Legislative Assembly of Ontario

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SELECT COMMITTEE ON THE PROPOSED TRANSACTION OF THE TMX GROUP AND THE LONDON STOCK EXCHANGE GROUP

Final Report

2nd Session, 39th Parliament
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Legislative Assembly of Ontario

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The Honourable Steve Peters, MPP
Speaker of the Legislative Assembly

Sir,

Your Select Committee on the proposed transaction of the TMX Group and the London Stock Exchange Group has the honour to present its Final Report and commends it to the House.

/Signed/

Hon. Gerry Phillips, MPP
Chair

Queen's Park
April 2011

SELECT COMMITTEE ON THE PROPOSED TRANSACTION OF THE TMX GROUP AND THE LONDON STOCK EXCHANGE GROUP

MEMBERSHIP LIST

2nd Session, 39th Parliament

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CONTENTS

INTRODUCTION

The legal, economic and social complexities of international mergers cannot be overstated. The proposed transaction involving the Toronto Stock Exchange and the London Stock Exchange, announced by their parent companies on February 9, 2011, contains all of these elements. Moreover, it involves one of Canada's most iconic companies, a symbol of commerce and economic activity that dates back to 1861.

Although elements of the proposed transaction will be subject to review and approval in other forums, namely, the securities regulators in Ontario and Quebec, and the industry minister in Ottawa, the Ontario Legislature concluded that it was critical that it obtain a better understanding of the issues associated with a transaction that could have significant and long-term consequences for the economy of this province.

Accordingly, the Legislature approved the following motion introduced by the Honourable James Bradley on February 23, 2011:

> That a Select Committee on the proposed transaction of the TMX Group and the London Stock Exchange Group be appointed to consider and report its observations and recommendations concerning the impact and net benefit to Canada, including Ontario, its economy and people, Toronto's financial services sector and Northern Ontario's mining industries.

The Select Committee's full terms of reference are attached in Appendix A to this report.

This report reflects the findings, observations and recommendations of the Select Committee, which held public hearings in Toronto on March 2, 3, 9 and 10, 2011. As described in the report, the most debated topics during our hearings were governance, control and regulatory issues.

The Select Committee wishes to emphasize that it has no power to impose its view on this matter. It is our hope that the recommendations will be taken into consideration by the proponents of this transaction before seeking the necessary approvals and by regulatory bodies and governments as they proceed with their review/approval processes.

We would like to thank all of the witnesses who participated in these hearings on short notice, as well as those who provided written submissions. In addition, the Committee wishes to express its appreciation to all of the legislative staff who assisted us in our work.

OVERVIEW

The Proposed Transaction

The proposed TMX/LSE Group's transaction was described as a "merger of equals" in a joint statement issued February 9, 2011:

> London Stock Exchange Group PLC ("LSEG") and TMX Group Inc. ("TMX") today announced an agreement to combine Europe's and Canada's leading diversified exchange groups in an all-share merger of equals. The merger will create a world-leading organisation and is unanimously being recommended by the Boards of both LSEG and TMX.
>
> The combined transatlantic group . . . will be jointly headquartered in London and Toronto and will offer an international gateway, leading global pools of capital formation and liquidity together with a unique portfolio of highly complementary markets, products, technologies and services.
>
> The Boards of LSEG and TMX believe that the merger is strategically compelling and will create a more diversified business with greater scale, scope, reach and efficiencies, generating substantial benefits for all stakeholders.

At the Committee's hearings, the TMX Group described the transaction as a swap of shares – there would be no cash or debt considerations. Ownership would be based on the respective capital positions going into the deal. In particular, under the merger arrangement, TMX Group shareholders will receive 2.9963 shares of LSE Group for each share of TMX Group that they own. Following the transaction, LSE Group shareholders would own 55 percent and TMX Group shareholders 45 percent of the enlarged share capital of LSE Group. Structuring the transaction with shares was said to give both groups the opportunity to participate in the future success of the merged entity.

Renamed after closing, the LSE Group would be the holding company of the merged entity. It would be listed on the TSX and the LSE and registered in the United Kingdom. As well, the operating exchanges would continue under their existing names. The name of the TMX Group would not be changed; however, it would not be used publicly.

We heard that each exchange would report revenue and pay taxes in the jurisdiction where it was earned. Canada, the United Kingdom and Italy would each generate about one-third of the merged group revenues.

The merger agreement is available online at http://www.tmx.com/en/pdf/reg_filings/2-9-2011-MerAGt.pdf.

The Proponents' Current Operations

TMX Group Inc., the corporate parent of the Toronto Stock Exchange (TSX), was described to the Committee as a holding company for some of Canada's most important exchanges. The Toronto Stock Exchange Venture (TSXV), located in Calgary, provides junior or venture equity; the TSX provides senior equity and is located in Toronto.

Derivatives are the specialty of the Montreal Exchange (MX). The Natural Gas Exchange (NGX) in Calgary was said to be the leading energy exchange in Canada for trading in electricity and natural gas contracts. Calgary-based Shorcan Brokers Ltd. is an inter-dealer bond broker dealing in fixed income. Another TMX Group member is the Canadian Derivatives Clearing Corporation (CDCC).

