, with the Maple transaction that a number of these services that are presently provided would continue to be provided but at higher price or would not be provided? Or both?

MR. VIRVILIS: I expressly wanted to go through the exercise to achieve a couple of things.

First, to ensure that it was understood the breadth of services that CDS offers to financial services, and to debunk if I can the correlation that CDS and CDCC are equivalent organizations, just at the

other ends of the spectrum.

Secondly, I wanted to point out that because they are more than just a clearing and settlement organization the services that they provide are pervasive throughout the dealer back office, and, as such, if we could go back in time and look to complete these services in an environment where CDS was a for-profit organization I'm not so sure that all of them would have ended up there. And so it's a very difficult time for all of us because I think it's a very significant and fundamental difference when we convert this institution from a not-for-profit to a profit-motivated organization.

CHAIR: I'm still trying to understand why they wouldn't offer it. Because nobody would pay for it? Because they don't value the service? I'm still not understanding that.

MR. VIRVILIS: I'm not suggesting they wouldn't offer any of those services, but I would suggest they will go through a different evaluation of whether they will continue to provide those services than perhaps CDS does today.

Today, CDS takes instruction to deliver functionality to its participants based on what they want and the direction they're given, and their

motivation is simply to recover their costs, and if that's what participants want that's what the participants get to a large degree. A profit-motivated organization won't see it that way, and so some of the services may be re-evaluated.

For example, if I suggest that example that I gave, the tax database that was created by CDS, to my knowledge, wouldn't pay anything for the use of that service. If Maple walks in and decides that they change the economics as it relates to that particular service, it may not be cost-effective to subscribe to it or for them to deliver.

COMMISSIONER CONDON: Thanks for that. That was useful. One of the things that presenters for Maple this morning were very strongly encouraging us to think about was the increased ability for CDS together with CDCC to engage in innovation going forward if they are embedded within the Maple structure so that they will be able to be well positioned to undertake their responsibilities that are consequent on the G20 commitments and so on.

Meanwhile, you suggested yourself in your own remarks that CDS as a not-for-profit entity has not been noted for its ability to innovate.

MR. VIRVILIS: If I may correct, what

my intent was was to suggest that on their own they have not been able to innovate but through the use of their participants, through the influence of their participants they've done a reasonably good job. But it's not that they come forward as on a proactive basis, if you will, to the creation of innovative items.

COMMISSIONER CONDON: Could that pose a problem in the future if the Commission proceeds as you suggest, which is to leave CDS as a not-for-profit cost-recovery organization? Is there a risk that clearing and settlement won't achieve the benefit of innovative technology or services?

MR. VIRVILIS: I'm suggesting it has done a reasonably good job to date as a result of the fact that they are very responsive to the ideas of their community. And while they on their own don't necessarily...I couldn't qualify them as an overly innovative organization, they take instruction real well. And so the dealer community has provided the impetus for innovation, and it's a very interesting and a very complementary set of dynamics. The dynamics I think will be disrupted in an environment where we're dealing with a for-profit organization.

CHAIR: I'm smiling because I'm just

trying to think of anybody who takes instruction really well. Maybe I'm missing something, Mr. Virvilis.

MR. VIRVILIS: It's a relative term.

CHAIR: I understand. IIROC. You talked a little bit about the IIROC component and share ownership in CDS. The way you described it I was a bit unclear. I guess I thought that the IIROC share ownership was being held on behalf of all IIROC dealers. Did I hear you say that it was being held on behalf of a certain component of IIROC dealers, or did I misunderstand that?

MR. VIRVILIS: No, I don't think you did. If I may digress --

CHAIR: I really, really, really want to understand this, so I'm not sure whether or not -- if digression helps, please digress.

MR. VIRVILIS: The ownership structure of CDS started with a third being funded and owned by the banks, a third by the trusts, and a third by dealers.

Over the years, as we know, the trusts were bought by the banks, and so, effectively, two-thirds are owned by the banks.

The one third was left to be owned by the dealers and has been bifurcated, if you will, where

15.2 percent of the shares are owned by or held by IIROC. IIROC has recognized why they have those shares, and they have recognized that the representation on that board is somewhat unbalanced. And so I'm not clear on exactly the wording, but the way I've understood it is that their view is that the shares are held in trust for the non-bank-aligned dealers. Bank-aligned dealers already have plenty of representation on the board, and so the 15.2 percent that they hold are held for the non-bank-aligned dealers; the balance of the third were assumed by the TMX as their own.

COMMISSIONER KELLY: And the Investor Protection Fund, is there a convertibility feature to those? Or is your recommendation to convert them?

MR. VIRVILIS: To convert.

COMMISSIONER KELLY: What would they be worth in terms of --

MR. VIRVILIS: I probably have it here someplace. I believe the overall capital structure with preferreds is about $6 million, and CIPF owns somewhere between 2-1/2 and 3 million of those.

CHAIR: A final question. I think there's a bit of an overlay, if I can put it that way, to the remarks you've made. It seems to flow out of

overall concerns about concentration.

You did mention that bank concentration, or words to that effect, was a matter that seemed to sort of underpin your remarks with respect to some of the ownership issues associated with the Maple transaction. I wonder whether or not you might be able to assist us and elaborate on that issue as a matter of concern.

Is it, from your perspective, an issue of market power, an issue of order flow, is it an issue of being able to control CDS in a manner to advance the owners and disadvantage other financial market participants? How do you view that issue from your perspective?

MR. VIRVILIS: I think as an organization we generally do not believe that further concentration of our capital markets anywhere near beyond where we are today is to anyone's benefit - certainly not to the health of the Canadian capital markets.

As such, we see this as further concentrating power and the future of Canadian capital markets amongst a very small group of those organizations, and so we do fear the growing concentration of power within the banks.

CHAIR: I think that concludes our questions. Thanks for the heavy-lifting on two panels, Mr. Virvilis. We appreciate you coming today.

Is FAIR here?

MS. PASSMORE: Yes.

CHAIR: Thank you.

SUBMISSIONS BY MS. PASSMORE:

Good afternoon. I'm Marion Passmore, Associate Director of FAIR Canada, and I'm here to present on behalf of FAIR Canada today.

We requested to attend this hearing so we could provide some further details on our submission on governance of the TSX and TSX Venture Exchange and, in particular, the need to address listings regulation and conflict of interest. So my remarks are focussed on that.

FAIR Canada is concerned about how the TSX and TSX Venture Exchange are currently discharging their roles as regulators of listed companies and how the proposed Maple transaction would impact those regulatory roles.

When the TSX demutualized conflicts of interest in market regulation were addressed by the creation of a new SRO in co-operation with the IDA, called Market Regulation Services. The two SROs are

now IIROC. Listings regulation conflicts of interest, however, was not addressed at that time.

Thus, the TSX carries out the regulatory function of listings regulation while, at the same time, being a for-profit exchange and profiting from the listings business function.

The listings business function is a major commercial function of an exchange and, in particular, for the TSX. The listings regulation function also is an important regulatory or standard-setting role that has a significant impact on market integrity and investor protection.

For example, the TSX determines whether an issuer qualifies to be listed, must apply rules and requirements on listed companies, including disclosure, protection of minority shareholders' interests and corporate governance.

FAIR Canada commissioned a report entitled "Managing Conflicts of Interest in TSX Listed Company Regulation" which was conducted by John Carson. That report notes:

"While the TSX recognition order contains specific conditions to address self-listing conflicts of interest, it does not contain any terms requiring the TSX to separate its listings regulation

operations from business operations or to implement any policies or procedures to address the conflict of interest between its listing business and listing regulation mandate."

The FAIR Canada report examined seven major exchanges worldwide, and all of those exchanges have addressed the conflict of interest in listings regulation and have done so in one of three ways: One, a regulation subsidiary company with an independent board of directors; two, the statutory regulator mainly performs the listing regulation function; or a special independent committee and listings department that is separate from the business operations of the exchange, including listings business development regulation.

Of the jurisdictions reviewed, only the TSX carries out listings regulation as part of a unified listings department that's responsible for both mandates.

The report noted that the TSX does not have any policies or procedures to address the conflict of interest between those two mandates.

The structure that existed at the time that the TSX demutualized still remains in place today. Its listing business development function and regulation function are part of what is entitled a

"unified listings department". However, separate groups do perform those functions.

There are three units to that department: A listing services unit, compliance and disclosure unit, and business development unit. All of those units report to the senior vice-president of the TSX.

There is a staff listings committee which approves new listings and makes decisions on the application of the listing rules. Only directors and managers of the listing services unit are on that committee and involved in decisions.

