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Secretary of the Commission
Ontario Securities Commission
20 Queen Street West
Toronto, Ontario
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RE:OSC Proposed Recognition Order for the Maple Group

ITG Canada (ITG) would like to thank the OSC for this opportunity to comment on the proposed recognition order for the Maple Group. We appreciate the extensive research and thought that went into the recognition order, and hope our comments will constructively illuminate areas that may require further careful consideration.

ITG is a Global brokerage firm offering leading edge research, trading, cost measurement and trade management tools and services to retail, institutional and brokerage clients. We have long been a top 10 dealer in the Canadian equity space, and are well within the top 20 in the U.S., Western Europe and Asia Pac. Our breadth of tools and markets, coupled with our agency focus, grant us a unique client investor aligned view on market structure matters.

ITG's thoughts on this deal will be largely influenced by our overall views on competitive markets and market structure. To that end we feel it is instructive to briefly outline those views before wading into the specifics of the Maple transaction.

ITG firmly believes that markets should be fair, competitive, transparent and practical in order to attract the greatest possible participation of natural investors. In terms of fairness, and competitiveness, we believe that regulators should take adequate steps to ensure a level playing field for competition within groups of investors, dealers and marketplaces. Should the systems, either through regulation



or excessive barriers, prevent such competition we risk a market that lacks the confidence of both providers and consumers of capital, to achieve their full potential, and would be handicapped from competing for issuers and investors globally.

In terms of transparency we strongly advocate for transparency of regulation, process and economics along the entire vertical. It is important that all marketplace participants understand both how our markets work, and why. We note that transparency should not include the transparency of investor intent. Regulatory policy should in fact be aimed at ensuring investors have control over the manner in which their intents are made known to the street, allowing them to best determine the trade-off between advertising for contra liquidity and managing potential costly information leakages. It is with this in mind that ITG has developed many of our most valued tools including IOIs, various dark pools around the globe and our leading edge algorithms and smart order routers.

We further submit that the resulting market structure must be practical. The passing of regulations that are not practically applied, monitored, and enforced is counterproductive and again potentially discourages natural participation within our marketplace. To this end we would strongly urge against any remedies that independent marketplace participants will find either costly or overly difficult to implement.

Our goal in commenting is not to influence whether the deal is consummated. Rather, ITG wishes to suggest a number of remedies that will help to ensure that the proposed deal does not detract from the integrity of our marketplace, nor from the global perception of our markets. Given ITG's extensive knowledge of global market structure, and relative independence from this deal, we believe we are uniquely suited to give guidance around the necessary structures and remedies that must be in place to ensure the integrity and viability of our marketplace going forward. Consistent with ITG's first comment letter sent to the commission on November 9th 2011, we will be focusing on governance, the proposed CDS acquisition and the proposed Alpha acquisition. Our thoughts around each will focus on how to ensure the fairness, transparency and practicality should the deal



go through, and we will also look at the resulting costs and complexity created by any such remedies.

Finally, we would like to make clear that, given the advisory relationship between the Competition Bureau and the OSC, we will be discussing a variety of pricing and competition concerns that are clearly beyond what the OSC has historically deemed to be its mandate. This is both to inform the Bureau of our concerns, and to highlight that the OSC will have to take a more aggressive stance on issues like data pricing if this deal is allowed to proceed. For the record, ITG believes that the OSC should take a more aggressive stance on data pricing even if the deal fails to close.

Governance

First, we would like to state that the OSC is to be commended for their approach to addressing many of the critical issues related to governance of the Maple organization (which includes Maple, TMX group and the TSX). We specifically endorse and agree with their view that the business of the Maple group must be conducted in a manner that is consistent with the public interest in order to uphold the fairness and integrity of our markets. In general, we are supportive of the terms outlined by the OSC and believe that they have improved on the original governance structure as outlined in the Maple proposal. There are several areas in which we would suggest even stronger safeguards to protect the public interest and, in addition, would like to raise a few questions and concerns that should be considered in order to strengthen the governance and oversight model as outlined in the recognition order.

Board of Directors and Independent Directors:

The proposed changes to the structures of the Board of directors for each of Maple, TMX and TSX are positive and we believe that, in order to effectively address potential conflicts of interests, it is critical to ensure a governance structure which has strong requirements for directors who are independent and unrelated to the original Maple shareholders. We agree with the requirements and constraints that the OSC has put forth related to how “independent” and “unrelated to the Maple



shareholders” are to be defined. We also approve of the suggested structure of the Governance Committee as being composed of five independent directors. We believe the following would further strengthen the governance structure:

- The structure should provide that at least 50% of the directors be both independent and unrelated to the original Maple shareholders and that, in addition, the Chair be independent and unrelated to the Maple shareholders. Note that the chair would not be taken into account in determining whether at least 50% of directors are independent and unrelated to the Maple shareholders.
- We note that the CEO as defined in the Order would not be taken into account in determining whether at least 50% of the directors are independent. While we believe that the intent of this statement is to strengthen the independence of the Board, we have some concern that the CEO, in some circumstances, may be unduly influenced by the Maple shareholders, particularly if that individual has previously been an executive of one of the major shareholders. If that were the case, then the Board, as proposed in the order, would be composed of 8 Maple shareholder directors plus the CEO, who, acting together, would form a majority and could outvote the independent directors in any matters.
- The nomination process should be transparent for new nominees to the Board so that new nominations do not solely come from existing Board Members. This may include a public posting of Board positions and/or the use of a search firm to find suitable candidates.
- The independent directors of the boards must represent the interests of all investors and, to that end, it is critical that independent directors have sufficient knowledge about capital markets and marketplace operations to

make sound, fair and informed decisions on what are very complex matters. The independent directors MUST include representatives of small investment dealers.