Currently, TMX Group employs approximately 840 people across Canada, the United States and the United Kingdom.

In his presentation to the Committee, Chief Executive Officer Thomas Kloet spoke of the strength of Toronto's financial markets during the recent global crisis:

> Our institution weathered the storm, our financial sector outperformed most of the world and our public markets operated uninterrupted. Today, Toronto is seen as a stable and healthy financial centre in a world of uncertainty. Our brand recognition on the global stage has never been stronger and our future is promising.

At the Committee's request, Mr. Kloet outlined two of the TMX Group's weaknesses. The first was a lack of access to a broad array of stock indices. The London Stock Exchange's joint ownership of FTSE, the leading non-U.S. dollar index provider in the world, would solve this problem and enable development of index products in Canada. Secondly, the TMX Group is involved in developing multilateral clearing for over-the-counter-executed derivatives, an issue associated with the 2008 financial crisis. The London Stock Exchange's clearing operations would assist in the development of a Canadian solution.

The Committee heard that the London Stock Exchange Group (LSEG) is a holding company for equity, bond and derivative markets. The Group includes the London Stock Exchange; Borsa Italiano, which provides 50 percent of group revenues; MTS, Europe's leading fixed income market; and Turquoise, which provides European and U.S. equity trading.

LSEG's chief executive, Xavier Rolet, described the past fifteen years as the successful operation of a small and medium (capitalized) equity market along with Europe's only two fixed-income electronic markets designed for small and medium enterprises (SMEs) and retail investors. It was noted that both the TMX and LSE Groups cater to SMEs. Operational strengths of the London Stock Exchange Group were described as its ownership of the largest electronic market for issuing government bonds, and the third largest clearing settlement entity in the Euro zone.

When asked to describe the Group's most significant weaknesses, Mr. Rolet identified the need to grow the fledgling derivatives business, currently ranked third in Europe. He noted the derivatives units of the two groups would be combined and headquartered in Montreal to facilitate growth. Mr. Rolet also observed that, unlike other North American exchanges, the LSE Group had not yet lowered its unit costs.

Context for the Proposed Transaction

The Chief Executive Officer of TMX Group told the Committee that "we do not operate in isolation of the events taking place in the world around us." In particular, we heard that the proposed transaction has been announced in the context of global trends that include the merger of major stock exchanges, growing competition from alternative trading systems and the evolution of trading technology.

Consolidation

Proponents of consolidation say it is a necessary response to competitive pressures. They say the main benefit of mergers is the economies of scale that result from combining technology investment and listings revenue. We heard that five exchange operator combinations had been proposed around the globe, and that clearing house operators have also been contemplating consolidation.

The former Chief Executive Officer of the TSX Inc. recalled that at the turn of this century the oldest stock exchange in the world, Amsterdam, which opened in 1602, agreed to merge with Brussels and Paris exchanges to form Euronext. Before that agreement, the Vancouver and Calgary exchanges had agreed to merge in 1999, and subsequently merged with the TSX Inc. It was stated that the Canadian merger raised concerns that Western Canada would lose its place in a unified Canadian capital market, something that did not happen. An observation was made that a similar concern has arisen in regards to the transaction before the Committee.

Witnesses disagreed on the inevitability of consolidation of exchanges. Some said the need for liquidity and depth would force consolidation. Those who considered it inevitable ("even the mighty New York Stock Exchange") recommended that policy-makers focus their efforts on ensuring good jobs for foreign-owned multinationals in Canada.

One witness told the Committee that if it didn't like the current merger proposal, the next one would be even less appealing. The next round could involve the

New York Stock Exchange or NASDAQ resulting in a takeover, not a merger of equals. This witness recommended that the transaction be completed quickly in order to make the merged group a more formidable competitor.

Committee members wondered why the Canadian banks were divided on the matter. The Royal Bank and BMO are advisors on the transaction, and have indicated their support. TD Securities, the National Bank Financial Group and the Bank of Commerce disagreed with the proposal.

TD Securities and the National Bank Financial Group contended that Toronto would be well positioned under current arrangements to compete globally and that they have had access to exchanges in New York or London to raise funds. Their criticism of the merger proposal was that it would cede majority ownership, high value jobs and potentially, regulatory control.

Witnesses recalled, with some irony, that the Canadian banks withstood the global financial crisis because of a decision made in 1998 not to allow them to merge. The rationale for those proposed mergers was viewed as similar to the rationale for the current proposal. Some wondered whether elements in the proposed transaction would impact Canada's ability to withstand the next global downturn. CEO Tom Kloet offered that compliance with Canada's regulatory model would afford protection.

Running counter to the merger trend is Hong Kong's exchange, which has retained a monopoly position. With about $23 billion in market capitalization (compared with $3 billion for the TSX), it is considered a strategic asset for the development of local markets.

Alternative Trading Systems

The Committee heard that, whereas the TSX previously operated as a monopoly, as of December 31, 2010, TMX Group held approximately 72.6 percent of the Canadian trading market by volume. Today in Canada there are now nine trading platforms, including three equity exchanges that compete on the basis of speed and price. In short, traditional stock exchanges are no longer monopolies.