There's also a listings advisory committee that provides input on regulatory policy issues and proposed changes to its listing rules. There are 16 members, apparently, of that committee. The exchange has not disclosed the identity of the members, the organizational structure of the listing service function is not transparent to the public and is not made clear.

The TSX is required, in accordance with the OSC's recognition order, to ensure that its listed issuers are appropriately sanctioned for violations of the rules and to provide notice to the Commission of any violations of securities legislation of which it

becomes aware. That's paragraph 18 of the order. By paragraph 16, it is to ensure that it has appropriate review procedures in place to monitor and enforce issuer compliance.

It also has a number of administrative remedies to ensure compliance with its listing rules and has discretion on whether to approve specific transactions for filings.

At the time of the report and to our knowledge, to date the TSX is not able to provide data on the number of it has used certain powers under its listings rules or the number of times it has notified the OSC of potential violations of securities laws. The TSX has stated it doesn't track these numbers.

The report also stated that the TSX and recommended that the TSX should record and monitor information on its compliance activities, including its application of specific penalties or remedies under its rules and should be maintaining such data and release summaries of its compliance activities to the public.

FAIR Canada and I believe the report believes that transparency on such activities would serve the public interest.

In short, there is no proof that they have ever taken disciplinary action against a director

or officer for breaches of their rules other than delisting for non-payment of fees.

The TSX view on the conflict is that it doesn't believe there really is a conflict of interest between its listing regulation function and listings business function, given how it processes work and how it approaches listings regulation.

The report states:

"The interests of the TSX in maintaining a successful and credible listings business are best served by maintaining the integrity of existing rules and standards. Therefore, the TSX believes that goals of maintaining profitability of the business and regulatory standards are congruent."

However, it is clear that there are potential conflicts of interest in these two mandates that can manifest itself in various ways, including lowering standards of supervision of compliance in order to maintain relationships with its existing customers, pressure from big listing customers can result in biased administration of the rules, tensions can exist between business development needs and regulation responsibilities which can impact regulatory policy initiatives, and discriminating against listed companies that compete with it or

favouring companies that are business partners can occur.

In FAIR Canada's view, an example of the conflict in the two mandates can be seen in the TSX's current marketing efforts to attract China listings to date and over the last decade. Without adequately considering whether the regulatory framework in Canada is adequate to ensure adequate oversight and investor protection.

The media has recently -- and the TSX recently announced that they have opened an office in China to attract new listings. They are going full speed ahead despite the problems that exist today.

Recent events involving Sino-Forest and subsequently more than a dozen TSX Venture issuers that are also emerging market listings have resulted in billion dollar losses for investors and, in particular, retail investors.

In our opinion, this demonstrates that the TSX and TSX-V have not properly considered the risks and the public interest in their campaign to increase their China listings, and this demonstrates conflict in the two mandates.

FAIR Canada would also like to point out that their approach to the listings regulation

conflict can be contrasted to their approach to managing conflicts of interest relating to their obligations in performing market regulation functions for the derivative market such as the Montreal Exchange. The Montreal Exchange has strong mechanisms to address conflict of interest relating to its regulation division.

Government has also recommended that the Ontario Securities Commission take steps to address the potential conflict of interest that exists in these two mandates. In its March 2010 report on the Ontario Securities Commission, the Standing Committee on Government Agencies cited concern "with the perception that the TSX falls below international standards with respect to the separation of its regulatory and commercial activities."

The Committee recommended that:

"The Commission review the potential for conflict of interest between the regulatory and commercial functions of the Toronto Stock Exchange and that it take steps necessary to address any problems identified."

FAIR Canada believes that the Maple proposal exacerbates existing conflicts of interest given that listing standards and the administration of

listing requirements may be influenced by the financial interests of the firms that make up Maple investors. Conflict of interest exists where the dealers, who dominate the listing, are owners and significant shareholders of the exchange.

The subsequent acquisition of Alpha, were it also to become an exchange, would also likely result in an increased focus on the listing business function.

As a result, FAIR Canada recommends and its preferred approach and recommendation would be that the Commission should transfer the listings regulation function of the TSX to another regulator, preferably an independent SRO. This was the approach taken by Canadian regulators with respect to the TSX member regulation and market regulation function when it demutualized, and therefore would be the most natural evolutionary approach to address the issue. It would also make sense given the provincial nature of securities regulation in Canada today.

In the alternative, we recommend one of the other methods adopted, such as transferring the regulatory function from the exchange to provincial regulators or establishing a separate subsidiary with an independent board of directors.

FAIR Canada would like to note that Canadian Coalition For Good Governance provided a submission in which it cited concerns listing regulation conflict of interest at the TSX and stated in its submission:

"The approval of the application should be contingent on the TSX finally addressing the conflicts of interest inherent in its business model. At a minimum, the TSX should be required to establish an independent entity overseen by securities regulators to establish, interpret and enforce requirements for its listing issuers."

Thank you for the opportunity to present here today, and I'd be happy to answer any questions you have.

CHAIR: Thank you very much. Let me ask you a question. Overall, from the point of view of FAIR presentation here, how do you connect the listing function... We're well aware of the report that was issued by FAIR and your comments. How do you connect that to the Maple transaction? Do you see this as just an opportunity to bring this issue before the Commission in the context of the matter? Or do you see it as in some way or another the issue that from your perspective is exacerbated, if I may put it that way,

by the transaction? How do you see it?

MS. PASSMORE: We think it is an issue to be addressed regardless of any existing proposal. We don't have per se a view as to the Maple proposal itself, but we think it does exacerbate the problem, given the additional conflicts of interest that will be at play should the proposal go forward.

COMMISSIONER CONDON: I just wanted to ask a question about governance because your comment letter does address that issue and there are various proposals made throughout the Maple application around the way it will handle conflicts of interest in relation to overall governance of the group and various subsidiary activities that will be engaged in.

What position would FAIR take around the question of that structure representing the views of retail investors? Are there specific proposals that you would make in that regard? If so, do you have specific suggestions how to achieve the goal you'd like to see?

MS. PASSMORE: We did make recommendations that the board should be comprised of one-third non-independent directors, one-third investor representatives, and one-third listed issuer and other stakeholder interests.

COMMISSIONER CONDON: How would those investor representatives be chosen?

MS. PASSMORE: We didn't specify that, but one would think that people who have knowledge and experience of retail investor issues would have an interest in serving on the board, would be candidates for those positions.

COMMISSIONER CONDON: So the names would be forward to the nominating committee of the organization and would be selected in the same process as other directors?

MS. PASSMORE: That's one method. I'm sure there are other ways it could be done.

COMMISSIONER KELLY: Why would FAIR impose two-thirds independence in this case when the standard seems to be 50 percent?

MS. PASSMORE: Given the nature of conflicts of interest and given that the exchange should serve the public interest, we believe that a stronger non-independent board would better serve the capital markets and investors.

CHAIR: I think you went quickly over an issue which kind of intrigued me. You seemed to have suggested that somehow or another the way in which the CDCC manages conflicts of interest regarding

listings -- or was it the MX?

MS. PASSMORE: The MX.

CHAIR: And you suggested that they seemed to manage it in a manner which you are more comfortable with than TSX does. Did I hear that correctly?

MS. PASSMORE: We're saying that TSX does have procedures and policies with respect to conflicts of interest over the -- with respect to the Montreal Exchange but it doesn't with respect to listings regulation. So just contrasting those two situations.

CHAIR: Have you asked them why? Or maybe you're going to ask us to ask them why.

MS. PASSMORE: We can ask you to ask them.

CHAIR: I guess we're going to ask them why. But the point of is that is you seem to suggest they're contrasting, and you seem to think one is preferable, obviously.

MS. PASSMORE: One is. I mean, having something there is better than nothing. I think given the time that's passed our preference is to have an independent SRO perform the listings regulation function, but there are other alternatives that

obviously the Commission and regulators can consider.

CHAIR: So, in your view, speaking primarily from an individual investor perspective and the evolution of capital markets and the challenges that individual investors have in these markets, why would the issue of conflicts of interest with respect to listings be of any significance to your organization?

MS. PASSMORE: It's of importance to our organization because the manner in which investors -- the way listed issuers are regulated does have an impact, a significant impact on retail investors. The way that regulatory policy is developed at the exchange does impact retail investors.

For example, in 2008 the TSX introduced the Special Purpose Acquisition Corporation and in four months had instituted that vehicle which we don't think is a particularly good vehicle for retail investors. You can contrast that to its regulatory policy initiative on shareholder rights and acquisitions where it took a significant period of time and then reissued a consultation paper in which it proposed a 50 percent threshold, which was not anywhere near the international standard, and then finally implemented something in November of 2009. So its for-profit

mandate seemed to take precedence over in the issues.