- The directors of the Boards should also have a broad diversity of representation reflecting the Canadian investor base. This will include representation from diverse geographic regions.
- We note that there is no specified term for a director. This should be defined as part of the order as well as the term for the chair.
- There is currently no reference to what constitutes a quorum for a meeting of the Board of directors and would note that a quorum should also reference the appropriate representation of independent directors.

Governance Review Process:

We strongly endorse the concept of a governance review as outlined in the Recognition Order as being critical to the effective functioning of the Maple entity and to ensure effective management and oversight of potential/actual conflicts of interest.

We would also add the following recommendations:

- The order states that the governance review is to be carried out by “an independent consultant acceptable to the commission”. Given the complexity of the issues which must be considered under the governance review, it may be necessary for the commission to consider having a Governance Review Committee which has individuals with a variety of skill sets; e.g. expertise in market microstructure, clearing/settlement, legal, accounting, etc.

- There should be a public process for submitting issues/complaints to the individual/committee conducting the governance review.

Fee Models/Incentives etc.

We support the restriction outlined in the order which address the issue of Maple setting fee structures which may discriminate against certain market participants and unfairly affect their ability to operate their businesses. We note that these restrictions cover pricing, discounts and rebate structures which could be construed as anti-competitive. These restrictions should apply, not just for new fee models and incentive structures created in the future, but should also apply to existing agreements held by any of the Maple entities (TMX, Alpha, and CDS). We would recommend that such existing fee structures should be reviewed against the standards set out in the Recognition Order.

Central Clearing Agency Governance (CDS and CDCC):

The Maple recognition order lays out two different board structures for CDS and CDCC even though the Maple proposal argues that they should be under common ownership to ensure the they coordinate priorities and investment to achieve cross margining between the two. Intuitively we would have expected the Maple Group to merge CDS and CDCC into one entity, given their assertions that the proposed benefits of the deal cannot be realized by two unique entities working in concert/ (an assertion we question given the success DTCC and OCC have had with cross asset margining in the U.S.). We therefore question the effectiveness of the two separate boards where the members appear to have very different selection criteria and experience. We also question why the size, structure and criteria other than product expertise will be different as both clearing agencies have respectively common mandates of providing clearing service to all Capital Markets participants in Canada. Many of the larger users of CDS and CDCC are the same.

As noted in the Maple proposal they have identical boards¹ across Maple, TMX Group, TSX, ME and TSX Venture and by extension the Alpha boards we think

¹ Page 89, Schedule 1 Letter from Maple Regarding Changes to the Application.

that the same principals of independence should apply to both CDS and CDCC. A common application of corporate governance will decrease concerns that the different boards treat conflicts in a different manner. We suggest that the CDS, Market Participant Advisory Committee (MPAC) concept should be applied across all boards that are responsible for listing, trading and clearing of securities where those entities hold a majority or dominant portion of the Canadian Capital Markets activity. We also suggest that CDS and CDCC boards should have as noted above with the Maple board, at least 50% independent directors when excluding the chair, an independent chair, an open process to find candidates, representation from small dealers, diversity, term limits and transparency of process such as quorum as part of the recognition order.

We suggest that a combined CDS and CDCC board, albeit larger in size than each of the separate boards, could achieve all of the stated goals of coordination and commitments to corporate governance. The product expertise of clearing both equities and derivatives will be required for any cross margining efficiencies.

CDS

The proposed Maple acquisition, as outlined in the OSC Recognition Order of May 3, 2012, could result, despite best intentions of all involved, in a monopoly across asset classes in the Financial Services arena, from equities and derivatives through to fixed income. But even more troubling for participants in Capital markets in Canada would be the 100% lock on clearing of these asset classes that would result from this acquisition. For \$167 Million, a mere sliver of the total earnings of the Maple Group for even one quarter, the group would be able to control the barriers of entry and pricing for the critical elements of settlement.

Clearing of trades is one of the components least considered when discussing the totality of the investment process. Much is made of the front end investment banking, trading, sales, portfolio management, listing, etc. But these are all race cars which require a road on which to travel. Imagine if all the roads – large and small – were toll roads like the 407, and owned by one entity. Even if the 407 promised pricing controls for infancy of its arrangement, competition fears would

abound. But over time these pricing controls will become subject to the Board of CDS and possibly the Market Participation Advisory Committee (“MPAC”), an organization with arguably no real power over the Board which will ultimately govern CDS, and control its direction.

While the recognition order speaks in general terms about “Public Interest” and OSC approval required for any ownership changes, over time, the might of a powerful Board which only has one third of its members as independent directors could have a significant impact. While this ratio would be sufficient for a public company, it is important to note that the CDS is the only means by which participants in Canada can settle an equities trade; and potentially in the near future OTC derivatives trade.

To the credit of the OSC, the revised OSC recognition order provides certain minor concessions which play to the tension between the Maple Group’s natural desire to control something which they wish to acquire, versus the needs of Capital Markets which will foster not just the utility of clearing, but will do so in a competitive manner with innovation and market needs paramount. In order to understand the stark changes that would result, one must know that currently CDS operates on a cost recovery model for all member participants, somewhat like a credit union. Under the new paradigm, Maple intends to credit CDS participants with some rebates, arguably less than what was provided in earlier years, up to a certain cap of \$4 Million.

