PLAN FOR THE FUTURE

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Ontario Securities Commission
20 Queen Street West, Suite 1903
Toronto, ON M5H 3S8

Attention: Mr. John Stevenson
Secretary of the Commission

Dear Sir:

**Re: TMX Merger Proposals**

OMERS would like to thank the Ontario Securities Commission (OSC) for the opportunity to comment on the proposed transaction to combine the London Stock Exchange Group (LSE) and the TMX Group (TMX). As a significant participant in Canadian capital markets, OMERS supports any transaction consistent with a fair, open and transparent marketplace. Capital markets are an important part of a vibrant Canadian economy, providing capital to support the growth and prosperity of businesses. Any action that improves market efficiency is beneficial to all capital market participants.

**<u>Views on key issues as identified by the Ontario Securities Commission</u>**

**1. Regulatory Oversight over TMX Group, TSX and Mergeco**

Any transaction involving the TMX Group may significantly alter Canadian capital markets and should include protections to ensure that regulatory oversight of the Canadian marketplace remains under Canadian control. Strong regulatory oversight is a key part of an efficient and effective marketplace.

Under the transaction proposed by the LSE and TMX, regulation of the Toronto Stock Exchange (TSX) will remain in Canada under the control of the OSC. The Investment Industry Regulatory Organization of Canada (IIROC) will continue to provide certain regulatory services for the TSX. Overall, under a combination of the LSE and TMX, regulatory oversight of the TSX remains unchanged – OMERS does not view the proposed transaction as an impediment to proper regulation of the TSX.

As part of the transaction, the LSE and TMX propose that the combined Board of Directors shall include seven Canadian directors out of a total of fifteen Board members, with provisions to maintain this proportion of Canadian directors until on or after the fourth anniversary of the combination of the LSE and TMX. On or after the fourth anniversary of the merger, the Board of Directors for the combined entity is required to have the greater of: a) three Canadian directors; or b) the number of Canadian directors which the entity deems appropriate after giving consideration to the relative size of the Canadian business in the combined entity on both a financial and strategic basis.

Generally, OMERS supports the view that the number of Canadian directors of Mergeco should reflect the importance and size of the Canadian operations to the combined entity. We are encouraged by the fact that Mergeco will have an independent board; however, OMERS also believes a strong Canadian presence on the Board of Directors of Mergeco over time is required to ensure the LSE/TMX remain aware of the effects its decisions may have on the TSX and on Canadian capital markets. In the longer term, we think it would be appropriate for a minimum of 25% of Mergeco's directors to be Canadian. At this level of representation, there would be a strong presence to ensure the impact of Mergeco's activities on Canadian markets remains a key concern to the overall entity. It would require a two-thirds majority of the non-Canadian directors to agree to proposals to which Canadian directors are opposed – a sufficiently high hurdle.

## 2. Ongoing Share Ownership Restrictions

Currently, without prior approval by the OSC, no person or company, acting jointly or in concert, shall own or control more than 10% of the voting shares of the TMX Group. The LSE and TMX propose that if they combine, the OSC would retain the authority to approve of any party seeking to have legal or effective control of the combined entity (control over 50% + 1 of the shares of Mergeco). The UK Financial Services Authority (FSA) would have, as it does for the LSE currently, the authority to approve all owners of Mergeco greater than 10%, as well as reviewing ownership when they gain control of 20%, 30% and 50% of the entity.

OMERS believes that the TSX represents an important piece of financial infrastructure in Canada. As such, the OSC should retain the right to approve those wishing to acquire significant ownership in the TSX and its parent entities, including a combined LSE/TMX group. Regulation and oversight in other jurisdictions may evolve over time, and it would be prudent to ensure Canadian regulatory authorities have the ability to approve significant ownership in an entity vital to the health of Canadian capital markets. In our view, "significant" ownership in the combined LSE/TMX would begin at ownership levels closer to 10% rather than the 50% level where the OSC would have authority to examine ownership under the proposal by the LSE and TMX.

