UNIVERSITY OF CALGARY

SCHOOL OF PUBLIC POLICY

June 28, 2011

To: Secretary of the Commission, Ontario Securities Commission,
20 Queen Street West,
Toronto, Ontario, M5H 3S8,

E-mail: jstevenson@osc.gov.on.ca.

I am writing with respect to Ontario Securities Commission hearing on the TMX-LSE merger and Maple takeover of the TMX. Although issues will be clarified better after the June 30th vote, I understand there is a deadline of June 29th for any submissions and requests to appear before the OSC.

I am submitting two recent opinion editorials on the subject as a basis for my views. I am willing to provide a more detailed oral and written review after June 30th if requested to appear before you at a time that is convenient.

Sincerely,

Jack Mintz
Director and Palmer Chair

Jack Mintz: A TMX deal is needed

Jack M. Mintz Jun 21, 2011 – 8:44 PM ET

National Post

London Stock Exchange CEO Xavier Rolet, left, and TMX Group CEO Tom Kloet shake hands after announcing their merger plans on Feb. 9 in Toronto.

Otherwise, it will remain a regional exchange with limited liquidity

On June 30, TMX and LSE shareholders vote on the proposed merger of TMX Group with London Stock Exchange Group. Even if the merger is accepted by shareholders, the majority being U.S. investors in case of TMX Group, the story will not end there. The Ontario Securities Commission as well as Quebec, U.K. and Canadian regulators, including Investment Canada, must provide approvals.

If the merger is turned down on June 30 or later, Maple Group, owned by a consortium of Canadian banks and pension plans, will have its chance to acquire through a hostile bid TMX Group, which is expected to be merged with Alpha trading and Canadian Depository for Securities Ltd. It too will need regulatory approval, the most important stumbling block coming from the Competition Bureau that reviews anti-competitive impacts.

While markets will sort out which is the better financial result for TMX shareholders, Canadians are most interested in the economic net benefits accruing from either the TMX-LSE merger or the Maple Group acquisition. The proposed TMX-LSE merger is, unfortunately, politically charged in Canada, similar to the debate over BHP Billiton's attempted acquisition of Potash Corp. Already, Dwight Duncan, Ontario Minister of Finance, and Quebec Premier Jean Charest have wrapped themselves in the Canadian and Quebec flags.

Before politics takes over economic reasoning, it is best to outline the various policy issues at stake. In this case, a critical principle is the efficiency of financial markets. Other principles are less important since, by and large, the regulatory system will continue to ensure investor protection and stability under both proposals.

The role of financial intermediation is to reduce the transaction, risk and information costs of matching borrowers with lenders. On these grounds, the TMX-LSE merger makes sense. Canadian investors will be able to access a larger variety of investments with the merged exchange at lower cost. Similarly, Canadian companies will have better access to international markets and have their shares traded at lower cost among a larger pool of investors. To put it in simple terms, the merged TMX-LSE structure reduces the cost of intermediation for Canadian investors and businesses.

Further, the globalization of capital markets is forcing stock exchanges to consolidate to reduce costs arising from economies of scale with trading platforms. The TMX-LSE is one response to these competitive pressures — so are many other cross-border exchange consolidations that can be accessed by Canadians today.

Some opponents have mused that there are better dancing partners than the LSE, including Singapore, the Chicago Marketing Exchange or even the Deutsche Boerse, which is likely to merge with NYSE-Euronext. But these are questions that only markets can best sort out since consolidations at the international level shall continue in the coming years.

The political arguments against the TMX-LSE merger are rooted in Canadian angst over foreign direct investment and loss of control of Canadian companies. Yet, Canada has changed much since 1995. Canadian companies invest more abroad than foreign companies invest in Canada. Canada is not being swamped by FDI. Foreign direct inflows in 2004-08 were only 3.8% of GDP, 46th highest among 92 countries. Our recent reaction to the BHP takeover of Potash has marked Canada as being less hospitable for FDI when it comes to more significant companies. The OECD has continuously ranked Canada as having one of the more restrictive regimes for FDI.

Regardless of our concerns for FDI, TMX-LSE is touted as a “merger of equals” with joint control of the exchanges. In this sense, Canada may be viewed as increasing its sovereignty in stock markets. Nonetheless, concern is raised that Canadian representation will only represent 45% ownership with seven of 15 directors on the newly constituted board, although the chair of the board will be Canadian.