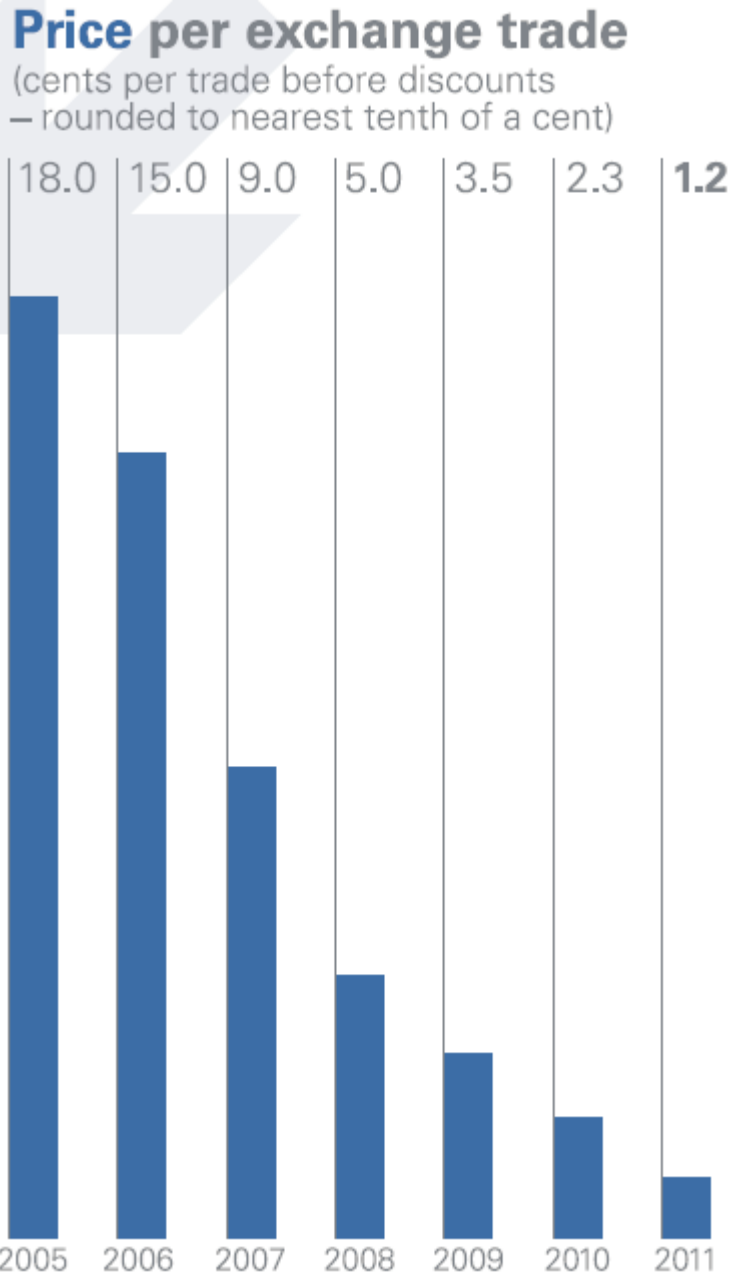
The Revenue numbers for CDS are also an instructive angle to review the CDS component of the proposed Maple acquisition. While the projected 2012 revenues are \$94 Million, only \$63 Million of this revenue is deemed “Core” to CDS. And the recognition order only speaks to protecting this “Core” revenue. The remaining \$31 Million is presumably non-Core, and thus not subject to price controls. This includes the invaluable functions of SEDAR, SEDI, NRD, Market Data, 3rd party data distribution, and other innovations that could materialize, not to mention other daily services such as connectivity to CDS. The proposed pricing model is silent on many issues which, of themselves, may not appear material. But when they



could effectively discourage new entrants, they could become a problematic pill to swallow.

Of the \$63 Million of revenues that is subject to a fee freeze, as per the recognition order, we note that even this will not prevent increasing costs for non Maple members. While Maple has agreed to freeze fees at the 2012 level, we note that this is on a per transaction basis. [Such fees have been declining steadily for the past several years, and are widely expected to continue declining in the near future as average trade sizes decline and total volumes climb.](#) (Note that while volumes have dropped the last several months, the trend suggests that over intermediate to longer term we will see continued volume growth). As per the chart below, per transaction fees have been decreasing roughly 30% per year for some time. By setting fees at current levels and giving Maple 50% of any efficiency, the OSC is most likely setting fees at levels that are higher than those the street would pay ex the Maple deal being consummated. On top of this the guaranteed rebate – which caps out at \$4 million per year as of 2016--is less than the street rebate in 2010. [\(No rebate was paid in 2011, not for lack of efficiencies, but rather CDS chose to hold back those funds to beef up capital...those funds continue to be held by CDS and appear likely to be assumed by the Maple Group. We believe the OSC should rule on the ultimate outcome of these funds\).](#)

