



Canadian Foundation for  
Advancement of Investor Rights  
Fondation canadienne *pour* l'avancement  
*des droits des investisseurs*

May 27, 2011

John Stevenson  
Secretary of the Commission  
Ontario Securities Commission  
20 Queen Street West  
Toronto, ON  
M5H 3S8

Delivered via email to: [jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)

**Re: Application for Recognition of Alpha Trading Systems Limited Partnership (“Alpha LP”) and Alpha Exchange Inc. (“Alpha Exchange”) as an Exchange**

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Dear Mr. Stevenson:

FAIR Canada is pleased to provide its comments on the application by Alpha LP and Alpha Exchange (together, “Alpha Group”) for exchange recognition.

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit [www.faircanada.ca](http://www.faircanada.ca) for more information.

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### **1. Listing Regulation Conflict of Interest**

The Alpha Application proposes to establish an exchange without proper separation of the commercial and regulatory functions, a model which falls below international best practices. The Ontario Securities Commission (the “Commission”) should require that Alpha adopt a model consistent with international standards.

FAIR Canada has expressed its concerns in the past regarding the inherent conflict of interest that exists in the “for profit” status of the Toronto Stock Exchange (the “TSX”) and the TSX acting as a regulator of listed companies for which it has a responsibility to act in the public interest. We also commissioned an expert report (the “Expert Report”) on the subject which we have provided to the Commission and the Canadian Securities Administrators (the “CSA”)<sup>1</sup>. We have stressed the need for Canadian regulators to

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<sup>1</sup> See Letter to Mr. David Wilson, Chair of the Ontario Securities Commission and the CSA dated June 30, 2010 and the Expert Report prepared for FAIR Canada by John W. Carson, Compliax Consulting Inc. entitled “Managing Conflicts of Interest in TSX Listed Company Regulation” dated June 23, 2010.

address this conflict of interest in a way that is consistent with international standards. **The Report found that the TSX is the only exchange amongst those in the developed markets that has not implemented specific measures to manage its conflicts of interest in regulating listing companies.**

Over a year ago, the Ontario Legislative Assembly's Standing Committee on Government Agencies (the "Ontario Legislative Committee") issued a unanimous report which addressed the TSX's listings regulation function. The report states that "[o]ur concern is with the perception that the TSX falls below international standards with respect to the separation of its regulatory and commercial activities." The Committee therefore recommended that "...the Commission review the potential for conflicts of interest between the regulatory and commercial functions of the Toronto Stock Exchange and that it take the steps necessary to address any problems identified."

To date, the Commission has not initiated such a review and in its Notice and Request for Comments for the Alpha Group application (the "Notice"), it continues to assert that the requirement in a recognition order that at least fifty percent of the members of the board of an exchange be independent directors will address the conflict of interest between an exchange's commercial listing function and its listing regulation functions. The position of Commission Staff ignores both the findings of the Expert Report and the recommendation of the Ontario Legislative Committee.

The goal of the Expert Report was to inform public discussion of the issues and outline potential alternatives available to manage the conflicts of interest. For example, management of the conflict of interest between listing business operations and listing regulation responsibilities has been achieved by other major exchanges through the following approaches:

- I. The exchange establishes a regulation subsidiary with independent governance to perform listing regulation;
- II. The exchange establishes a listings regulation department that is separate from the business operations of the exchange (including listings business development) to perform listings regulation; or
- III. The statutory regulator performs listings regulation.

FAIR Canada believes that now is the time for the Commission to take steps to review its approach to address conflicts of interest in listings regulation.