We were also informed that exchanges face significant competition from Alternative Trading Systems (ATS) that have been granted licenses to operate through what was described by some as lightly regulated platforms. The ATS compete at low cost as a result of technology improvements and have forced traditional exchanges to reduce fees. In the two years it had been operating in Canada, Alpha Group had gained close to one-third of all trading in TSX listed securities.

Trading Technology

It became clear during the hearings that technology was playing a major role in the evolution of stock exchanges. As the former CEO of the TSX stated:

> Electronic trading may have closed all of the iconic trading floors all over the world, but it had also created the possibility of growth that everyone was thinking about. It was only a matter of time. Finally, geography was no longer an obstacle to becoming something bigger.

John Manley, President and CEO of the Canadian Council of Chief Executives, described technology as a globalizing force, that makes the buying and selling of securities an international business, allowing investors to trade around the clock without regard for borders and that the provision of international services has become a point of competition.

GOVERNANCE AND CONTROL ISSUES

The most debated topics during our hearings were governance, control and regulatory issues (discussed in the next section).

Governance Model

The TMX and LSE Groups described the governance model as one that would ensure Canadian exchanges continue to be governed and managed by Canadians. In addition, Canadians would hold senior leadership positions at the parent company.

At the exchange level, the Committee learned of the following commitments, which would be provided to, and enforceable by the Ontario Securities Commission and other Canadian securities regulators. According to the TMX/ LSE Groups:

- At least 50% of the directors and members of each of the committees of the board of directors of the TMX Group, the TSX, the TSX Venture, the Montreal Exchange and the Canadian Depository Clearing Corporation will be ordinarily resident in Canada and independent.
- The head office and executive office of each of the TMX Group and the TSX will be in Toronto.
- The CEO of each of the TMX Group and the TSX will be in Toronto.

At the parent company level, the Committee learned the following undertakings will be provided to the federal government under the *Investment Canada Act*, until the fourth anniversary following closing of the deal. These include the following:

- Toronto will be global co-headquarters of the combined group along with London.
- Canadian residents will have seven seats on the board of directors (compared to five for the United Kingdom and three for Italy), forming the largest contingent on the board.
- The Chair of the board will be a Canadian resident. Canadian directors will have proportionate membership on all board committees.
- The President will be based in Toronto and all global business units will report to him or her. The CFO will be based in Toronto and will be responsible for the global finance function, which will be headquartered in Toronto.
- The global primary markets business unit (responsible for listings) will be headquartered in Toronto and run by an executive based in Toronto, ensuring that the competitive battle to attract and retain listings is led from Toronto.
- The global derivative business unit will be headquartered in Montreal and run by an executive based in Montreal.
- The global energy business unit will be headquartered in Calgary and run by an executive based in Calgary.

Sunset Provision

Witnesses expressed concern about a provision of the merger agreement which provides that, at the end of four years, Canadian representation on the new board could be reduced from seven of 15 members to a minimum of three members.

The Committee heard that this provision could potentially diminish the Canadian influence in the merged group, particularly as it expands. As the TMX Group was viewed as critical financial infrastructure, a recommendation was made that it should exercise greater control over the strategic direction, which will be set by the board and the executives of the merged group.

The Dean of the Rotman School of Business considered it more important that legislators assist in the creation of a structure that would help the merged group thrive. What would be in the best interests of Canada would be a merged group that is more successful than its competitors.

Other recommendations included that Canada should preserve its influence in the merged company as further consolidations occur, possibly with a 30% shareholding; and that a memorandum of understanding be executed between the TMX Group and its stakeholders, which would stipulate that Canadians would continue to hold a specified percentage of board seats, and a specified percentage of executive roles.

Merger of Equals?

Witnesses were not convinced that the proposal was a merger of equals, given the TMX Group's minority ownership position (45% of the merged group) and minority board position.

The CEO of the Canadian National Stock Exchange, on the other hand, saw the proposal as a merger of equals, but offered his own interpretation. He stated that both groups were large incumbent exchanges facing competitive threats, with few opportunities to expand and diversify. Both would need to streamline costs, improve technology and diversify from their current focus on cash equities.

The Investment Industry Association of Canada provided the Committee with conditions negotiated in the merger of the Singapore and Australian exchanges which provided for an equal number of directors; commitments to maintain operations, assets and key staff in Australia, the smaller partner; and commitments to invest, develop and introduce new products and services in both countries. It was recommended that these be used as a template.

REGULATORY ISSUES

Although there was a division of opinion on the strength of the business case underlying the TMX/LSE Groups' transaction, witnesses were united in their view that there needs to be clarity with respect to regulatory issues. The main regulatory issues identified during our hearings are discussed below.

Parent Holding Company

There is uncertainty about how the parent holding company (Holdco) would be regulated. The Ontario Securities Commission (OSC) advised the Committee that Holdco would be regulated by the Financial Services Authority (FSA) in the United Kingdom.

We received one recommendation that details should be provided regarding the regulatory model that would oversee the merged entity, and how the rules in Canada and the United Kingdom would be coordinated.