## 3. Governance and Core Operations of TMX Group and TSX

The combined LSE/TMX Group proposes to continue maintaining the TSX's core operations in Canada. OMERS views it as imperative that the TSX remains an important national exchange with domestic operations. The presence of a strong exchange has important network effects which lead to increased financial sector relevance and financial sector employment which benefits and diversifies an economy. Long Finance's most recent issue of its global financial centres ranking, *The Global Financial Centres Index 9*, ranks Toronto as the tenth most important financial centre in the world and the third most important in North America.[1] The presence of a vibrant TSX in Toronto is vital to ensuring Toronto's continued strong standing as a centre of financial influence.

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[1] *(Long Finance, 2011)*

It is in the combined LSE/TMX Group's interest to maintain the TSX's core operations in Canada. The TSX's stakeholders, including market participants such as OMERS, broker dealers, listed companies on the TSX, and prospective listing entities have a significant presence in Canada such that a combined LSE/TMX would still find it necessary to maintain the local infrastructure required to support the operations of the TSX, its customers and issuers.

The LSE/TMX proposal also includes assurances that the TMX Group and TSX Boards of Directors have at least 50% of their directors be ordinary residents of Canada and independent. We believe these standards are adequate to ensure the appropriate representation of Canadian interests on these Boards of Directors, particularly if combined with our view that the parent board of the LSE/TMX Group should have a reasonable level of Canadian representation in the longer term. Overall, significant Canadian representation at all Board levels would ensure that Canadian concerns are given their due weight in the ongoing evolution of the entity which controls the TSX.

## 4. Assessment of Proposed Transaction

National exchanges worldwide have historically operated as monopolies, but the desire for greater competition led to the elimination of barriers to entry. This opened up traditionally protected markets to competition from other regulated exchanges looking to diversify away from domestic markets and led to the emergence of new players in the form of alternative trading systems (ATS), both of which have put downward pressure on pricing. OMERS expects this downward pressure on trading fees to continue should the proposed LSE/TMX transaction be completed.

Given the high fixed cost structure of the exchange business model (mostly related to technology expenditures), scale has become an increasingly important factor for exchanges to remain competitive. ATS have offered lower trading fees to attract volumes, negatively impacting exchange profit margins across the industry. Equity trading has become a commodity-like business, as a higher number of companies now compete on price, with any differentiation on technology usually short-lived. Improved technology has also allowed market participants to use venues across the world to access best execution for their investment needs. Exchanges need to find ways to be more efficient to earn adequate returns on capital – this can be achieved by spreading fixed costs over higher volumes.

In an environment of low trading volume growth worldwide, consolidation among exchanges is required to generate necessary cost synergies on both operations and capital spending (i.e., one trading platform instead of two with ongoing back-office savings). OMERS views the LSE/TMX transaction as representing a necessary step to ensure the continued global relevance of the TSX and Toronto as a global financial centre.

The cost of listings for Canadian companies had been rising prior to the LSE/TMX deal announcement, most likely as an offset to margin declines on trading fees for the TSX due to intense competition. Any further increase in listing fees is unlikely to be a direct result of a merger between the LSE and TMX. While there has been some competition between AIM and the TSX Venture Exchange (LSE and TMX's respective junior exchanges) for small-mid capitalization listings historically, the proposed merger would likely not lead to further increases in listing prices for Canadian companies. Overall, given worldwide competition for listings and the desire for new parties to enter into competition for listings in Canada, we believe the longer term trend for listing fees is fundamentally downward. The cost of listings of Canadian companies should fall over time.

## 5. Clearing and Settlement

Under the proposed LSE/TMX merger, the combined entity would retain TMX's 18.1% interest in CDS Clearing and Depository Services Inc. and its parent company, The Canadian Depository for Canadian Securities Limited (collectively, CDS). Mergeco would also retain TMX's current 100% ownership of The Canadian Derivatives Clearing Corporation (CDCC). OMERS considers both clearing entities to be systemically important to Canadian markets.