(Graph 1 – CDS Price per exchange trade – source: CDS 2011 Annual

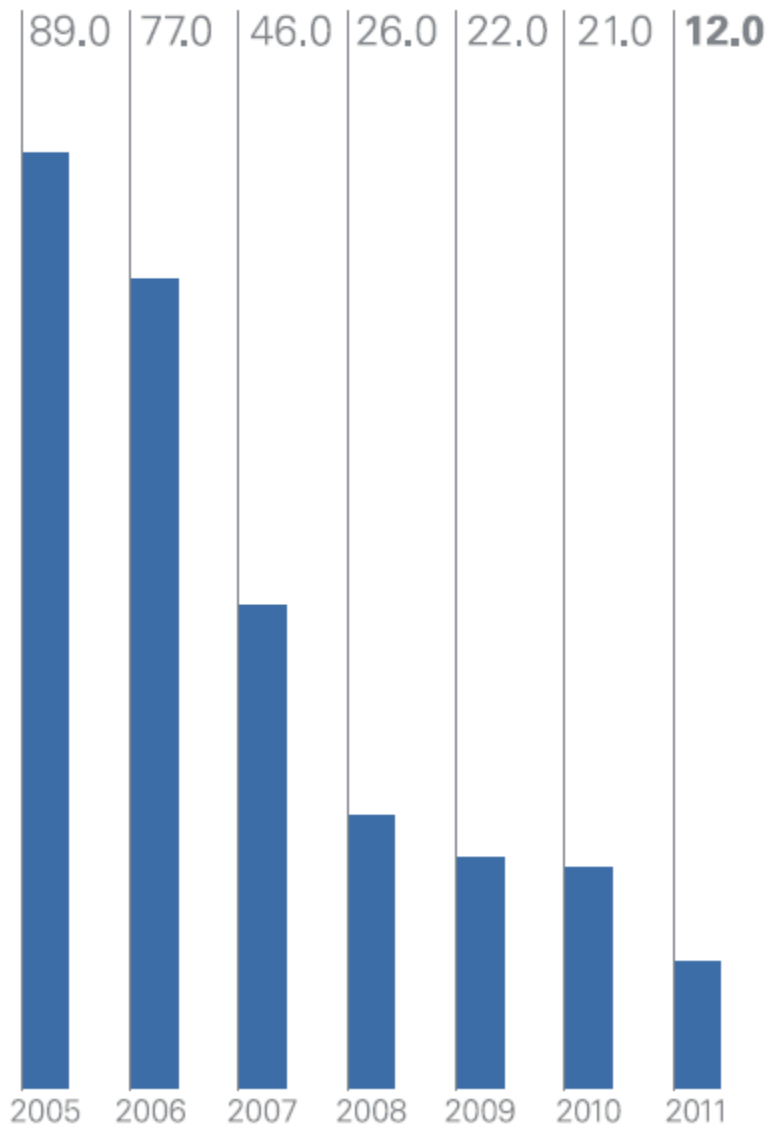


Report)

(Graph 2 – Price per non-exchange/OTC trade – source: CDS 2011 Annual Report)

Price per non-exchange/OTC trade

(cents per trade before discounts
– rounded to nearest cent)



Let's consider what would have happened if we had allowed somebody to acquire CDS in 2007, and offer the exact same per transaction price freezes. The cost per trade in 2011 would have been 9 cents per trade, versus 1.2 cents per trade, on 397 million trades. So instead of paying \$4.76 million to clear these trades, the street would pay \$35.73 million. Even after 50% of the new profits were rebated to the street, we would still be paying an **extra \$15.4 million dollars**. (Note if we consider a freeze in 2005 the **net extra cost to the street would be \$33.4 million dollars**).

We note that the number of trades is influenced by a number of factors, including order types and matching logic offered up by the marketplaces. If, for example, the TMX were to move to a pro-rata matching logic the number of trades would increase significantly, while the average trade size would plummet. The proposed deal would give great influence to the Maple Group over number of trades, and allow them to profit – Via CDS – from any such increase. We further note that any excess profits made on the clearing side could allow Maple to cross subsidize cheaper trading fees in an effort to squeeze the few remaining competitors out of the market.

Given that Canadian average trade size is still more than double that of the U.S. market, and the U.S. market continues to trend lower, we would suggest there is still considerable opportunity for average Canadian trade size to decrease. Such a decrease will be very profitable for the Maple Group at the expense of all other market participants. This new tax on all asset classes has the potential to make trading in Canada less efficient and attractive.

The added costs we are discussing are only for the equity clearing piece, which last year accounted for roughly 6% of CDS revenues. Similar increases can be found throughout the entire structure. And future efficiencies that are not created by Maple, will reward the Maple Group at the expense of the street. **For example, as international markets move to more transparent and electronic trading in fixed income products, they have witnessed a similar decrease in average trade size as we have seen in equities. If Canada starts to participate in this trend the per trade clearing cost will only decrease – based on the profit split – at half the rate that it**

otherwise would. This will result in higher total clearing costs for non Maple market participants. This added cost may negatively impact the natural evolution of fixed income markets to a more transparent “equity like” trading mechanism.

ITG notes that several of the Maple owners would be well served to keep the status quo in this market. As it is, the various Fixed Income dealing networks will now be largely controlled via the Maple Group and its founding members, which already limits the ability of this market to evolve away from its dealing desk roots.

If the OSC allows this deal to be completed they must ensure the Board has better independence and is more responsive to participants and even regulators. It might be appropriate, once the importance of CDS is properly recognized, to ensure there is a staggered board comprised of the following:

1. A maximum of 50% of the CDS Board can be comprised of non independent directors. (CEO and other Maple / TMX executives would be considered non independent).
2. A minimum of one third of participants must be independent members of CDS who consume these services. Note independence means the member has zero economic interest in the Maple Group.
3. One member must be from a marketplace that clears on CDS
4. One member must work for a regulator or commission and be nominated from that entity. Possibly even the Competition Bureau could have a seat.

Furthermore, potential new marketplace and/or clearing house entrants must be first reviewed by the MPAC who would make a recommendation to the OSC. While the recognition order requires CDS to provide time to connectivity standards, and it might not be possible to spell out such standards now, it is in the best interests of participants that the proposed new marketplaces receive public



recognition so participants can be informed of potential new changes to the marketplace environment.

In addition, the order discusses the need for CDS to inform the OSC of any new and or material risks. However, this is left to CDS to decide what needs to be disclosed to the OSC. Instead, one would want to have a structure in which regular risk reporting to the OSC would ensure the OSC have a timelier and fuller picture of risk at any given moment. Thus participants can know that a qualified independent body is properly overseeing the potential market risks that could be warehoused in the sole clearing corporation for equities, and again in the near future, potentially OTC derivatives.