CHAIR: Thank you so much, Ms. Passmore.

SUBMISSIONS BY MR. CARLETON AND MS. PETLOCK:

MR. CARLETON: Thank you, Mr. Chair, Commissioners. On behalf of CNSX market, we would like to thank the Ontario Securities Commission to continue the conversation about the proposed Maple Group transaction.

Before beginning our comments, in particular I'd like to commend Staff of the Ontario Securities Commission for their very thorough review/summary of the Maple Group transaction as well as their framing of the issues. It was truly an excellent piece of work.

CHAIR: You're going to get me in trouble now. I'm going to have to say the same thing to them. Thank you for opening up that one, Mr. Carleton. They did do a very good job. So thank you.

MR. CARLETON: Before getting into the meat of our submissions, I think it might make sense to spend a couple of minutes talking about who CNSX markets is. We started operation in 2003 as the

Canadian Trading and Quotation System with three listed issues operating as a quotation and trade reporting system under the Act, and by the summer of 2004 had become a fully recognized stock exchange.

At the time, CNSX markets was the first stock exchange to be recognized in the province of Ontario in more than 70 years. At present, its listed venue is known as the Canadian National Stock Exchange. We have 158 listed issues. By way of comparison, the Toronto Stock Exchange lists approximately 1,600 issues, and the Venture Exchange has 2,400 issues at present.

To broaden the range of services that the organization offered and to leverage the market operation experience that was hard won between 2003 and 2006, we decided to launch a competitive continuous auction market system that would post the securities listed on the Toronto Stock Exchange and later the Venture Exchange for trading.

We launched Pure Trading, as the venue became known, first as a block trade reporting system in the fall of 2206. The system launched in the fall of 2007. By early 2008 all issues listed on the Toronto Exchange and Venture were posted for trading on the Pure Trading system.

The primary reason for delivering this service was to deliver a competitive alternative that would support the need for better service, competitive pricing, and to facilitate a more efficient operation of the public capital markets in Ontario and, by extension, in Canada.

At this point, Pure Trading accounts for approximately 3 percent of the trading activity in TSX-listed stocks. To operate these two markets we employ 28 full-time employees and six consultants at offices in Vancouver, soon to be Calgary, and Toronto with representation in Montreal.

To go to the matter at hand, there are three broad areas of concern we would like to speak to this afternoon. The first relates to the governance issues that are raised by the Maple application; second, the impact on the competitive landscape for the provision of listings and trading services in Ontario; and third, our concerns as they relate to the inclusion of the Canadian Depository For Securities in the entity proposed under the Maple Group transaction.

Turning first to governance, I think as you've heard over and over again today it's well understood that stock exchanges are a key part of the investor protection regime in Ontario. Entities that

vet candidates for public listings establish trading rules that seek to maximize the fair and efficient operation of the markets and also in some instances set rules for the conduct of participating dealers. It is clear the exchanges themselves are a critical comment to efforts to maximize in the and public confidence in the operation of the securities markets.

So for these reasons, governance of the organization is of critical importance and has to represent the balance of a number of competing interests.

Significant shareholders who are obviously concerned with maximizing the profitability of the enterprise have an interest, listed companies, investment dealers, institutional and retail investors all have a stake in how the source operated.

So to ensure that the exchanges are able to fulfill that public interest mandate that they have assumed by virtue of their recognition as a stock exchange under the Securities Act, we have seen a careful balance which has been struck to ensure that there is adequate representation from truly independent directors on the board of the recognized exchanges. So, mindful of these concerns, as we highlighted in our written submissions, we don't see how the proposed

composition of the Maple board adequately addresses those issues.

The application asserts that eight of the 15 proposed directors are independent. However, three of the individuals would be nominees of what we consider to be significant shareholders. If the deal is concluded as proposed they will own somewhere between a fifth and a quarter of the shares in roughly equal proportions.

Now, that's not to say that the individuals proposed give rise to any concern whatsoever. I suspect all three of them are in the room this afternoon and any board would be lucky or fortunate to have the benefit of their services.

But simply put, it's not fair to these individuals to put them in a position where they're forced themselves to balance their interests as significant shareholders, their economic interests, and also be able to successfully discharge their obligations to the public interest.

As we submitted in our written materials, we believe that the cut-off point should be no greater than 5 percent ownership of the shares on a diluted basis to be considered an independent director for these purposes.

Moving to the competitive landscape in Canada now, we will confess that we are somewhat of two minds about the integration of Alpha into the Maple Group consortium.

However you measure market share, whether it's by trades, value of securities or number of shares on a daily basis, it's clear that the combined entity will result in somewhere between 80 and 85 percent market share.

A number of observers, including ourselves sometimes, believe that a sophisticated consumer group in any market, and I think it's fair to say the Canadian securities dealers represent such a sophisticated group, are not going to tolerate or support a marketplace where one provider has that large a market share when viable, competitive alternatives exist.

Viewed in that light, there's potentially an opportunity, as a result of the integration of Alpha, for the competitors to, in fact, gain business at the expense of the combined entity.

On the other hand, the competitive experience to date suggests that a different outcome is possible. I want to take a couple of moments to talk about the challenges facing competitive providers of

listings and trading services in Canada and address some of the issues around the possible entering of new competitors into Canada following a possible successful completion of the transaction as set out.

The first point we want to make is that the framework first introduced approximately ten years ago to provide for competitive listings and trading services in Canada has been successful. Investors have seen tighter spreads, reduced costs and greater liquidity in the Canadian marketplace as a result of competition.

So we very much believe and support the enhancement of competitive market forces as we move forward in the evolution of the Canadian securities markets. We have also seen a lot of innovation as far as market models, order types, and pricing.

Now, that said, Canada is something of an outlyer amongst the developed markets in the world where competitive or alternative market services are available. If you look at market shares in the United States, there is no individual market centre today that has more than 18 percent share of the trading business. In the European Union, the combined BATS Chi-X Europe entity would be the largest single provider so a new entrant, approximately only three years old at this

point, with the largest single provider of equity trading services, the incumbents have lost a tremendous amount of market share.

In Canada, however, the incumbent markets, Toronto Stock Exchange and Venture Exchange, have managed to retain a relatively high share of market in Canada. So why is that? We think there are a number of things we can point to.

The first one is there is a lack of market data, visibility for the alternative markets. Put another way, it's very difficult for an individual investor or an institution or even a dealer to make arrangements to have all of the data from all of the markets present on all of the devices that are supporting their information needs. It's expensive, and it's an administrative burden that isn't present, for example, in the United States.

Routing decisions. So dealers who are originally responsible for providing order protection or, put another way, trade-through avoidance, often made the tie-breaker the volume of shares traded at a particular venture, which meant in the event of a tie where the same price was available at a number of different venues they might go to the Toronto Stock Exchange, Alpha second, Chi-X Canada third, and so on.

There was later adoption in Canada of sophisticated routing technology on the dealer part that enabled them to be able to collectively post resting client flow away from the incumbent markets. That resting client flow, which drew additional market-making flow and so on, reinforced the notion that the liquidity had stayed at the incumbent market and made it more difficult for people interested in supporting the alternative markets to do so.

Finally, and we will acknowledge that the Toronto Stock Exchange, unlike many of its peers on the international level, made timely improvements and investments in its service delivery that enabled it to retain a significant amount of business from the high-frequency trading community who have replaced the traditional market-makers as a source of liquidity for investors to trade against. That's on the trading side.

On the listing side, exchange listing may be hard-coded into the investment mandate for a manager of an investment fund. For example, if you look at the mandate, it may be restricted to owning shares listed on the Toronto Stock Exchange and the Venture. No mention of CNSX markets or the Canadian National Stock Exchange until the mandate comes up for

renewal in another five years.

Reputation. It takes an awfully long time to develop investor and advisor confidence in the venue and services you are offering. Companies are simply not going to be willing to list on your market if it puts them at a cost of capital disadvantage as compared it other available venues.

Retail investor access. This has been a significant issue for CNSX markets. At this point it's been operating for eight years. There isn't a single bank, discount investor operation that provides market data, electronic access and fundamental information for CNSX listed companies.

So we ask ourselves, will the inclusion of Alpha and the increasing concentration of activity within the Maple Group affect the competitive balance in a positive way? That was a rhetorical question, by the way.

A number of competitors have spoken about barriers to entry and how easy it is to set up a competing alternative. As I mentioned, commentors have talked about...

--- Off-the-record discussion.

MR. CARLETON: There's a quote from the former chair of the New York Stock Exchange, Dick

Grasso, who, of course, was extremely frustrated by the agility of some of his competitors, and he complained it took two programmers and a bunch of servers three weeks to get a marketplace up and running. That's true up to a point. He was leaving out a whole bunch of other details I'll take you through.