More than one witness observed that a missing element in the discussions so far has been the fact that the Toronto Stock Exchange is itself a self-regulatory body that makes rules governing how stocks are traded and who may list. It was suggested by one witness that, post-merger, TSX would be reporting to the merged group in London, where a less sympathetic view could jeopardize TSX's regulatory role.

One proposal is that the merger agreement stipulate that, for the foreseeable future, Canadian companies would get access to equity capital on an efficient basis, along the lines of what was proposed in the arrangement between Australia and Singapore. It was also stressed that the OSC should retain its ability to protect investors.

Light Touch

The term "light touch" was used to describe the regulatory environment in the United Kingdom. Witnesses told the Committee that this could lead to migration of issuers to London, particularly to the AIM venture market. Mr. Rolet, the LSEG's Chairman, disagreed with this characterization, observing that oversight is quite strict in London. If this were not the case, he said, companies would already be migrating there.

Although the combined company would be regulated in both Canada and the United Kingdom, some predicted there would inevitably be a harmonization of regulations, potentially resulting in the lowest common denominator.

The opposite view was expressed by the Dean of the Rotman School of Business. He advised the Committee that AIM is not a great concern, in part because it hasn't succeeded. Academic research, we heard, is showing the benefit to companies of listing in a strictly regulated jurisdiction.

Assurances Provided by the TMX Group and the LSE Group

We were assured by TMX and LSE Groups' representatives that the regulatory framework is a cornerstone of the agreement. Exclusive domestic regulation and oversight of Canadian exchanges, clearing houses and issuers would be maintained. In short, the regulatory status quo would be preserved. In particular:

- The transaction would change the ownership of the parent companies of the exchanges, not merge the exchanges.
- Regulation of the Canadian exchanges would not change except to add protections to reflect the new parent company.
- The TMX Group, the TSX, the TSX Venture Exchange (TSXV), the Natural Gas Exchange, the Montreal Exchange and the Canadian Derivatives Clearing Corporation would continue to be based in Canada. They would be locally managed and regulated by the Ontario Securities Commission; Quebec's regulator, the Autorité des marchés financiers (AMF); and the British Columbia Securities Commission.
- Companies would continue to be listed on TSX and TSX Venture and the exchanges would continue to operate under their brand names.
- TSX and TSX Venture listings, standards and rules would continue to be developed in Canada, and continue to be subject to the approval of Canadian securities regulators.
- The OSC and AMF would have approval rights on any future transaction that results in a change in control of the new holding company.
- The OSC would maintain its public interest jurisdiction over how the TSX carries on business and would retain the power to revise or revoke TSX's recognition order at any time.

IMPACT ON JOBS

There was little agreement on the expected impact of the proposed merger on jobs in Ontario.

TD Securities and the National Bank Financial group see potential for a migration of jobs from Canada to London. They see aspects of the derivatives business staying in Canada, at least initially, but said there is no long-term guarantee. They were especially concerned that London could be the global centre for technology solutions, which potentially means the loss of high value tech jobs. It was also suggested that there is potential for the migration of listings to the LSEG. This migration, it was suggested, could result in the loss of head offices in Canada, in both the resources and financial sectors.

Other witnesses, expressing concerns that some employees in the financial sector could end up in London, recommended that safeguards be built into the proposal to protect Ontario's interests.

Countering these views, TMX Group argued that the enhanced efficiency of raising capital would make Ontario's employees more competitive. In addition, the regulatory structure and the undertakings being made would protect these employees.

The CEO of TMX Group predicts that new listings will be drawn to Toronto by virtue of the exchange's recognized brand and the enhanced financial capability resulting from the merger. More listings would generate demand for ancillary professional staff such as lawyers, accountants, analysts, consultants, underwriters and geologists.

THE MINING SECTOR

Many presenters spoke of Canada's global reputation in the mining industry. The Committee heard that over the past five years, 80 percent of mining equity transactions across the globe have been handled by the TSX and the TSX Venture.

Potential risks for the mining sector identified during the hearings included uncertainties regarding how the merged entity would evolve and its impact on access to listings and capital. It was recommended that assurances be given that existing services will be maintained and improved upon.

The Chief Executive Officer of TMX Group argued that access to a larger pool of capital would enhance the raising of funds and the marketing of mining companies to international markets. An executive in the mining sector enthusiastically agreed with this assessment, calling the proposal the best thing that had happened to the junior mining industry. On the other hand, the President of the Prospectors and Developers Association of Canada did not see the need for the proposed merger.

THE SMALL AND MID-SIZE MARKET PLACE

Statistically, small and mid-size companies are the largest component of Ontario's economy, and comprise the largest proportion of TMX Group's equity listings. We were informed that 500 companies that started on the TSX Venture Exchange have graduated to the senior market (the TSX).

TMX Group maintained that there would be post-merger benefits for small companies, including a larger pool of capital, the world's largest issuer base, and globally competitive fees.

Some witnesses predicted that, post-merger, smaller firms would in fact have less access to capital, and that Toronto would, in effect, become a small fish in a bigger pond. One witness pointed out that the majority of TSX listed companies have market capitalizations of less than $250 million, below the radar screen of most global investors.