**FAIR Canada Recommendation: FAIR Canada urges the Commission to consider the findings in the Expert Report and the recommendation of the Ontario Legislative Committee. We urge the Commission to reconsider its approach to dealing with the conflicts of interest in listing regulation in light of international standards and in order to protect investors. The Commission should resolve listings regulation conflict of interest in a manner consistent with international standards when considering the Alpha Exchange application.**

## **2. Hypothetical Nature of Present Application in Light of Other Developments**

The application by Alpha for recognition as an exchange may be a hypothetical exercise in light of other current market developments, most notably the Maple Group Acquisition Corp. (“Maple Group”) takeover offer for TMX (which is said to include Alpha Group as well as the Canadian Depository for Securities Ltd. (“CDS”)), and the proposed transaction between the TMX Group and the London Stock Exchange Group. It may be appropriate for the Commission to defer consideration and public comment on the Alpha Exchange application until it is known whether Alpha will in fact be proceeding to establish an independent exchange or whether it will become part of a merged TSX/Maple entity.

In light of these other proposed transactions, it is even more important that the Commission consider how it addresses potential conflict of interest issues regarding listing exchange regulation. How the Commission approaches conflicts of interest in the context of these proposed transactions is of great public importance.

**FAIR Canada Recommendation: Defer public comment on the Alpha Exchange application until there has been a decision that Alpha will in fact establish an exchange and not be part of the Maple Group bid for the TMX.**

## **3. New Set of Conflicts of Interests with Alpha Application and Other Developments**

It is clear that new concerns with listing regulation conflicts of interest arise with the proposed Alpha Group’s application for recognition as an exchange. In addition, the Maple Group takeover offer for TMX raises further conflict of interest issues. Regulators and governments will need to examine the issues associated with the Alpha Group application and the Maple Group takeover offer for TMX (which would involve integrating Alpha into the TMX as well as CDS) to determine their impact on Canada’s capital markets and the interests of investors. It is essential that regulators and government ensure that such market developments would be in the public interest.

**FAIR Canada Recommendation: It is premature for the Commission to make a decision on the Alpha application at this time.**

## **4. Independent SRO to Create and Administer Core Listing Requirements**

FAIR Canada made a formal presentation to the Select Committee of the Ontario Legislature about the proposed TMX/LSE Merger on March 9, 2011. Our formal remarks can be seen at [http://faircanada.ca/wp-content/uploads/2011/03/FAIR\\_CANADA\\_remarks\\_on\\_TMX\\_-\\_LSE\\_Merger\\_FINAL.pdf](http://faircanada.ca/wp-content/uploads/2011/03/FAIR_CANADA_remarks_on_TMX_-_LSE_Merger_FINAL.pdf). We suggested that the best way forward may be to transfer the TSX’s listing regulatory functions to another regulator (such as IIROC) and to have a uniform set of core listing standards. This is the same model that the CSA used to address conflicts of interest in regulation of trading with the creation of Market Regulation Services Inc. and the adoption of Uniform Market Integrity Rules (“UMIR”).

**FAIR Canada Recommendation: The Commission should consider transferring the listings regulatory functions of Alpha, TSX, TSXV and any other exchanges to an independent SRO that can be responsible**

**for the creation and administration of core ongoing listing rules. Under this model, Alpha (and other exchanges) would continue to set listing standards for admission to listing on the Alpha Exchange.**

In the event that the present application is not to be held over, FAIR Canada provides its responses to the specific questions in the OSC's Request for Comments on Alpha's Application for Exchange Status below.

**5. Response to Request for Comments on the Alpha Application for Exchange Status**

**A. Governance Structure**

**(i) *Independent Representation on Alpha Exchange Board Does not Adequately Address Conflicts of Interest - Need to Adhere to International Standards***

Alpha's shareholders are the six bank-owned investment dealers (BMO Nesbitt Burns Inc., CIBC World Markets Inc., National Bank Financial Inc., RBC Dominion Securities Inc., Scotia Capital Inc., and TD Securities Inc.), Desjardins Securities Inc., Canaccord Financial Inc. and the CPP Investment Board Private Holdings Inc. Having an exchange owned by the dominant financial institutions in Canada raises potential conflicts of interest which must be addressed in order to determine whether granting exchange status to Alpha would be in the public interest.