There is, of course, the whole notion of whether you're an ATS or exchange or have aspirations in either direction, dealing with our friends across the aisle here, which can be an educational and productive and constructive exercise, but it doesn't necessarily happen over the course of a couple of weeks.

CHAIR: Now you're getting close to --

MR. CARLETON: A big, very big chunk of work in time and money is devoted to the technical integration with the existing dealer work flow. You have to make sure all of the access vendors, market date, vendor router provision, back office service vendors have all tested their system rigourously, tested the system end to end in conjunction with the other services, and finally taken the step of releasing access to you into production. That is at least a three- to six-month effort depending on sort of how much your system conforms to the existing technical

conventions or not.

There's also integration with CDS. You provide them with files according to standard formats and test that through the system.

IIROC requires a specialized fixed regulation fee that has to be rigourously tested before you can proceed into production.

Last but not least, you have to make your data available and tested and have the network established and set up to the information processor which is operated at the TMX Group.

So all told, if you're an ATS this can take you a year or more to complete, and so after the two programmers have plugged their service in.

So for an exchange, you have to do all of that plus you have to negotiate and develop and deploy a robust listed company regulation model. So the timeline can be easily twice that long.

Even once you've completed all of those tests there's obviously no assurance of success.

So taking it back to the present context, we have particular concerns in the Maple application over the issue of venue preferencing. There is an acknowledgement in the application that some of the participants may have preferenced the Alpha

venue over competitors in Canada, presumably in order to build revenues and market share at the expense of competition.

So we think there are two main issues that arise from the preferencing.

The first one is if you blindly preference a particular venue on the basis of best price alone, what it means is you're not going to reward those venues that are innovative or compete on cost. That hinders the competitive pressures in the marketplace.

Secondly, we found it informative that the Maple Group participants did not pledge to not preference the Maple Group exchanges following conclusion of the transaction. What they did do was stay if Alpha is not included we won't engage in preferencing activities with Alpha, presumably at the expense of the TMX and other marketplaces. We think it curious that that pledge was not provided.

So, to summarize, our competitive concern is as follows. Implementing a new marketplace in Canada is a very material undertaking. It takes a tremendous amount of time, energy and money. It is not a trivial exercise to enter into this marketplace.

Secondly, the competitive landscape to

date suggests it may not be that attractive for new entrants anyway. Market share concentration in Canada far exceeds our peer markets in the United States and European Union even after five years of vigourous price and service competition.

Finally, combining Alpha and the TMX exchanges to increase the overall market power of the incumbent where some of the largest market participants have acknowledged a history of venue preferencing gives rise to serious concerns as to whether competitive market forces will be brought to bear in order to reward innovative and more efficient competition.

Finally, Mr. Chairman, I'd like to turn to the issue of clearing. We were very clear in the written submissions that we do not think that the inclusion of CDS in the Maple Group, as proposed, is in the public interest. We do so for a number of reasons.

First off -- and again I think you've heard this concern raised a number of times today. Moving a not-for-profit organization, which by definition returns excess of revenue over expense to its users in the form of either investments in service improvements or in reduced costs, to turn that into a for-profit entity is going to result in serious changes to how those services are delivered going forward.

We think that they will be more expensive and we think that there's the opportunity within CDS to skew the competitive landscape in Canada in a number of potentially uncontradictable ways.

We don't believe that proposed measures such as rate of return regulation are appropriate again because we believe that not-for-profit focus has been extremely successful in reducing costs in Canada to the second lowest in the world.

We also think, and we are coming a bit close to home again, Mr. Chairman, that although the CRTC, the National Energy Board and some other regulators may have the capacity to engage in rate of return regulation, this is not a skillset that is present within the Ontario Securities Commission currently and one that again we don't know that it's appropriate that -- it's an appropriate area of activity for the regulator.

We are also concerned about the competitive impact of CDS being integrated into the Maple Group. We obviously don't know and can't predict how the organization would behaviour following integration with the incumbent markets.

What I can do is look at our colleagues around the world and the trouble that they have had

with clearing organizations that are owned by incumbent exchanges.

If you look at the experience of Chi-X Europe and I would encourage you and believe that Mr. Kozun tomorrow morning will probably go into this in some detail. They were forced to interpose an entire clearing mechanism in between themselves and the European exchange-owned clearing agencies in order to get up and running.

The Brazilian clearing organization, which is owned by the stock exchange and derivatives exchanges, has clearly signalled to new entrants in the Brazilian market that they will not work with them, permit them to be integrated into those services.

Chi-X Australia has had similar issues with the Australian clearing organization which again facing regulatory response from competition authorities in Australia finally relented and agreed to permit Chi-X Australia to access their facility on a more or less reasonable basis.

We are very concerned that in the event that CDS was operating within a for-profit enterprise that the alternatives in Canada would be in for a similar rough ride either on an on-going operating basis or as new entrants sought to enter the

marketplace.

Finally -- and again, I don't know whether these issues have been addressed today or not, but the risk model at CDS is a very important means by which competitive imbalance could be introduced. By adjusting the model to make it more expensive for an independent or smaller dealer to conduct the same transaction as a larger, better capitalized dealer could skew, as I say, the competitive balance amongst the large and small dealers.

Finally, we do have a concern that increased integration around the infrastructure as between CDS and CDCC could increase the systemic risk that's presented to the marketplace in the event of a failure.

Now, the one area that we do agree with in the proposal is the provision or the organization of cross-margining services between CDS and CDCC. It's very clear that Canada is at a competitive disadvantage to other jurisdictions around the world in that our market participants have to capitalize long and short positions in the cash and derivative markets independent of each other, and we don't believe that that's appropriate, nor does it make Canada as competitive a jurisdiction as it could be, and we

believe that efforts should be made amongst the various participants to make this a reality.

On behalf of CNSX markets, if there's we can do to support that initiative we will certainly make ourselves available to do so.

In summary, Mr. Chair, we believe that there are three significant areas of concern: The proposed governance model, impact of a competitive landscape, and inclusion of CDS in the consortium.

Those are the prepared remarks. If you have any questions, we would be pleased to respond.

CHAIR: So, Mr. Carleton, how do you get at these benefits through cross-margining? You seem to be supporting a situation where you are supporting the status quo.

MR. CARLETON: I am far from an expert in the operation of the clearing and settlement organizations either on the cash or the derivatives side. However, I will observe that the options clearing corporation, the futures clearinghouses which are proprietary in the United States and deposit at this trust and clearing organization in the United States have managed to pull it off. I suggest that our entities should be able to come to some accommodation to support that activity.

CHAIR: So are you thinking across platforms or asset classes? What are you thinking of here?

MR. CARLETON: I think you can start with the low-hanging fruit where you would have a long position in cash versus a short position in the derivative is a natural and easy cross-margining solution to come up with.

You can, with more sophisticated risk management capabilities, as you understand the variance/co-variance of the instruments involved, begin to get more creative about how you cross-margin. As I say, I'm not an expert in any of these things, and I would leave it to the experts to come up with those sorts of solutions.

COMMISSIONER CONDON: Just to clarify, if I may. It's pretty clear from your presentation you don't support the Maple acquisition of CDS, and you have made a number of comments about the way that the competitive trading marketplace works. But it wasn't completely clear if in fact you did favour the status quo with respect to the competitive marketplace or not. What recommendations or what submissions would you make about that?

MR. CARLETON: Well, as I said at the

outset of my remarks on the competitive landscape we are very much of two minds. In the event that competitive market forces are allowed to operate we believe that almost counterintuitively a combination of Alpha with the TMX Group will probably result in a greater amount of market share or business available to the competitors.

I can't think of a market where you have sophisticated consumers that permit that kind of monopoly power from a provider. So, as I say, we can certainly construct a version or vision of the future that would support more business being available for the competitors.

That said, I am not a hundred percent confident based on the acknowledged activities to date and our experience to date that that's necessarily the case.

COMMISSIONER CONDON: And so in the event that Maple does acquire Alpha there is nothing that you would see the regulators would need to do to address the interests of the unaffiliated marketplaces?

MS. PETLOCK: I would say that's a slightly different issue. I mean, there are questions to date as to whether some of the behaviours wouldn't attract regulatory scrutiny, so we would imagine going

forward there would be closer scrutiny because of the concentration, and we have almost had a little Petrie dish to look at so far, and then it would be more apparent in the new world.

I think to have a preferencing agreement included in an application that says if this happens, don't worry, we won't preference them any more, I think that that leaves regulators at least with a starting point to look at things in the future.