Witnesses further told the Committee that the experience of Northern Ontario with multinational takeovers has been mixed. Of particular concern is the fact that, despite assurances, the proposed benefits of takeovers do not always materialize. It was also observed that there appears to be no remedy when foreign investors renege on commitments they make to our governments.

One group discussed the importance of reverse takeovers, an important tool for small companies that want to gain access to public markets. Currently, these decisions are made by the TSX. Concerns were expressed that Canadian interests could be sacrificed if these decisions were moved offshore.

OTHER OPPORTUNITIES AND RISKS ASSOCIATED WITH THE PROPOSED MERGER

Opportunities

The Merged Group as a Global Leader

According to TMX Group, the merged group will be ranked first in terms of the number of listings; natural resources, mining, energy, clean tech small and medium enterprise listings; international listings from emerging markets; cash equities trading in Europe; and trading in cash equities and derivatives and their clearing in Canada.

Following up on this theme, the LSEG's CEO spoke of the importance of contributing to Canada's economic well-being:

> In fact Canada's success, and the future growth and success of TMX Group, are critical to the long-term success of the new merged group. It is in our collective best interest to see that all stakeholders affected by this merger benefit and that we all share in the rewards of this transaction.

In this regard, it was suggested that the extensive business development arm of the London Stock Exchange would market Canada to the world, bringing it new international issuers and adding to the 300 global listings on the Toronto exchanges. One bank in favour of the proposal agreed that the deal would stimulate listings, leading to more trading and corporate finance activity, and ultimately, jobs and capital investment.

Cross-Selling and Cross-Listing

LSEG's CEO outlined joint opportunities that he believes would emerge from the proposed deal. These include cross-selling of data services, new index products, post-trade services development, and shared knowledge of fixed-income markets to build on existing businesses.

Most witnesses expressed doubt that cross-listing would occur, since jurisdictions would want to retain sovereignty over products being sold within their borders. Moreover, the evidence from other mergers is that there would be little interest and few savings resulting from cross-listing in London. For example, since the NYSE-Euronext merger, only nine out of 4,500 collective companies have cross-listed.

It was recommended that Canadian and UK regulators expedite a review of the merits of mutual recognition of listing requirements and subsequently take concrete actions to realize these benefits.

Access to New Pools of Capital (Liquidity)

Merger proponents anticipate new issuers in Ontario, especially in the resource sector. They envision seamless access to new pools of capital in Europe and across the globe.

The head of the Canadian Council of Chief Executives expressed support for consolidation of markets in principle, as this should (in theory) improve access to capital and reduce its cost for listed companies. The potential is also there for lower transaction costs. Others agreed adding that more liquidity means a more efficient market and that this would lead to more accurate pricing of equity.

Other witnesses disputed the notion of greater access to pools of capital in Europe. One witness told the Committee that multi-billion dollar market cap firms know the importance of raising capital at home: "they know you can't push your story onto a foreign market." Another called the notion of greater access to capital, "smoke and mirrors."

The Committee was also advised that the United States is traditionally a more favoured destination for foreign listings. Access to that market has been facilitated by the Multijurisdictional Disclosure System (MJDS), an arrangement negotiated by Canadian regulators with their U.S. counterparts. A recommendation was made that something similar be included as part of the proposed merger.

Finally, it was pointed out to the Committee that Canadian companies already have the ability to list on the LSE; however, only 17 do, and 85 percent of the trading in the seventeen happens on the TSX. The inescapable conclusion, it was suggested, is that the proposed merger is unnecessary, since global investors already come to Canada to finance Canadian companies through the TMX exchanges.

Economies of Scale

According to the merger's proponents, economies of scale are often the driving force in mergers. In particular, they say a properly executed plan would produce the following economies:

- a competitive price structure resulting from increased listings;
- new products and services developed jointly and shared by investors and traders; and
- pooling of technology investments to keep costs down and enable upgrades.

Others remain unconvinced by these predictions of improved efficiency. These witnesses made a number of recommendations relating to the possibility that economies of scale might not flow from the proposed merger. These include:

- Canadian regulators should introduce regulatory restrictions on market data pricing, similar to what the Securities and Exchange Commission has done in the United States.
- A contingency plan should be presented for possible rationalization of structures and decision making.
- The TSX should draft a memorandum of understanding with its stakeholders (companies, regulators and the provincial government) guaranteeing that the cost of listing on the TSX will drop in the first five years, post-merger; and that the TSX will continue to spend a specified amount on the promotion of activities it supports in the community.
- In regards to technology, which was said to be critical to the success of the merger, it was recommended that the TMX and LSE Groups provide a detailed assessment of the timing and likely effect of the proposed changes to technology, including the potential for increased costs for clients. In addition, they should clarify where the key centres for technology will be located.

Potential Risks

While the TMX and LSE Groups believe that the main risk in this transaction relates to their ability to execute the plans as a combined entity, and to effectively integrate and cross-sell, other witnesses expressed a number of additional concerns.

Future Mergers

Many witnesses believe that, should the proposed merger go ahead, it is highly probable that the merged entity would soon be looking to expand again.

Some witnesses were concerned with how future mergers would affect the merger arrangement that is being proposed today: Would everything be on the table? Others focused on the absence of a strategic plan for further acquisitions, and whether Ontario would have a say given its minority share position.