**CDS:** As many Canadian securities can only be cleared though CDS, OMERS believes ownership limitations in CDS should be established to restrict ownership by any individual, entity or group of related companies in order to prohibit control, either directly or indirectly, by a single individual or entity. Ownership limits would help ensure that no one entity is the sole source of a clearinghouse's capital. The proposed LSE/TMX combination would not result in a change in CDS's ownership structure as it stands today, whereby no particular entity controls the activities of CDS.

**CDCC:** OMERS believes it is important that Canada have an able clearing house for derivative products that is responsive to the needs of Canadian capital market participants. While it is possible that Canadian OTC-based derivative products could be cleared through foreign clearinghouses, the willingness of those entities to accept products that are unique to Canada is less than guaranteed. Unlike securities traded through CDS, OTC derivative products are less standardized and will have features that are unique to the Canadian marketplace. An inability to identify a clearinghouse willing to clear Canadian-based OTC derivative products could leave the Canadian derivative markets comparatively less efficient and less liquid than other markets.

Further, Canada may need to have its own clearinghouse to ensure the Bank of Canada has visibility into the exposures of Canadian financial institutions to derivatives products, their various counterparties, and the overall interconnectedness of the financial system. The stability of CDCC and its regulation is a key interest of Canadian capital markets participants, including the Bank of Canada. It is important that regulators ensure there is proper governance and oversight of clearinghouses in Canada to make certain that capital market participants have input into the evolution of these entities going forward.

In principle, OMERS believes central clearinghouses owned and controlled by a group of industry members on a cost recovery basis serves to maintain a fee structure that is competitive and reasonable for industry participants. Any transaction conducted in a Canadian marketplace should be required to clear through a clearing agency that has been recognized by a Canadian regulator to ensure that it is subject to appropriate governance and minimum standards for managing counterparty, operational and technological risks. Regulation should ensure that fair and open access to clearing and settlement systems exists for all market participants in Canada, and to support enhanced competition in the marketplace and encourage entrants to the Canadian marketplace.

Currently, CDCC is owned by the TMX Group as opposed to an industry-based association while CDS is owned by a group of Canadian financial institutions. In the longer term, OMERS would encourage the CDCC and CDS to move towards a business model whereby all Canadian capital market participants have input into their evolution. As it stands today, we believe that the LSE/TMX merger would have limited negative effects on the fundamental business model currently in place for clearinghouses in Canada, given proper regulatory oversight of a combined LSE/TMX entity and its clearinghouse holdings and subsidiaries.

**6. Strategic Asset or Infrastructure**

OMERS believes the TSX represents a key piece of Canadian financial infrastructure. A strong stock exchange is an important part of a vibrant capital market and an important determinant of the development of financial centres. However, with proper ongoing regulation and oversight of such institutions, there is limited value in constraining their ownership based purely on nationalistic concerns.

The combination of global exchanges may in fact increase the value and efficiency of national exchanges over time by increasing the sharing of ideas with other entities. Combinations of exchanges, including the LSE/TMX, will help ensure they remain consistently competitive with other market venues worldwide. Such combinations will allow exchanges to offer new products and services, have stronger technological infrastructure, and earn adequate returns on capital into the future.

**Conclusion**

The global exchange industry is undergoing a period of significant change. Various lines of business, including listings, trading and market data face downward structural pressure. Capital flows are becoming more global. The LSE/TMX transaction represents a prudent and logical step by the TMX to ensure its continued relevance in the world marketplace well into the future.

The proposed transaction would ensure that all market participants are treated fairly and would support a business environment that allows for competition among market venues in Canada, thereby ensuring continued low fees for market participants and efficient access to capital for Canadian businesses.

With proper governance, which OMERS views as possible under a LSE/TMX merger with some improvements to the current proposal which we have outlined, the TSX would become a stronger entity under a LSE/TMX combination and would lead to continued high confidence in Canadian capital markets by market participants in Canada and worldwide.

Yours very truly,

Michael Nobrega

Michael Nobrega
President and Chief Executive Officer