CHAIR: So do you believe there has been intentional preferencing of Alpha to date?

MR. CARLETON: Yes.

MS. PETLOCK: Absolutely.

CHAIR: Are you basing it only for their market share? Do you not base it potentially on the fact that we have marketplace rules and requirements for best execution? We have obviously I would think a fairly high quality marketplace in place in Canada? I think many of our colleagues to the north or south maybe would agree there are many aspects of our marketplace they would desire to have. Your colleague to your right agrees with that since she had something to do with putting it in place.

So having said that, let me understand what you're saying here when it comes to this issue.

MS. PETLOCK: Everyone always has to be careful with this because much of what we know is often in the industry just discussed. If we could provide a piece of paper to you we would, but it is common knowledge and it's been published by Alpha itself that they created the Momentum Initiative, right, which stated there would be trading in certain names on certain days. That was acknowledged.

And it was done in order to provide liquidity, sure, but you have to have owners prepared to all agree to send all their orders in certain names or a critical mass order in those names upon a certain day. I think there are many people who would argue that that isn't necessarily a normal competitive response.

CHAIR: Let me ask you this. If you believe the purpose that Alpha was created for a particular purpose arising out of the then -- would have been ATS rules, now marketplace rules. If you believe that's the case, and if one of the reasons for that given the ownership structure was to cause the TSX to become a more innovative efficient organization and reduce its costs, and by that I mean trading costs, I think we all agree that's occurred.

I think you indicated, Mr. Carleton,

greater liquidity, pricing spreads narrowed, all the things that high-frequency traders like to talk about today as well and an issue obviously regulators are trying to understand.

So if that's been the case, hasn't the objective been made out and as a result of despite the ownership struck fewer some of the advantages or benefits to the marketplace has occurred because of it?

MR. CARLETON: I don't know I would describe the state we find ourselves in necessarily to the creation of Alpha.

What I would say is, yes, we are in a better state of affairs than our colleagues to the south where rampant internalization, wholesaling of order flow removed the retail investor from the public markets and instead their orders are executed in dark pools and proprietary books that wholesalers and so on and price discovery is now conducted amongst a series of high-frequency trading firms and quants and so on and so on. That's not a market structure that any of us would advocate.

But at the same time, we do believe that our market structure could be better and that without preferencing initiatives being conducted by various entities in the marketplace we would see

innovation and cost efficiency rewarded to a greater degree than we have to date.

CHAIR: So just taking a step further, when you look at this transaction obviously there's the trading side and CDS side, and you have obviously very strong views. I realize and I appreciate the qualified position you take with respect to Alpha disappearing, if it did, because obviously it might benefit your organization. So we understand the position that you're taking and appreciate that.

But if you think a little bit more about the CDS side and the cost-recovery models versus a for-profit model you spoke of, there has been a lot of discussion about that, and obviously it's a really important issue for regulators to come to grips with.

I'd just like to understand a little bit more clearly how you see that directly effecting CNSX or Pure Trading as well. Just help me with that a bit.

MR. CARLETON: I think it works in two ways. The first one is when we began the operation of both markets in sharp contrast to some of the examples internationally that I cited we had a willing and constructive partner in CDS in the integration of our services into their offering. So from that

perspective, as I say, they were a joy to work with, and I'm not so sure that the next marketplace that comes along CDS were a for-profit model owned by the incumbent markets would necessarily have that same experience, so again directly relating to us.

Secondly, we are obviously very concerned about Canada's overall efficiency in the delivery of both pre- and post-trade services so that when we go out to talk to people in the United States or internationally they don't care about Pure Trading, they don't care about CNSX markets. They want to hear about Canada, what's our market structure, what's the reputation, the regulatory -- what's the clearing like, is it an open system?

So, as I say, from our perspective, that's part of infrastructure we have created, at the very effective in its present state. Again, in power submission, particular concerning with that model develop successful to date represents a significant risk to our industry.

CHAIR: What about the risk of not doing it? It seems like the status quo in your mind is very definite. I see nothing definite or definitive about the capital markets today. Look at the last several years for obvious reasons and where we are

going in our capital markets with traditional globalization which I think is the reality. We talk about local clearing of derivatives in this country and we realize if that occurred we certainly need some international participation or the cost would be fairly considerable for Canadian participants. So why do you think the status quo is so reflective of where we need to go?

MR. CARLETON: I don't know it does. We talked a little bit about cross-margin initiatives. That's a place we need to go. The links that CDS has with DTCC to clear cross-border transactions to the United States is a facility that should be better developed, it should become more efficient, the amount of friction between taking securities cross-border in cash should be reduced. But that is something that the users of CDS, a direction that they're going to drive, and I think that the track record is that by and large they have driven CDS in the appropriate directions and, as I say, compared to the direction we see if CDS is within the Maple Group we certainly prefer door number one as opposed to door number two.

MS. PETLOCK: I think there's one other distinction. I think to say this would drive innovation is very difficult for me at least I think in

my years of experience with these kinds of issues to see because I don't believe it's the for-profit nature that would necessarily drive it but whether or not there's competition.

So in a way we're looking at a whole combined issue when there's different pieces of it that have different results. So a monopoly traditionally supposedly does not do innovation well. So all we would be doing is creating a monopoly in a for-profit body, which doesn't necessarily lead to innovation. So I think that's what we are reacting to.

No one in this room ever said there can't be improvements. Even the people at CDS would suggest there could be. We're just saying this doesn't actually address that issue in any way.

CHAIR: But you're not really talking about competition in clearing, are you.

MS. PETLOCK: Well, what I'm saying is if there could be, then maybe, maybe for-profit clearing could lead to innovation. I'm not even suggesting it necessarily does because of the nature of clearing. I'm not really thinking that the Bank of Canada is going to want to backstop another clearing agency in Canada, and I don't think the participants are going to want to join with other credit rings.

CHAIR: So how do you get innovation then?

MS. PETLOCK: I think what's said in the earlier panel is true. Participants have done a relatively good job. Maybe it's slower than we would like but in this model it's a bit of art and science.

MR. CARLETON: Again to be clear, we don't believe including CDS within the Maple Group is going to drive innovation. Our concerns, our fear in fact is it's going to drive anti-competitive forces.

CHAIR: So what if it was just part of TMX and not part of the Maple Group? Would that make you feel better? Same issue?

MS. PETLOCK: Same issue.

MR. CARLETON: Yes.

CHAIR: Same issue. Because, as you've heard, TMX or TSX attempted to acquire over the years the CDS group for reasons that Mr. Kloet indicated, Mr. Virvilis had indicated as well. So you view it as being the same. A status quo is what works, unless you have competition. It's unlikely you'll have competition. So therefore CNSX's view is leave thinsg alone.

MS. PETLOCK: So it's a bit of a mixed bag.

MR. CARLETON: And it's clear if you look at comparative analysis of exchanges that are integrated with the clearinghouse investors report, those organizations with a higher multiple. Their cost of capital is lower and the returns are greater. So if I were Mr. Kloet I would be attempting the same thing just as vigourously as he did.

CHAIR: I think the one undisputed fact is between DTC and CDS the lowest of clearing costs exist in North America. I don't them that can be disputed unless maybe there is another clearing system somewhere else that's not as evident to us were lower clearing costs. In any event, I think that seems to be the case.

COMMISSIONER KELLY: Ms. Petlock, when you submitted your written submission, there -- you didn't deal with it today in the explicitly in your presentation but I understand its indicated there's really no realistic possibility of competition in Canada because there are natural constraints around DTCC which you just touched on. I assume that's what you were referring to, the Bank of Canada backstop and setting up credit rings.

MS. PETLOCK: I think there are two parts.

COMMISSIONER KELLY: I was just going to ask you whether you felt that DTCC actually does provide any competition right now, and just elaborate a built more on what those natural constraints on DTCC are.

MS. PETLOCK: From the conversation I do agree with the statements earlier. One of the things we have observed is Canadians trade in Canada and Americans trade in the U.S. Obviously, it can happen, but the majority of trading is the location of the investor.

As better described earlier, that's partially probably because of the costs. No matter what you do to do that cross-border link, people are going to want to hold the securities. Ultimately, one of the depositories is going to have to sort of maintain. So it's going to go back and forth. I know something about clearing, but I'm certainly no expert.

That's why so far we have had this cross-border competition for years and it's never really formed competition because of those barriers. Unlikely DTCC would want to be regulated in Canada if it were to try to open up shop and be a fully regulated clearing agency. More so I think all of the infrastructure built in this utility model has served

the participants really well, and I think they would be very, very uncomfortable with having to participate in two different sets of clearing in order to maintain competing clearing.