One presenter concluded that while it is impossible to anticipate what is going to happen 10 and 20 years down the road, the London Stock Exchange might be able to offer up concessions to guarantee that future mergers would benefit Canada.

The Dean of the Rotman School of Business told the Committee that all countries around the world think they are unique in being hollowed out by the rest of the world. He added that, while "everybody's nervous about change; to me, it's [all] about change."

Finally, we were reminded that, in the event of a change in control of the post-merger entity, the proposed merger agreement provides for approval by the Ontario Securities Commission.

The Centre of Gravity

Some witnesses are predicting that, under the terms of the proposed merger agreement, the "centre of gravity" would move to London. This shift is all the more likely, it is said, because the proposed merger is only the first step in building a much larger network that will cover Asia and other regions.

To address this concern, it was recommended that domestic safeguards be established to prevent greater market harmonization and competition from abroad from causing Canadian opportunities and jobs to move to a more favourable location.
Others said that Toronto's future as a global financial centre depends ultimately on whether we continue to build on the reputation for sound regulation, transparency, good corporate governance and openness to foreign competition. Responding to a question from the Committee, one witness said that if there is a drift of the stock exchange business to London, the OSC has a responsibility to intervene.

Systemic Risk

Some witnesses see risks associated with the structure of the parent Holdco and the possibility that its strategic decisions could drain funds away from the TMX Group.

Sceptics of the proposed deal urged the Committee to assess the implications of merging the equities, derivatives and commodities markets. Permanently linking our markets to those in Europe, it was argued, is a significant issue that deserves to be studied in great detail. Systemic risk could result from shared investments (notably, derivatives), shared investors, the failure of a major financial firm, or a sovereign debt crisis. A major failure or financial crisis in Europe could potentially spread to Canada and our financial markets more easily under a merged exchange.

In contrast, the Dean of the Rotman School of Business offered the following view on the positive aspects of foreign investment:

> Most of the myths about the Canadian headquarters of foreign owned multinationals are just plain wrong – and dangerously so. They give as much to charity; they employ as many professional advisers; they pay higher salaries; they do more R&D; they are great for Canada. We have helpful trade deals only because the world has adopted the conceptual framework of reciprocity for merchandise and service trade.

COMMITTEE'S RECOMMENDATIONS

As noted in our introduction, the Select Committee has no power to impose its view on this matter. It is our hope that the recommendations will be taken into consideration by the proponents of this transaction before seeking the necessary approvals and by regulatory bodies and governments as they proceed with their review/approval processes.

After carefully considering the testimony of all the witnesses and the written submissions we received, the Committee makes the following recommendations:

Structure of the Board of Directors

1. In a joint press release on February 9, 2011, the London Stock Exchange Group and the TMX Group announced they would join forces in what was described as a "merger of equals". The Committee therefore recommends that there be equal representation on the board of directors of the merged entity with the number of directors ordinarily resident in Canada equalling the number of directors ordinarily resident in the United Kingdom/Italy with no limitation in time, and that this provision be written into the agreement between the TMX Group and the London Stock Exchange Group (the "Agreement").

2. The Committee recommends that TMX Group shareholders not be prevented from owning a majority of the shares of the LSE Group and that this be written into the Agreement.

Role of Regulatory Bodies

3. The Committee acknowledges the critical role of the Ontario Securities Commission in reviewing and approving regulatory aspects of the proposed transaction, and any future mergers. The Commission told the Committee that the recognition order process sets out an established framework, with a set of criteria that will guide its determination of whether the proposed transaction is in the public interest, and on what terms and conditions its approvals should be granted. The Committee recommends that the terms and conditions of any Ontario Securities Commission approvals be incorporated into the Agreement.

4. The Committee recommends that the Ontario Securities Commission should make public the findings of its review. The Commission's review should address strategic and regulatory issues that may arise respecting the merger.

5. The Committee wishes to emphasize the importance it places on the regulatory oversight of the future operations of the TMX Group in the merged entity, and accordingly recommends that there be no diminution in the role of the Ontario Securities Commission. Specifically,

- The TMX Group businesses should continue to be subject to Canadian laws, in particular the recognition orders of the Ontario Securities Commission and other provincial regulators.

- The Ontario Securities Commission and other provincial regulators should continue to oversee fundamental changes to the TMX Group businesses, including any change in ownership.

- The Agreement should ensure the autonomy of any TMX Group business in areas where it serves a de facto regulatory role, such as the role of the Toronto Stock Exchange.

6. The Committee recommends that the Agreement contain an undertaking that the exchanges of the TMX Group continue to meet the needs of the Canadian capital markets, including access to capital, competitive fees, range of listings, trade execution, market data and index products, and the clearing and settlement of derivatives.

Strategic Decision Making

7. The Committee recommends that an undertaking be provided in the Agreement that the development and introduction of new technology, products and services will be carried out in Canada and the United Kingdom, and benefit both countries.

Impact on Jobs in Ontario and Canada

8. The Committee recommends that the Agreement contain an irrevocable commitment that the operations, assets and key staff of the TMX Group and its businesses will continue to reside in Canada. This would include listings, trade execution, clearing and settlement, as well as expertise in law and accounting.