Obviously, any new pricing by CDS must be approved by the OSC and must not be designed or have the impact of discouraging new entrants. But one should be permitted to openly query what will be the result of simply informing the OSC of any changes to pricing, outsourcing, partnerships. Will there be a public and transparent review? Will the OSC apply an internal standards test?

Lastly, the efficiencies of CDS are touted as one of the hallmarks of the strength of this deal. However, one neglected remedy would be to allow for bilateral netting by participants. This would allow participants to submit fewer net trades into CDS, minimizing both market impact and costs for all.

Overall, the OSC is to be commended for taking steps to tighten up controls and governance on the clearing level. However, the proposals simply do not go far enough in some instances. One must remember once this is finalized, it will be difficult to go back to owners to adjust governance and reporting metrics.

One must not lose sight that ownership of the TSX, a publicly traded company, should be open to different ownership up to the point where it is anti competitive. The only equities clearing corporation in Canada, currently run by members on a cost recovery method, poses a much larger threat to the competitive landscape of

Canada. Arguably, in such a large multibillion dollar transaction, this utility called CDS works well enough as it stands and could be easily carved out of the entire Maple transaction.

Aside from our previously mentioned suggestions around CDS board composition, we would suggest the following remedies should the CDS purchase be approved:

- 1) All visible markets should remove anything in their contracts with dealers that limit choice around clearing agent. Dealers should be able to use a facility outside of CDS for bilateral netting before clearing at CDS.
- 2) Any fee regulation should consider all fees charged by CDS not just those that have somehow been deemed to be “core”. Dealers, and ultimately investors, are subject to all such fees and should have price protection on the entire suite.
- 3) Fee caps, on a per transaction basis, at current levels should be reconsidered given the history of such fees. Clearly, non Maple dealers have good reason to believe that such fees will naturally fall as trade sizes continue to decline, and volumes continue to rise in the intermediate and longer term. If regulators are serious about protecting the non-Maple portion of the community, then fee caps need to consider the natural price declines that are likely to occur without Maple.
- 4) Given the monopoly Maple will have on all things clearing, and the extremely high barrier to entry into this space, we would like to hear more on how the regulators expect to handle proposed pricing of new products like OTC derivative clearing. As Maple is the only viable bidder for this business, we would be concerned if the regulators had not set up a proper framework to ensure reasonable pricing.
- 5) The recognition order suggests the OSC could further reduce CDS fees if they deem that CDS is making too great of a profit relative to international benchmarks. We would like to have greater understanding of how these

benchmarks will be determined, and what the acceptable level of profit is before the deal is approved. Deferring this decision puts the commission in the awkward situation of having to make qualitative decisions at a later date. Any benchmark should be heavily weighted towards pricing at DTCC, as the U.S. market is our closest competitor, and also the clearing firm that CDS has historically striven to match. Should we instead use a mid-point of international clearing firms – all of which outside of DTCC currently operate at higher costs than CDS – we will see a spike in clearing costs, which is ultimately borne by those trying to invest in Canada.

- 6) Full transparency around the pricing and internal accounting within the clearing vertical(s). Such transparency will allow non-Maple members to better understand how all clearing costs are derived, and to voice objection should inappropriate costing decisions be made.

ALPHA

Of the three areas that we are focusing on the one with the least clarity is the proposed – and largely negotiated – acquisition of Alpha LLC. The reason for the lack of clarity is twofold:

Firstly, after a full year of discussion and analysis around this proposed transaction we have still not heard a comprehensive explanation of the reason for the Alpha purchase. Beyond offering the existing Alpha shareholders a monetizing opportunity than can best be described as a Kobayashi Maru – (i.e. the solution to the unsolvable problem) we do not see what the purchase offers to the Maple Group beyond the ability to retire a singular large and disruptive competitor. If this is indeed the *raison d'être* for the purchase then we cannot conceive how it can be viewed as viable within the constraints of Canadian competition law as we understand it. If retiring said competitor is not the driving force for the proposed



purchase then we, having paid considerable attention to the deal and all the verbiage around it, are still unaware of another stated purpose.

The second reason for the lack of clarity is the remaining uncertainty around the future of the various Alpha assets should the deal be finalized. We inquired during the May 11th TMX earnings conference call as to the plans for Alpha should the deal proceed, and we were told by TMX CEO Tom Kloet that he was unsure which, if any, markets would be closed or whether they would continue to charge for Alpha market data over and above charging for TMX data. Maple Group members, including Maple Group CEO Luc Bertrand, have been equally vague in discussing the future plans for Alpha.

With this lack of clarity we believe it is instructive to consider the state of competition within the Canadian equity trading landscape. Looking at the current state and considering the potential future state, we turn to the benchmark Herfindahl Index. (The Herfindahl index is a commonly used measure of the level of competition within an industry. Typically, an index level greater than .25 is considered to be a threshold at which a market becomes uncompetitive, and an increase in the index of 0.025 is considered a possible risk for any industry with an index already in excess of .1).