For example, FAIR Canada is concerned that Alpha's listing standards and administration of listing requirements may be influenced by the financial interests of the securities firms that are also the owners of Alpha. A conflict of interest exists where the dealers who dominate the listing business own and control Alpha. We understand that Alpha has provided financial incentives for its investment dealer shareholders for directing trading to Alpha. If it obtains approval for exchange status, it should be prohibited from providing incentives for dealers to list on the Alpha Exchange. We also reiterate a concern that the exchange could be owned by the entities (if the parent companies of the shareholders list on Alpha) that the exchange is responsible for regulating.

The increased competition for listings that may result if Alpha's application is approved gives rise to the possibility that listing standards will be lowered in order to improve market share for listings. If the conflict of interest in listing regulation is not addressed appropriately, the public interest will not be served. Regulatory arbitrage would not be in the interests of retail investors.

**FAIR Canada Recommendation: Act to resolve the issue of listings regulation conflict of interest and do so in a manner consistent with international standards. This issue should not be deferred and should be addressed when the Alpha Exchange application is considered.**

**(ii) *Proposed Role of the Regulatory Oversight Committee ("ROC") and Meaning of "Independence"***

The Alpha Group application does not propose fifty percent independent representation on its board as preferred by Staff of the Commission. Instead, Alpha Group proposes that Alpha Exchange will have a

board of eight directors comprised of four non-independent “industry” directors (directors that are representatives of dealer members), three independent directors and a chief executive officer.

Alpha proposes that owners that are not members of Alpha Exchange but own less than ten percent should be able to act as independent directors. The Notice states that two of the limited partners of Alpha LP are not investment dealers and, given the ownership structure, only one of them would be precluded from being an independent director under the proposed materiality threshold. FAIR Canada believes that the materiality threshold should be lowered to five percent for purposes of the definition of “independence”. The limited partners of Alpha LP should not be considered “independent directors” for purposes of governance and oversight through the ROC.

The application also proposes a ROC which will have certain decision-making powers regarding the handling of conflicts under the Trading Policies or Listing Handbook, and is expected to provide oversight and attention to the regulation functions to be performed by the exchange. **However, other regulatory activities that it will have will be only advisory in nature: such as rule-making; the setting of a regulation budget; and changes to the regulation and compliance programs of Alpha Exchange.**

The ROC will be composed of three “independent” directors and two non-independent directors. While an attempt to deal with the conflicts of interest that will arise, the ROC is not a model which has been adopted by other leading international exchanges and has potential defects that warrant further examination. For example, FAIR Canada questions whether the ROC will be effective and efficient in its regulatory role of dealing with appeals from decisions made under the Trading Policies or Listing Handbook or in dealing with code of conduct and conflict of interest issues given its composition and its relationship to the exchange itself.

**FAIR Canada Recommendation: That the materiality threshold for what constitutes “independence” should be lowered from ten to five percent.**

**FAIR Canada Recommendation: If responsibility for regulation is not transferred to an independent SRO, the ROC should be replaced by an independent subsidiary of Alpha with the majority of its board consisting of independent directors and this subsidiary should have final decision-making powers regarding listing policy, rule-making and budgetary matters. If Alpha establishes such an independent subsidiary we would have no objection to the majority of directors of the Alpha Exchange being non-independent.**

***(iii) Venture and Non-Venture Issuer Status***

FAIR Canada agrees with CSA proportionate regulation for listed issuers, which imposes appropriate levels of regulation for issuers of different sizes and the existing categories of “non-venture issuers” for senior issuers and “venture issuers” for junior issuers or issuers listed on the TSX-V and CNSX.

FAIR Canada agrees that it is appropriate to classify tier 1 issuers as “non-venture” issuers and tier 2 issuers as “venture” issuers under applicable securities legislation.