COMMISSIONER KELLY: And that infrastructure you're referring to is what specifically? Is it the stuff we heard about earlier over and above the clearing and settlement?

MS. PETLOCK: No. In essence in order to make the clearing work you have a lot of entities who are taking on the risk. They all play different roles. It was well described earlier that there are a number of protections built into clear, the last of which is the Bank of Canada, before that it's the lenders.

So you have the largest entities the banks sort of holding -- there are credit rings everybody joins. You have to put a bunch money in and collateral. Then it kind of gets moved around. If things go wrong there's a series of things who holds the bag at the end if other people fail. So there's all these agreements in fail how it's going to work. People are putting up serious money in order to make all this work on a daily basis. And then you would have to try and put together the two streams from two

different clearing agencies. It's not viable especially with the size of the Canadian markets.

I would go back to DTCC to say remember that's not free. They would never have a way in and whether any Canadian institutions to date want to be a clearing member in the United States, bifurcating their responsibilities and their collateral and they probably wouldn't prefer that although I guess they can answer that for themselves.

COMMISSIONER KELLY: Thank you.

COMMISSIONER CONDON: Just one last question just in relation to your remarks about the standard of independents for directors. You noted that in your view that should be 5 percent of ownership. Can you elaborate on where the 5 percent number comes from?

MS. PETLOCK: We actually struggled with that. I have to laugh to say this because I used to struggle the with the whole principle based concept. As we looked at this we realized more and more the panes is how do you define independence? Does it start somewhere with someone who can go to the table and not be influenced by something other than the public interest, reasonably influenced? Everyone has various conflicts but somebody sitting at the table who can

easily say they're there for the public interest.

If you have a significant ownership interest, and we kind of struggle with what's the percentage, but certainly if you have given all the standards and securities law, start at 5 percent but maybe ten or twenty percent, we thought at least 5 percent was somewhat reasonable.

But if it's 5 percent among a group of people who have already agreed they will act in a similar way, then all of the rules consolidating position would apply. It would be hard to be independent if you were a group. Certainly, there was no magic behind the 5 percent. We were trying to find a level consistent with other levels for what triggers something material for an investor.

CHAIR: We're like the trains; we never run on time, unfortunately. Thank you both for coming and for your presentation. We have a very difficult decision to make. We are going to finish teachers take few minutes.

--- Recess taken at 4:35 p.m.

--- On resuming at 4:42 p.m.

CHAIR: Mr. Royan, you're back for a second appearance?

MR. ROYAN: Definitely.

SUBMISSIONS BY MESSRS. ROYAN
AND MR. STYLES AND MS. GIGUERE:

My name is Bill Royan. I am the Vice-President Relationship Investing, Ontario Teachers' Pension Plan. Teachers' manages the pension fund assets for the benefit of approximately 300,000 active and retired Teachers' in Ontario.

Sitting with me today are Marie Giguere, general counsel of the Caisse de depot et placement du Quebec, and David Styles, Vice-President Relationship Investing of the Alberta Investment Management Company.

I will devote my remarks today to the issue of corporate governance and particularly our submission that the directors nominated by Maple Pension Investors should be considered independent under the existing rules governing the TMX and should also be considered independent in the context of the proposed Maple transaction structure.

In doing so, I should state that Teachers' has a long-standing commitment to developing, practising and promoting the highest principles of good corporate governance, both in Canada and abroad.

The OSC Notice states: "Where an exchange has one or more large shareholders or where a

group of shareholders may act jointly or in concert, the independent 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."

Teachers' believes several factors. First, the varied interests of the Maple investors; second, the existing 10 percent ownership restriction over TMX shares which Maple proposed to adopt; third, the established legal tests to determine if parties are "acting jointly or in concert"; finally, fourthly, each director's obligations under corporate law.

Each of these functions to ensure that one or more shareholders acting together will not exercise disproportionate influence or control over Maple.

The issue warrants a deeper discussion both in the context of the Maple transaction and in light of our concern that the basis upon which this Commission has raised this question could have a broad and clearly negative impact upon the manner in which large organizations like Teachers' invest in Canadian public companies.

As you heard this morning, the Maple

investors have no agreements and no understandings to act together following the acquisitions of Alpha and CDS. We are very different organizations with divergent and often competing interests. Some on the buy side, some the sell side.

The funds compete with the funds both in Canada and globally. The banks compete with the banks for business and for customers, and in many cases the funds and banks compete for a whole range of products.

While we have agreed on a high-level business model, the on-going assessments and implementation of that business model will be in the hands of the board and of management. Maple's senior management will be the current TMX senior management, and each of the board of directors will be required to act in the best interests of the corporation, a point I will address in detail shortly.

If the Commission is concerned that Maple investors act together to implement a common vision, the TMX is already subject to restrictions which address this concern - the 10 percent ownership restriction coupled with the acting jointly and in concert analysis.

These restrictions are not applied on a

one-time basis on the date of the acquisition. They are on-going restrictions with severe negative consequences if breached and are subject to enforcement by the Commission at any time.

Under Canadian law, a corporate director owes a fiduciary duty to the corporation, which itself embodies a diverse array of shareholder interests and stakeholder interests.

This applies to directors elected by a majority of shareholders in a widely held public company just as it will apply to each director nominated by a Maple investor and subsequently elected by the public shareholders of the TMX.

The duty of a director in Canada is to the corporation and not to the investor who nominated that director to the board. This is the law of the land, this is good corporate governance, and a failure to respect it carries personal liability for the director in question.

Maple is not a model in which certain directors will be serving the Maple Fund investors, other directors serving the banks, one serving the independent community, and so on.

Instead, there will be 15 highly capable directors, each acting in the best interests of

the corporation. Given the TMX's mandate, the best interests of Maple will squarely include the public interest.

We also note that the nomination process proposed by Maple is designed to enhance corporate governance integrity at the board level. No investor has an absolute right to appoint a specific individual to Maple's board. Each nominee proposed by an investor must be vetted and approved by the governance committee of the board, a committee which will be comprised of independent directors. The ultimate decision on whether a specific director nominee will serve on the board lies ultimately with the shareholders.

Maple has previously stated that it will adopt majority voting such that if any nominee individually should receive less than 50 percent of the votes for their election to the board, that individual will offer to resign. Any shareholder with a concern about a director's independence or that director's performance will be able to express that concern with his or her vote.

On a more fundamental level, we believe that the interests of Maple's shareholders and the public interests are aligned. Maple's board and

management will create value by building a strong and competitive business that meets the needs of its users.

Given the intense level of competition that exists in the global, North American, and Canadian exchange space today, low barriers to entry, and rapid technological change, among other things, if Maple does not deliver a business model that serves the public interest, its users will simply route their trades elsewhere. At the click of a mouse, issuers will seek access to capital on other platforms and in other markets.

Conversely, if the potential of the integrated model is realized, Maple can create a business that preserves open access fees, increases capital flows and liquidity, builds on the TMX's leadership in derivatives clearing and trading, and enhances the regulatory ability to manage systemic risk.

As Ontario Teachers' stated in our letter to you, securities laws do not currently deem, and we are not aware of another situation where the Commission has determined, that a nominated director lacks independence due to his or her nominating shareholder owning less than 10 percent of the issuer's securities or by virtue of having been a proponent for

that transaction.

We are deeply concerned with the precedent set by redefining this definition of "director independence". The introduction of a novel independence exclusion could have a broad impact beyond the Maple transaction.

There are a great many regulated, for-profit, publicly listed businesses in Canada that serve the public interest. If the Commission choses introduce a novel independence exclusion based upon Maple's public interest mandate, it is difficult to see that that exclusion would not eventually appear in the context of these other businesses.

The idea that a director lacks independence merely because that director was nominated by a large shareholder of the company is a concept that would materially and adversely impact the ability of institutional investors to invest in and to be meaningfully involved with the oversight of portfolio companies. It also runs counter to the fundamental belief that the interests of shareholders and directors should be aligned.

On behalf of Teachers' and the rest of the Maple Fund investors, we submit to you that there is no need for the Commission to introduce a novel

independence exclusion. The varied interests of the Maple investors, the existing ownership restrictions and acting jointly tests, and the fiduciary duties owed by the directors are sufficient to address any concerns regarding undue influence by the Maple investors going forward.

In addition, the governance model that we have proposed is appropriate and suitable under the circumstance, fully meets the test of an independent board, and will well serve the interests of the business and all of its stakeholders, including users, the public, and Canada's capital markets.

My colleagues and I will be pleased to answer any questions the Commission may have.

CHAIR: So are your colleagues making any submissions? I'm not asking you to. I'm just wondering.

MR. STYLES: Not independently, but obviously, we agree with what our colleague from Ontario Teachers' has said.