(We exclude warrants, rights, preferreds, debenture and venture listings to best filter for the noise of high volume trades in very low priced stocks and the skew created by the different board lots in the debenture markets. Should we not exclude this there is slightly more volatility in the numbers but the averages are very similar if not slightly more anti-competitive in nature)

Actual Herfindahl Index

	TSX & Select	Alpha	Chi-X	Omega	Pure	Liquidnet	MatchNow	Herfindahl
12-Apr	63.84%	19.39%	10.10%	1.26%	2.01%	0.24%	3.16%	0.46
Q1/12	64.61%	19.51%	8.75%	1.55%	2.23%	0.26%	3.09%	0.46
Q4/11	63.04%	21.00%	8.69%	1.88%	2.71%	0.16%	2.53%	0.45
Q3/11	61.84%	21.35%	8.65%	2.17%	3.44%	0.16%	2.39%	0.44
Q2/11	60.30%	21.39%	9.50%	2.14%	4.25%	0.24%	2.18%	0.42
Q1/11	62.31%	22.55%	7.88%	1.80%	3.76%	0.19%	1.51%	0.45



Q4/10	64.30%	22.00%	6.92%	1.00%	3.88%	0.13%	1.57%	0.47
Q3/10	66.63%	22.10%	6.81%	0.64%	2.39%	0.13%	1.30%	0.50

(Of interest you will note the marked downturn in volume on both Pure and Omega since just before the introduction of the new IIROC regulatory fee reallocation model. While we are fully supportive of IIROC's new model, we do believe that this reallocation model has created a higher barrier to entry for new markets and made the environment slightly less competitive. This can be further evidenced by the collapse in volumes at Sigma X coinciding with the new model taking effect on April 1, 2012 – which undoubtedly was partially responsible for the closure of Sigma some 3 weeks later).

We next look at what those Herfindahl numbers would have been if we considered TMX and Alpha as one entity. This is done to approximate the change in the competitive environment for equities trading should the deal proceed. Note that the Herfindahl index increased by over 50% under this scenario.

Herfindahl Assuming Alpha Fully Integrated

	Maple	Chi-X	Omega	Pure	Liquidnet	MatchNow	Herfindahl
12-Apr	83.23%	10.10%	1.26%	2.01%	0.24%	3.16%	0.70
Q1/12	82.38%	8.75%	1.55%	2.23%	0.26%	3.09%	0.69
Q4/11	82.41%	8.69%	1.88%	2.71%	0.16%	2.53%	0.69
Q3/11	82.13%	8.65%	2.17%	3.44%	0.16%	2.39%	0.68
Q2/11	81.69%	9.50%	2.14%	4.25%	0.24%	2.18%	0.68
Q1/11	84.86%	7.88%	1.80%	3.76%	0.19%	1.51%	0.73
Q4/10	86.30%	6.92%	1.00%	3.88%	0.13%	1.57%	0.75
Q3/10	88.73%	6.81%	0.64%	2.39%	0.13%	1.30%	0.79

Finally, we consider the Herfindahl index, over the same period, assuming Alpha was nonexistent and spreading their existing market share on a pro-rata basis



amongst the remaining exchanges. Note that the index still increases by more than 30% under this scenario.

Herfindahl Assuming Alpha Closed and Pro-rata Distribution of Alpha Volumes

	Maple	Chi-X	Omega	Pure	Liquidnet	MatchNow	Herfindahl
12-Apr	76.62%	12.53%	1.56%	2.49%	0.30%	3.92%	0.61
Q1/12	78.11%	10.87%	1.93%	2.77%	0.32%	3.84%	0.62
Q4/11	77.72%	11.00%	2.38%	3.43%	0.20%	3.20%	0.62
Q3/11	77.28%	11.00%	2.76%	4.37%	0.20%	3.04%	0.61
Q2/11	76.71%	12.08%	2.72%	5.41%	0.31%	2.77%	0.61
Q1/11	80.45%	10.17%	2.32%	4.85%	0.25%	1.95%	0.66
Q4/10	82.65%	8.89%	1.29%	4.99%	0.17%	2.02%	0.69
Q3/10	85.53%	8.74%	0.82%	3.07%	0.17%	1.67%	0.74

Clearly, the proposed merging of TMX and Alpha will be detrimental to the competitive landscape for Canadian dollar trading of TSX listed securities. While the Maple Group will argue, and have argued, that NYSE and NASDAQ exert significant competitive pressure on this marketplace, we don't agree.

Firstly, we note that TMX pricing is significantly higher than that of NYSE or NASDAQ – and in many instances is more than 10% higher than NYSE or NASDAQ could charge under SEC REG NMS. (As we suggested in our OSC Hearing testimony this point was made extremely well by TD Securities in their excellent response to the CSA proposal on Dark Pools and Dark Liquidity. In that response they suggested that for Canada to match the 30 mill taker price cap within NMS we would need to cap our take rates at 14 mills to normalize for lower average priced stocks on a volume traded weighing basis). The discrepancy in pricing within the Market on Close facilities of TMX, NYSE and NASDAQ is



even more staggering, with TMX average fees currently more than twice the highest NYSE or NASDAQ rate even after accounting for fee caps. (As the table below clearly indicate the take fee on stocks trading over \$5 is significantly higher than on any of the other Canadian lit venues as well. This would tend to suggest the TMX already exerts a dominant force on such trading.)

Perhaps the clearest indication of competitive pressure is how the TMX responds to pricing changes. Since 2007 the TMX has responded quickly, and aggressively, to several pricing structures offered up by Alpha, but has failed to respond in a similar manner to pricing changes by any other venues – whether located in Canada or the U.S..