***(iv) Issuer Regulation – Exercise of Discretion by Exchange is Required***

The Alpha Exchange application has rejected the use of the exercise of discretion by the exchange in the review of transactions. This is in contrast to the TSX where the TSX does have the ability to exercise its discretion and may impose conditions on transactions, including the requirement to obtain shareholder approval. Instead, Alpha Exchange has provided objective standards set out in their Listing Handbook, together with both shareholder approval and the mandated involvement of independent directors to address transactions by listed issuers which could have a material impact on dilution or involve insiders or related parties.

While it may reduce the need for the use of “discretion”, FAIR Canada doubts that the proposed approach by Alpha Exchange can entirely remove the need for the use of discretion for all potential transactions that are to occur in the future. For example, exemptions from shareholder approval for related party transactions are often requested based on financial hardship and an exchange must exercise discretion on whether to grant an exemption.

**FAIR Canada Recommendation: The Alpha Exchange must contemplate the exercise of discretion by the exchange.**

***(v) Securityholder Approval Requirements for Investment Fund Acquisitions***

FAIR Canada agrees with the Commission Staff’s view that the securityholder approval requirements for acquisitions of listed issuers that are non-redeemable investment funds should be substantially similar to the requirements in NI 81-102 for mutual funds, including the requirement that the investment funds participating in the acquisition bear none of the costs and expenses associated with the transaction. We agree that the costs and expenses of an acquisition are more properly borne by the manager as opposed to the security holder, given that they benefit from the acquisition at least as much as the securityholders of the investment funds. We also share the concern that if there is not a consistent approach to investment fund acquisitions, this will create opportunities for regulatory arbitrage.

***(vi) Inter-Listed Investment Funds and Structured Products***

Alpha Exchange proposes to permit foreign issuers listed on a recognized foreign exchange to apply for listing, and this will include listed issuers that are investment funds and other comparable listed structured products such as exchange-traded notes. We agree that in order to minimize opportunities for regulatory arbitrage, there should be a process established to inform Commission Staff of applications by foreign listed issuers prior to listing in order to allow Staff to assess whether they would recommend a receipt for a similar investment fund product offered by prospectus in Canada. FAIR Canada agrees that Alpha Exchange should include Staff’s assessment as one of the criteria in their Listing Handbook for determining whether or not to inter-list a foreign investment fund or structured product.

**FAIR Canada Recommendation: In order to protect investors, impose a requirement that Alpha Exchange, at a minimum, notify the Commission in advance of listing and abide by the Commission’s**

assessment as to whether the Commission would approve a similar investment fund product if that product was offered by prospectus in Ontario. In order to protect investors from toxic, complex products that do not meet investor's needs, the Commission should be able to prevent such foreign investment fund or foreign structured product from being listed and, as a result, available to Canadian investors.

*(vii) Listing Standards for SPACs*

FAIR Canada believes that there has been inadequate consultation on the current TSX listing rules for Special Purpose Acquisition Corporations ("SPACs") otherwise known as "blank cheque" companies. It is not clear that the public interest is served by the use of SPACs and we urge that regulators undertake an analysis of how retail investors have fared under SPACs in the U.S. and in Canada. FAIR Canada's earlier submission on SPACs can be viewed at: <http://www.faircanada.ca/wp-content/uploads/2009/01/fair-comment-letter-on-spacs.pdf>.

**FAIR Canada Recommendation: Defer the decision as to whether to allow Alpha to list SPACs on the Alpha Exchange until such time as the Commission has considered whether the listing of SPACs is in the public interest following a public consultation on the issue.**

FAIR Canada welcomes the opportunity to discuss these important and timely issues with the Commission and other interested parties. Feel free to contact Ermanno Pascutto at (416-572-2282 or [ermanno.pascutto@faircanada.ca](mailto:ermanno.pascutto@faircanada.ca)) or Marian Passmore (at 416-572-2728 or [marian.passmore@fair.canada.ca](mailto:marian.passmore@fair.canada.ca)). We would also be pleased to meet with you at your convenience.

Sincerely

A handwritten signature in blue ink, appearing to read "Ermanno Pascutto".

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