CHAIR: I'm hoping to get a little action between you here, but I guess I'm not going to do that. Well, thank you very much.

The issue of independence raises sort of a basic question. Do you think it is important?

MS. GIGUERE: Yes.

CHAIR: Why do you think it's important? And why do you think securities regulators are sort of punching at this issue as hard as we might be?

MS. GIGUERE: We don't know why you're punching at it.

CHAIR: Wrong word.

MS. GIGUERE: But certainly -- and I think I can speak for the other people sitting at this table. I think as institutional investors we like to see strong, independent boards and people who are not unduly influenced by conflicts of interest and the like. So we do consider it important, and all of us have policies whereby in the companies that we own interests in we vote based on these criteria.

CHAIR: So you don't see anything unique in this situation? In other words, you use the 10 percent, which is quite interesting. Obviously, if it was more than 10 percent you'd say, well, that's not independent for sure? That's what you're getting at, Mr. Royan?

MR. ROYAN: No.

CHAIR: Because you used 10 percent. And we have a 10 percent requirement on ownership,

obviously. But let's say you have 15 percent. Would you still want 15 --

MR. ROYAN: Certainly, the classic and the current definition of "independence" whereby the relationship is of the director to management rather than the relationship between the director and whether its economic interests or conflicts of interest, the real question is whether economic interests adequately remove that director's interests from having challenges of conflict with regard to management.

Each of the investors are clearly of the view that that economic ownership stake is sufficient in and of itself to categorize the director nominee to be independent of management, and, therefore, able to exercise appropriate governance over the management of the firm.

CHAIR: I'm not challenging your view, and I recognize how we have defined it. I'm just trying to understand it in the context of this transaction, which I think we could all agree is a very important transaction for our capital markets. I think you are here because its importance and why you are representing the interests.

MR. ROYAN: And so the additional comment there away from that current and classic

definition of "independence" is the comment we made in some of these statements this afternoon and in the statements this morning whereby the duties of a director legally to the corporation are clear and encompassed in this unique case of the public interest.

CHAIR: You have a lot of experience in this area. I'm just going to challenge you a little bit now since you've raised it.

You have your duties, we know what directors have to do, they're legally obligated under corporate laws to the duty of care and their fiduciary obligations, and they exist regardless of independence. I think you would agree with me there. Regardless of whether you've independent or not you do have these duties, and they are requirements by law.

So if you view independence as important, why do you need this independence consideration as being so significant when you have these legal obligations which you're bound to have regardless of whether you're on the board or not? They have those duties and those responsibilities. Why is it that you think if you're not considered to be independent that somehow or another your interests, ownership interests wouldn't be looked after or considered? Why would that be the case?

MS. GIGUERE: Well, I think if you look at independence from management being the concept here, which I think it generally is in corporate law, the purpose of the board of directors is to oversee management. So that is, to me, the first truer test of independence. There could be other circumstances --

CHAIR: So you start there.

MS. GIGUERE: That's where you start, and that's I think where the concept of independence started and all the concepts of governance started actually.

CHAIR: Sure. We recognize that. I'm just trying to understand the extent of the connection that you're advocating. I think what you're saying is that basically you are still independent despite the ownership interest in Maple as advocated in this acquisition, is really what I'm saying.

MS. GIGUERE: Right. And directors have a duty to the corporation and shareholders. Therefore, you cannot disassociate the shareholders from the corporation and their board.

CHAIR: Right.

COMMISSIONER KELLY: You mentioned that you are having a hard time understanding why we are punching so hard at this. I guess I would ask the same

question of you: We're having a hard time understanding why there's such strenuous objection to the idea of more independence. Can you enlighten us a bit on that?

MS. GIGUERE: Bill made the point that one of the reasons is that this creates a huge precedent and could create a precedent for other investments, and I think that's one of the reasons that as a group the pension funds involved have raised the issue.

As we said, the Canadian Coalition for Good Governance indicated that they didn't feel there was an issue there and were concerned about the position.

MR. ROYAN: So in terms of an additional comment, one of the sentences that I did not read from the prepared text was there's a title for several of the areas within the comments we have provided. The title for the section where we finished was titled "A Damaging Precedent".

Back to Marie's comments, at the end of the day although that's a strongly worded title, one of the critical aspects that we as institutional investors view is that even though in this context the Commission's view it is a unique combination of facts,

circumstances combined with the public interest, a decision here is going to be used by issuers and in the broader Canadian context without that proviso. The fact that this was a decision made in a unique public interest case, the second half of that sentence from our perspective will be very quickly lost in circumstances where issuers or, under other examples, find that disappearance of the second half to be --

CHAIR: So you would say, just to take that a step further, if your respective funds decided to acquire 8 percent of a company listed on a stock exchange, for example, you would say that if we determined here that you were not able to establish independence in that situation that that would be an example of a damaging precedent that would flow from that decision?

MR. ROYAN: Absolutely.

CHAIR: And you believe that that would be the case.

MS. GIGUERE: Theoretically. Based on what we have heard so far, yes. And you're right, the entity could, before it occurred, have acquired 9.9 percent of TMX, right? And in the example you give, you could decide that that person is not independent.

CHAIR: You used "regulate". I think you were talking about regulated utilities when you used that example, but regulated utilities are different than what we do, and so a regulated utility really has a significant amount of regulatory oversight on all aspects of its operations, including what the cost of capital will be set for. It's a very different environment when you think about corporate governance in that environment than potentially in this environment. Do you not see the difference there?

MR. ROYAN: We see a difference, but we would say at a philosophical level, without the application of a specific set of details with regard to utilities, or railroads or a toll road, that at the end of the day the philosophy of the application is still generally the same. There is still significant regulatory oversight, there is the ability of the regulators at various levels to have a dramatic impact on how the business is run and operated and governed. And therefore, as institutional investors, the ability to have insight and governance with regard to a major investment in which we are reasonably large shareholders, and again are clearly independent of the management view, is very important.

COMMISSIONER KELLY: But would you

agree that market infrastructures by definition -- and that includes exchanges, clearing agencies, whatever, by definition are unique, and, as you talk about it, being precedent-setting, I wonder whether I would prefer to describe the environment as that, just a "unique" environment as opposed to setting a new precedent.

I mean, when you think about the definition of independent directors in this environment, should there not be a higher standard as one example? We are not talking about a railway here. We are talking about managing and regulating an entity that is critical to the efficient operating of our capital markets, and in inherent in that is huge systemic risk. So clearly I don't think the comparison can be made to some other utility.

MS. GIGUERE: But I think following up on what you said, what you need is to make sure that the directors on that entity understand the capital markets, are sophisticated and understand the public policy role that they have to play. That's what's important, is that they understand how the business works and that they be independent.

COMMISSIONER KELLY: But would you agree it is a unique set of circumstances?

MR. ROYAN: We are certainly very sensitive to that concept, but from our perspective there is a slightly different approach we would take, which is the exchange and the capital markets context create a unique set of circumstances in that industrial dynamic.

Back to your comment with regard to railroads, the fact that there are only two railroads, both publicly traded, and the percentage of the Canadian economy that depends critically on the transportation of those of goods is a very significant impact on Canada as a whole. It doesn't lessen the impact that the exchange has on Canada, but to say it's dramatically different than the railroads which have a very large impact on the Canadian economy as well...

CHAIR: It would be interesting to see, and I don't have that information, what the National Transportation Agency requires of Canadian Pacific Railways and Canadian National Railways with respect to its corporate governance requirements.

I don't have that information.

And they're not rate-regulated any longer, and I'm sure you're aware of that. Maybe we'll just get that information. I'm interested in what that might be.

Just following up, the issue here however is a little bit different because between the buy side and sell side you would have eight representatives. Is it eight?

MR. ROYAN: Correct.

CHAIR: Of 15? You could ask yourself the question: Why not two and two as opposed to four and four? Why would that make this transaction so - I'm just tossing this out for your comment - disagreeable? Why would that be the case?

MR. ROYAN: So the perspective we have there is it's both policy and it's practice.

So to start from a practice perspective, one of the conversations we had this morning was the fact that the types of investors within Maple are not monolithic. Each of the banks has a dramatically different set of perspectives and focus and each of the investors has a dramatically different focus or style or investment strategy. Therefore, the question of practically for a reasonably large investment in terms of hundreds of millions of dollars each and in terms of a reasonably large ownership stake in Maple, the practice is how does each of those investors oversee and have a sense of the performance of the business and the governance of the business?

And then with regard to policy, the fact that each of us as individual investors are not monolithic and have significantly different perspectives in furtherance of that creates an additional dynamic around desire for board representation.