Active Take Fees on Various Canadian Trading Venues

	<\$1	<\$5	\$5 -
TSX	1.5 -2	33-35	33-35
ALPHA	3	25	28
SELECT	1	2	2
CHI-X	1	29	29
PURE	4	25	25
OMEGA	0	0	0
MATCH NOW	1	5	10

Source: TMX, Alpha, Chi-x, Pure & Omega Websites – May 25th 2012

We note that the Maple Group have further suggested that the other existing lit markets have “unlimited capacity” and thus represent a true competitive force. As we closely monitor the performance of the various markets during higher volume periods, we can definitively state that the other markets do not have “unlimited capacity”. The recent Facebook IPO on NASDAQ should clearly demonstrate that even the biggest market does not have unlimited capacity. Our analysis of the current market suggests that Pure, and to a lesser extent, Omega, experience significant performance slippage during higher stress situations – and both of these markets typically have less than 2% ex-block market share. To suggest either is capable of quickly assuming a significant increase without technological

challenges or upgrades is inconsistent with our findings. We would be curious to discover how Maple came to their conclusions.

While Chi-X is now around 10% market share, and is likely more capable of handling an increase, we have concerns here as well. Chi-X is largely owned by Instinet. There have been many suggestions in the press recently that Nomura will fold Instinet into the parent company, which leaves some uncertainty around Chi-X's future. This uncertainty increases when one considers the financial performance of Chi-X's sibling Chi-X Europe. Chi-X Europe was purchased by BATS last year, and according to BATS later' FORM S-1 IPO Prospectus, during 2011 Chi-X Europe lost USD \$9.6 million. This despite having 18.4% market share in the issues they trade – issues comprising “listed cash equity securities within 25 indices across 15 national European markets, as well as ETFs, exchange-traded commodities and international depositary receipts”. This performance raises questions regarding the ongoing financial viability of the remaining visible markets. It is incumbent upon regulators to be fully aware of the financials of each of the remaining marketplaces, as well as have a comprehensive understanding of their on-going viability under current conditions, and also under a scenario where market data fees were set at a level more consistent with international markets.

Secondly, we would note that less than 300 of the 4,000 TSX listed stocks trade on either NASDAQ or NYSE. While these stocks account for a large portion of the total volume and value traded on TMX, this volume is significantly over stated due to the volume inflation created by interlisted arbitrage activities. Should either the OSC or the Competition Bureau remain unconvinced that NYSE and NASDAQ do not offer a serious competitive threat to TMX we would suggest you poll the various dealers within the Maple Group and ask how many are currently routing Canadian dollar orders for TSX listed stocks on an interlisted basis for their retail clients. If they truly consider NYSE and NASDAQ to be viable options for these trades we would assume they are all doing this.

Further exaggerating this current and future dominance of the equity trading landscape are the oncoming dark trading rules that pose a threat to the existing dark pools in the market. While we remain confident that MatchNow can continue



to offer significant value to natural investors looking for refuge from the informational leakage within lit markets, it would be foolish to think dark trading venues will not be handicapped by these rules.

Beyond the anti-competitiveness of the equity trading vertical, we note that the purchase of Alpha will also stunt the growth of competition in the equity listings space. With Alpha achieving exchange recognition last December, they have gained the rare position of a viable alternative to TMX for the listing of Canadian companies within their home market. While Alpha has yet to gain even a single listing, we do believe they are a larger threat to TMX than CNSX given the nature of their ownership and their ability to have the banks display quotes on any future Alpha listings on their various discount brokerage websites. To date these same banks have not displayed such quotes for any CNSX listings, which hampers CNSX's sales efforts. (We do understand that TMX would still have significant justifiable advantages within the listings space – including brand recognition, issuer marketing capabilities and potential index inclusion – and are not suggesting Alpha will easily gain the same share in listings as they have in trading, or anything even close to it).

Along similar lines we note that the removal of Alpha from the competitive landscape also hinders competition in the clearing space. As the Bank of Canada has clearly indicated a preference for a domestic solution to the OTC Derivative clearing need, Alpha is one of only three Canadian domiciled institutions to thus far indicate a willingness and ability to compete for this plum assignment. The other two of course are CDS and CDCC. The removal of Alpha from the playing field significantly reduces the number of potentially viable contenders, which should make for a less competitive bidding process.

Of course pricing is only one feature of a competitive market. Dominance can be exerted in other fashions as well. Currently the TMX Group is attempting to move to a new version of their Quantum trading engine – Quantum XA. The new trading engine brings questionable benefits to the street – TMX suggests it will

offer greater certainty of execution, but our current market leading SOR already achieves a level of certainty that we believe cannot be improved upon. We can demonstrate that the new trading engine brings significant risk of decreasing certainty of execution on interlisted stocks. (Note: We continue to make this very important argument despite the fact that we are the inventor of, and leader in, interlisted smart order routing, and will gain significant relative advantage should this new engine be rolled out). The questionable benefits will come at huge cost to the street – with Maple Group member TD offering up a very plausible estimate of \$50 - \$100 million in street costs – and even greater opportunity costs as valuable resources are diverted away from client driven development to comply with this forced upgrade. If the TMX is capable of forcing such a resource diversion on the street at its current market share levels, we must ask what they would be able to do with 85% market share. And would such diversionary tactics allow them to impede dealers’ ability to create routing tools to new entrants? While the OSC is currently reviewing the Quantum XA situation, we believe that in future such rollouts will need to be approved by the regulator before they begin. This will be even more compelling should the proposed transaction be completed. This of course leads to the question of the OSCs willingness to undertake such a position.