Impact on the Mining Sector

9. The Committee believes it essential that firm undertakings be provided by the proponents of the transaction to preserve the role of TMX Group as the global leader in equity financing for the mining sector. It therefore recommends that such undertakings be provided in the Agreement and/or to the Ontario Securities Commission. The undertakings should at a minimum, address the following:

   - measures to avoid any reduction in Canadian regulatory standards; and
   - the necessity for ongoing improvements to services provided by the TMX Group to the mining sector.

   Equally important, the Committee recommends that any such undertakings be regularly monitored and enforced by the Ontario Securities Commission.

APPENDIX A

TERMS OF REFERENCE

SELECT COMMITTEE ON THE PROPOSED TRANSACTION OF THE TMX GROUP AND THE LONDON STOCK EXCHANGE GROUP

That a Select Committee on the proposed transaction of the TMX Group and the London Stock Exchange Group be appointed to consider and report its observations and recommendations concerning the impact and net benefit to Canada, including Ontario, its economy and people, Toronto's financial services sector and Northern Ontario's mining industries.

In order to develop its recommendations, the Committee will:

a. invite both parties to the transaction to appear, specifically: TMX Group, and London Stock Exchange;

b. by March 10, 2011, conduct at least 2 days and no more than 4 days of public hearings in Toronto and allow participation from across Ontario and Canada via web conference, teleconference or videoconference and by written submissions due by March 10, 2011;

c. consider the role of the TMX Group in today's capital markets and how this might evolve;

d. consider the emergence around the world of consolidation amongst exchanges and the outcome and implications of these consolidations;

e. identify the role to be played by Ontario's financial sector in the proposed transaction, including management, regulation, direction, location of activities, listing of stocks, clearing and software development;

f. evaluate the short and long term impact of the proposed transaction on number and quality of jobs in Ontario;

g. consider the effect of the proposed transaction on future investment in Ontario, including the mining sector;

h. examine opportunities in the proposed transaction to strengthen Ontario's role as a financial services centre, and consider potential risks

That the Committee shall present or, if the House is not sitting, shall release by depositing with the Clerk of the House, its final report to the Assembly by April 7, 2011;

That the Committee have the authority to meet at Queen's Park on March 2, 2011 from 12:00 noon to 3:00 p.m. and 4:00 p.m. to 6:00 p.m., March 3 from 9:00 a.m. to 10:15 a.m. and 2:00 p.m. to 6:00 p.m., March 9 from 12:00 noon to 3:00 p.m. and 4:00 p.m. to 6:00 p.m. and March 10 from 9:00 a.m. to 10:15 a.m. and 2:00 p.m. to 6:00 p.m., to call for persons, papers and things; to employ counsel and staff; and, as the Committee deems relevant to its terms of reference, to commission reports; and

That the Committee may meet at the call of the Chair for report writing; and

That the Committee may examine any other matter it deems relevant to its terms of reference; and

That the Committee be composed of the following members: Mr. Phillips (Chair), Mr. Klees (Vice-Chair), Mr. Arthurs, Mrs. Albanese, Mr. Brown, Mrs. Van Bommel, Mr. Zimmer, Mr. Shurman and Mr. Bisson.

Carried February 23, 2011

APPENDIX B

DISSENTING OPINION

OF THE

NEW DEMOCRATIC MEMBER OF THE COMMITTEE

NDP Minority Report to the Select Committee on the Proposed TMX/LSE Groups' Transaction

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Introduction

New Democrats do not concur with the majority opinion of the Committee. This dissenting report lays out our view.

Simply put, this transaction of the TMX and LSE is a takeover – not a merger – and does not offer the right solution to creating a globally sustainable Canadian-based exchange.

In the words of Mr. Ermanno Pascutto, founder and executive director of the Canadian Foundation for Advancement of Investor Rights:

> In terms of whether this is a merger or a takeover, I think it seems to be fairly established that it's a takeover of the TMX by the LSE group. We do not see any clear benefits to the Canadian capital markets or to Toronto, as a financial centre, from this merger.

Fundamentally, the merged entity will move decision making from Toronto to London. Through this substantive change, Canada will become just one jurisdiction of three, along with the United Kingdom and Italy and, as more mergers take place, Canada stands to see its influence diminish even further.

With this shift in the centre of gravity in decision making away from Canada, a number of issues present themselves.

Issue 1: Loss of control over our capital markets strategy.

Overall structure

While the OSC and other provincial regulators will still play an important part in regulating the Canadian exchanges, these exchanges will ultimately report to the overall holding company which will be regulated by the United Kingdom's Financial Services Authority (FSA). This is very significant. Canadians will not be in control of the overall holding company and this ultimate governing body (the Holdco) will be subject to oversight primarily by FSA regulations.