CHAIR: I think you would agree with me Maple would be a highly concentrated entity. Do you agree with that? Both by way of buy side and sell side. Or perhaps you don't.

MR. ROYAN: If you could just clarify.

CHAIR: Order flow for example. Would you not agree that it would be highly concentrated, that they would account for a significant amount of order flow, buy side and sell side in Canada? Would you not agree with that? If you don't agree, that's fine.

MS. GIGUERE: On the sell side I would assume that they represent a reasonable percentage.

MR. ROYAN: We have the exact percentage. The fact is that the four Maple participating organizations plus the other participating organizations are something a little less than 40 percent of the annual trading volume --

CHAIR: Combined.

MR. ROYAN: -- and so is significant. There is a significant percentage of the order flow that exists outside of those participating in the Maple organization.

CHAIR: So that's helpful.

What I wanted to get at here is obviously you're highly involved in the proposed transaction, obviously. There is the issue of the profit maximization goals which you would have for this entity. I suspect you're not getting involved in this because you have just a great belief in the public interest. I'm not suggesting you don't, but you do have a profit maximization goal here, you do have your own fiduciary obligations to your own stakeholders and funds.

Tell me how that sort of augers with, if I might put it that way, with this issue of independence, given the change that's going to occur for example on the CDS side which you've heard a lot about here today.

MS. GIGUERE: I wouldn't see it as being different than the situation for the current directors because the current directors are operating in this regulated environment but in a for-profit corporation where they also have a duty to the

shareholders in addition to this public interest obligation.

CHAIR: You don't see the profit maximization issue as in any way affecting the issue of independence of participation on the board, is really what I was getting at. You don't see any difference?

MS. GIGUERE: No.

COMMISSIONER CONDON: Can I just follow up on the issue that Howard raised, not so much in terms of profit maximization but in terms of the fact that certainly with respect to the Teachers' Pension Plan there is a fiduciary responsibility flowing from the plan to the beneficiaries of the plan.

So with respect to some of the features of the proposal to do with the length of time that you've committed to remain a shareholder of Maple, the non-competition agreement, the non-preferencing agreement if that becomes an issue, you are satisfied that there's no possibility for conflict in terms of those sorts of agreements and your fiduciary responsibilities to your beneficiaries?

MR. ROYAN: Correct. In large part because we do not believe that those comments and the fiduciary duty of each of us to our plan participants overrule the fundamental duty of a director to the

corporation and the wide range of stakeholders.

MS. GIGUERE: And the decision to invest was made taking all of those elements into consideration.

COMMISSIONER CONDON: The decision to invest, absolutely.

But circumstances could change for the plan in terms of the viability or profitability of this investment. Meanwhile, you are required to stay in the investment for a particular period of time. That doesn't cause any difficulty for you as a fiduciary of a pension plan?

MR. ROYAN: Frankly, it does not because again the --

MS. GIGUERE: No.

MR. ROYAN: To loosely use this phrase, we do not have the perspective that the fund nominee directors have the optionality to opt out of their duties as a director of the corporation.

COMMISSIONER CONDON: Leaving aside the whole director issue altogether, just in terms of your role as an investor in Maple and your responsibility to your beneficiaries?

MS. GIGUERE: Again, I speak for the whole group, we often make investments where we do

agree to stay in for a period of time, and that's because we have a long view. And that is not unusual for pension plans our size.

CHAIR: Would you stay for five years?

MS. GIGUERE: It's just not unusual. I'm saying that we often make investments where we agree to stay in --

CHAIR: So what you're saying is let's say in year three it goes bust. What do you do then? How would you discharge your obligation, then, to your beneficiaries in that situation? No one hopes for that, but we all realize that the markets can be boom and bust from time to time.

I'm just following up on this question because you've locked yourself in and we're just trying to understand that. And maybe it's not a regulatory issue for the OSC. Maybe it's not. And I don't mind you saying it's not. But it is an interesting issue nevertheless.

MR. ROYAN: The practical answer is that it is not.

But that having been said, to provide some colour, each one of the funds at the table today have examples where in terms of long-term investments where the investment horizon is a period of years there

are examples of where those investments have struggled and the corporations have struggled. Each of us re-evaluates the circumstances at the time, and each of us has examples of where we put additional capital into that business because we have the view that that's the better way to ensure that the balance of fiduciary duty to the corporation, fiduciary duty to the plan beneficiaries, and the ability to make the investment better is well served by additional capital.

CHAIR: We understand that. You did indicate, I think, that it is standard practice for institutional investors to obtain a director nomination with respect to when there's a substantial direct investment? That is standard practice?

MR. ROYAN: Yes.

CHAIR: For all of your funds, I guess.

MR. STYLES: Yes.

COMMISSIONER KELLY: Just an anecdotal question, but humour me. You're all seasoned veterans, been involved in probably hundreds of transactions each. Have you ever been involved in a transaction where there are so many perceived conflicts? We talked about the unique nature of this in terms of it being infrastructure and so on, but also just in terms of -- as you've heard, many of you have been here all day and

would have heard the comments from many of the other presenters. Just curious.

MR. ROYAN: Certainly from Ontario Teachers' perspective, one of the realities of the last three or four years -- and this is actually a comment made by the chairman in one or two of the last sessions, was over the last three, four years, particularly in the financial sector, there has been an enormous number of banks or financial services firms needing capital generally for recapitalization purposes.

CHAIR: I think it happened yesterday, too. I think five central banks poured a lot of money into Europe or made it available.

MR. ROYAN: So certainly -- I don't have enough colour with regard to their funds, but Ontario Teachers' has been involved in a number of situations in the financial services industry where the public interest of investing in a bank in a circumstance where the financial capital markets are incredibly either liquidity- or solvency-constrained, where the government, U.S. government or in other jurisdictions, is either provider of capital as well, pushes capital from the federal government as well as private investor capital, also in conjunction with

often loss-sharing whereby some level of government or some regulatory body is actually absorbing some dollar losses, and whether they're the first dollar or the last dollar there's a whole range of investments that have been made, 2008, 2009 and today, which have very significant public policy, public mandate, public interest questions.

This is challenging, true. Maple does have a variety of many investors and many public policy and public mandate questions, but there are many other examples where, if only from a size perspective, there are very serious public mandate issues.

CHAIR: We could explore that at length, I think, but I think I understand where you're going.

I asked a couple of questions earlier, and since you are major investors in this entity, what's wrong with the status quo? If you see this, then I would -- I think your duty to your beneficiaries is to make these investments in a manner given the way in which particularly pension funds need to operate in this country. Do you see this as a commitment to the public interest and our capital markets, or do you see this as an opportunity to indeed invest in an entity in which profit maximization is very likely and possibly

more likely, given the obvious monopoly services that at least one aspect of this business will provide? How do you see it?

MS. GIGUERE: I think we see it as both. I'll speak for the Caisse right now. I think we see this - and the statement was made earlier today, this morning - as an opportunity to strengthen the Canadian market, which is, as we said earlier, a small market. I think it's a fairly unique opportunity. But we also look at it as a good investment.

MR. STYLES: I would go along with that. When the proposal was initially presented to us we looked at it as an investment. It came in and we saw an opportunity where we had an exchange, we think it is undervalued. And clearly at that point in time there was another global exchange that felt the same way. And we saw an opportunity through the plan that Maple was presented to build what we think can be a global competitor and can really build a strong and successful business.

So, sure, that ultimately leads to the profit motive, but we didn't view it as, oh, what can we do to squeeze every last penny out of the business as it exists. We see it, as with all investments, we can build potentially a global player at a

significantly higher value.

I guess one of the points... I came into the previous presentation at the very end, but from our perspective when we talk about the size of our investment and our independence, I guess I wanted to make the point that while it may be 5 percent of a company, if that company was a $10 million company 5 percent to us is very small.

I think in terms of looking at our independence, you have to look at the size of our funds and how big a piece of our fund any given investment would be and how that impacts on our view.

In this case, we are $200 million, give or take, and our fund is roughly $70 billion. So we have several investments much larger than that. So it's not the same as we might be buying -- if we put 5 billion into Apple and ended up with a tiny percentage, but obviously it would be something where we would have a different perspective.

CHAIR: I appreciate the direction you're going in, what you're suggesting.

I think we have reached the point where we don't have any other questions for the three of you. We appreciate you staying until the end of the day for this. Once again, thank you very much for coming.

Thank you for your submissions today, all three of you.

I think that concludes the hearing for today, and I think we are beginning tomorrow morning at 9:30.

--- Whereupon proceedings adjourned at 5:19 p.m., to be reconvened at 9:30 a.m. on Friday, December 2nd, 2011.