The OSC has not been inclined to aggressively regulate pricing, as has been evidenced by the lack of a market data pricing mechanism. This was made clear in recent weeks when Alpha increased their market data pricing – a move that was surprising both in scope and timing. Clearly, if Alpha and TMX were to be combined the existing market data revenues would allow them to price trading at uncompetitive levels over a time frame, thus putting excess pressure on the remaining visible marketplaces. The precedent for uncompetitive pricing in the Canadian lit market landscape has clearly been set with Chi-x having twice offered trading at prices that ensured them of a loss on those trades. (The most recent of those is the announced payment for cross trades gimmick. Should the TMX Group propose a similar loss leader pricing schedule we have no doubt that Chi-x would strongly object. We believe that any such pricing should be rejected – particularly on crossing as it opens the gate to dealer payment for order flow via “cost plus pricing mechanism”). We strongly urge the OSC to require Maple to cease charging for Alpha data should the deal be finalized. We continue to argue for a

regulatory mechanism to determine market data fees, thus eliminating the cross subsidization that currently occurs, and could potentially grow should this deal be consummated under the proposed recognition order. We again wonder, given the OSC's limited reaction to the excellent IIAC / SLGC study on Canadian market data pricing, what appetite exists at the commission to take on this issue.

We do believe the section in the recognition order aimed at ensuring fair and reasonable pricing for all is very well written. It would appear to us to eliminate both the TMX's ELP pricing model as well as Alpha's OTS Market Maker pricing. As we believe both of these models are detrimental to market quality, as they grant superior price to an arbitrary group of market participants with no offsetting obligations, we applaud this action and urge the commission to push forward with it even if the deal should not close.

Finally, we note that in our original comment letter we quoted both Tom Kloet and Kevan Cowen at length on the issue of dealer owned exchanges being highly conflicted, and likewise quoted Jos Schmitt at length on the matter of TMX anti-competitive pricing policies. Those quotes were lengthy, to ensure we captured the true context of the speakers. We don't believe it is necessary to repeat the quotes, but do not believe the proposed recognition order addresses these matters in a meaningful way.

Having written the above on the proposed Alpha purchase we would suggest the following remedies must be implemented if this purchased is to be allowed:

- 1) TMX should cease charging for Alpha market data upon completion of the transaction, and the OSC should publish a roadmap for future market data regulation.
- 2) TMX should adopt Alpha trading fees where they are lower than TMX. (Otherwise if they close or abandon Alpha that lower priced option disappears).

- 3) The OSC must deal with the pending Quantum XA roll out, and create a system to ensure any future development pushes are truly beneficial to the community and reasonable in scope.
- 4) Ensure the fair pricing standards within the current proposed recognition order eliminate both the TMX ELP and Alpha OTS Market Making fee structures, and any future similar structures.
- 5) Identify a legitimate domestic bidder for the OTC Swaps clearing business outside of Alpha, CDS and CDCC.
- 6) Ensure that both TMX and Alpha have a similar MPAC to those proposed for CDS. Ensure that the MPAC has an independent and knowledgeable chair, and that said chair will have semi-annual access to both the ROC and OSC Chairs
- 7) Require the banks within the Maple Group to display CNSX quotes on their brokerage websites (after ensuring CNSX fees for such quotes are reasonable).

Conclusion

Market structure in Canada has evolved over the past 10-15 years based on two major changes affecting capital markets and securities trading. The creation of the ATS rules by the CSA was intended to establish a framework to allow for competition among marketplaces to break down the monopoly position over securities trading held by the Exchange. Further, the demutualization of the Exchange sought to create an independent exchange which would not be subject to the potential conflicts of interest which resulted from dealers owning the exchange.

Last October, the Commission published its Request for Comment seeking input from the industry on specific issues related to the Maple acquisition such as

“concentration of ownership and the vertical integration of the trading, clearing and settlement infrastructures in a small group of large financial institutions” . We believe that the Recognition Order has sought to deal with the issues raised in the industry comments provided to the Commission and would urge the Commission to consider some of the ways that we have suggested to strengthen the order.

However, the structure proposed by the Maple acquisition is fraught with conflicts of interest across every facet of the trading, clearing and settlement infrastructure of this country. The conflicts of interest of the original shareholders of Maple owning the exchanges and clearing entities are so great and probability of such conflicts of interest arising so high, the Commission has been forced to create a governance and oversight structure which is extremely complex. While the Commission is to be commended on the thoroughness and completeness of the Recognition Order, the very complexity of the governance and oversight structure underscores the serious conflicts of interests represented by the proposed Maple structure. These conflicts of interest have the potential to seriously affect the ability of other participants to compete effectively in our capital markets.

In order to effectively manage this governance and oversight structure, the Commission must assume responsibilities far more extensive than their existing mandate and they must also ensure that they acquire the expertise and resources to manage these new responsibilities. We would ask what the cost of this oversight will be. The recognition order suggests that the added cost would be attributed to all market participants, while the profits will clearly accrue to the Maple Group. We would suggest the OSC consider taking a page out of IIROC’s playbook, and attribute the costs to the participants that are creating them – in this case any added costs should be attributed to Maple / TMX.

The intent of demutualization and the creation of competition with the ATS rules were to mitigate the monopoly position that had developed under the old exchange ownership structure. We wish to stress and underscore the challenges before the Commission in managing the conflicts of interest which will exist under the proposed Maple corporate structure, which will operate as a for-profit business and



will control the trading, clearing and settlement functions of our industry, across equity, fixed income and OTC instruments.

We thank the Commission for considering our concerns around the proposed deal and our suggested remedies. The deal in question is extremely complex, and encompasses a large portion of the capital markets. We believe that getting the proposed remedies correct is of utmost importance, and welcome the opportunity to offer guidance throughout the process.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Nick Thadaney'.

Nick Thadaney
CEO

A handwritten signature in blue ink, appearing to read 'Doug Clark'.

Doug Clark
MD Research

A handwritten signature in blue ink, appearing to read 'Kuno Tucker'.

Kuno Tucker
Chief Compliance
Officer

CC: The Canadian Competition Bureau
BC Securities Commission
Alberta Securities Commission

Autorité des Marchés Financier (AMF)

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