Where strategic decisions will really be made

According to Mr. Bob Dorrance, Chair and CEO of TD Securities:

> It is very important – and I think this is the differentiator – to understand that the TMX is a self-regulatory body. What that has allowed is that it makes the rules and decisions that dictate how stocks get traded in Canada, who gets to list in Canada, who lists on the TSX Vancouver, when they migrate to Toronto, how much they can finance, how many shares they can issue, whether the board of directors is appropriate – all those rules that are part of the fabric of how Canada has developed its financial system. That's the responsibility of the TSX, not of the supervisory commissions. The TSX will now report to the LSE-TSX. That's where management will be.
>
> The key thing is that the functioning, therefore, of the Canadian capital markets and how they evolve will now be set – not regulated; policies will be set – in the office of CEO, and that office, initially, will be in London. That's the regulatory nub.

With this takeover, basic capital market strategy for Canada will be set in London, not Toronto. Once this merger goes through, there is little the Ontario or Canadian governments will be able to do to change this.

At its core, the debate over this takeover is all about how you have a capital strategy that makes sense, that fits who we are in Canada, and that reflects what we do in our own country.

Issue 2: Access to capital

Proponents of the deal have argued that by listing on the LSE, Canadian companies will benefit from access to a deeper pool of capital. But as a number of presenters to the committee indicated, Canadian companies already have the ability to list on the LSE, and so far, only a few do. Global investors come to Canada to finance Canadian companies, and they do it through the TMX exchanges. They do not go to the LSE to finance Canadian companies.

Why is this? It is worth quoting Mr. Dorrance again:

> The TMX Group is a very successful part of a financial system that facilitates investing and access to capital for Canadian and international companies. They are particularly and historically strong at catering to the needs of Canadian companies. They service the dynamics of the Canadian marketplace and cater to the needs of small and medium-sized business.

Issue 3: Resource Financing

In addition, the TMX has become the *leading* resource exchange in the world. Currently, global resource companies come to the TMX exchanges to raise capital. Global investors provide that financing, both to Canadian companies and international companies. Being part of London really adds nothing to all this and perhaps reduces our role in resource financing in the future.

According to Mr. George Teichman of the Prospectors and Developers Association of Canada:

> We should not lose sight that the TSM is the largest marketplace in Canada and is our business beacon to the world. This is a strategic industry. Canada's capital markets cannot work efficiently without a stock exchange, and to have Canada's exchange controlled abroad, frankly, is not strategic.
>
> Exchanges should not, and cannot be globalized the same way as, say, company operations moving all over the world or the pricing of oil or gold – you know, "The world price of gold and oil is so and so." Exchanges are different. So for those who say that the LSE won't control our markets and that Canada's end of this merger – really, it's a takeover – will remain robust, I say, why does the LSE need 55%? Don't you think that they will, in time, try to muscle companies to list and finance over there, across the pond? Won't some executives, lawyers and bankers gradually make the move? And then, perhaps, the world's largest mining convention could even move across. Why, then, isn't a 50-50 marriage good enough? Suppose they hold the 45% end?

Issue 4: Australian Exchange rejection of Singapore bid

On April 8, on the advice of the Australian Foreign Investment Review Board (FIRB), Australian Treasurer Wayne Swan rejected a foreign takeover of the Australian exchange by the Singapore exchange on "national interest."

In his statement announcing the rejection, Mr. Swan said he was concerned that the merged entity could have resulted in new stock market listings drifting from Sydney to Singapore, with a resultant loss of fee revenue and the potential for undermining Australia's bid to build its reputation as an exporter of financial services.

In summing up the advice he had received from the Foreign Investment Review Board, the Australian Reserve Bank, the Australian Securities and Investments Commission, and the Australian Treasury, Mr. Swan said that "I have been advised that many of the claimed benefits of this transaction are likely to be overstated". He went on to say that "the opportunities that were offered under the proposal were clearly not sufficient to justify this loss of sovereignty."

Mr. Swan also said the deal would have been unlikely to have given Australian-listed companies better access to Asian capital markets. According to Mr. Swan, "Let's be clear here: this is not a merger. It's a takeover that would see Australia's financial sector become a subsidiary to a competitor in Asia. It was a no-brainer that this deal is not in Australia's national interest."

In four days of hearings here in Toronto many of the same of arguments (using many of the same words) were put to this committee urging rejection of the takeover by the LSE. In the NDP's view, the decision by the Australian government – whose exchange is also a global leader in resource financing – confirms that this deal is simply not in the interest of Canada or of Ontario.

Summary

Toronto is a leading global financial services centre, the headquarters to strong institutions that weathered the financial crisis, and home to the world's leading resource exchange. As such, it is well positioned to compete globally on its own without this takeover. The TMX group of exchanges has done tremendously well, not only in facilitating the capital formation required to grow businesses in Canada but also in developing a global niche that is unique: 55% of global mining companies are listed in Toronto, and 35% of oil and gas companies are listed in Toronto. There's been no solid case made to put all of this at risk.

The success of the TMX in the future will have everything to do with the evolution of the Canadian financial markets' business strategy. The TMX's current business strategy works for Canada and works for Ontario, and we should continue with it. There are numerous opportunities for growth.

No matter what changes are made to the deal, there is no way to absolutely ensure that the basic formulation and implementation of the TMX's capital strategy can stay in Canada for the benefit of Canadians and Ontarians. We fundamentally see this as a takeover and we do not believe it offers the right solution to creating a globally sustainable Canadian based exchange.

As the saying goes, "why fix it if it ain't broke"?