But it must be remembered that the LSE group is almost three-quarters larger than the TMX group in revenues, even though the more efficient TMX has better profit margins. Given the organization of the new entity, the TMX holdings are to be governed by their own management and boards, and will be regulated no differently than previously.

Concerns are raised that TMX will be hollowed out, with fewer research functions and less employment. Hard to say that would be case — in fact, it could go the other way, given the managerial and technical strength of TMX Group. Regardless, cost efficiency is important to clients using the stock exchange.

Others have argued for a national champion in Canada that would take on the world. Without the merger, the TMX might continue to play a role in attracting smaller resource companies for financing in Canada, but, at best, it will remain a regional exchange with limited liquidity.

This raises the question about the value of the Maple Group takeover that has been proposed as an alternative. While the Maple-owned exchange would fail to achieve the economic gains from international consolidation, a potential benefit is the integration of the TSX, Alpha and CDS as one platform, achieving lower costs with multiple product lines. Economies of scope are important to consider, but it would come at a price. The integration of the three platforms would likely result in less competitive trading practices, a concern that would have been important if the TMX had owned all three platforms. International competition with more-efficient consolidated exchanges would continue, putting some constraints on the Maple-led stock exchange. However, smaller clients could be hurt the most.

Should either the TMX-LSE merger or a later acquisition of TMX Group by Maple be approved, these public policy issues will be at the forefront when regulatory bodies review the proposals. An eventual outcome could be neither transaction being accepted. Should that happen, Canada would simply plod along with a less competitive and protected economy.

FP COMMENT

Jack M. Mintz: Politicians should stay out of markets

Jack M. Mintz Mar 14, 2011 – 8:40 PM ET | **Last Updated: Mar 14, 2011 8:59 PM ET**

Ad hoc blocking of takeovers may cost Canada its hard-won reputation as a good place to do business

With the great bank debate over another politically charged merger, traditional Canadian angst over foreign takeovers is rearing its head for a second time this year. On the heels of BHP's aborted acquisition of Potash Corp., the recent uproar over the TMX Group and London Stock Exchange merger is another manifestation of Canadian discomfort with playing in the global world.

Branding a stock market exchange as a "strategic" asset is well over the top. After all, what we are really talking about is a computer system for trading shares. This isn't a replay of Stanley Kubrick's masterpiece, *2001: A Space Odyssey*, when the computer HAL was ready to take over the spaceship — even then HAL became irrelevant once disconnected.

We should remember the primary role of financial intermediaries is to reduce financing costs for borrowers and improve returns on assets for investors. Reduced transaction, risk and information costs contribute to a more efficient and stable financial market.

The role of the stock exchange is to enable investors and issuers to trade as cheaply as possible. Currently, many large Canadian corporations list on global stock exchanges if they wish to gain access to larger markets. It is a matter of cost, since each listing is not cheap on its own. Typically, the New York Stock Exchange has been the most favoured exchange for interlisted share offerings, given the size and familiarity of the U.S. market.

With consolidation in recent years among stock exchanges, businesses save costs in issuing shares. Investors also have a larger set of shares made available for them to purchase.

The Toronto-London merger will reduce financial intermediary costs for businesses and investors, especially for resource listings, where both exchanges dominate. Instead of a company agreeing to multiple exchange costs, it can negotiate a lower fee with one exchange. Economies of scale are a significant reason for consolidations to take place — and it will continue to be a driving force in the future.

The regulatory regime in each jurisdiction still applies. As we have seen in Canada, mergers among provincial stock exchanges in the past have had little impact on provincial regulatory power. Sure, current heated discussions to create

a national securities regulator continue, but this debate is not a result of provincial mergers of Montreal, Toronto and Venture stock exchanges.

As The Economist recently pointed out, the merging of stock exchanges is really an amalgamation of monopolies in specific trading markets. It is the differences in regulations that help create these monopolies, not the ownership and control of the stock exchange.

Besides, it is far from clear that competitive stock markets cannot develop, with the entry of low-cost trading, such as in the cases of Canada's Alpha and CNSX exchanges. It is precisely their competition that has motivated TMX Group to find alternative arrangements.

Given the rapid consolidation of stock exchanges, you can bet that the Toronto-London merger won't be the end of further consolidation. CIBC's Jim Prentice has raised the concern that Canada's ownership in the new entity should be protected when further consolidations take place. He has an important point, although it needs to be spelt out as to why Canadian governments do not already have sufficient regulatory power to protect national interests without needing merger approval by Investment Canada.

It is the spectre of a single international stock exchange that should be of greatest concern to financial markets. An international monopoly in trading would lead to excessive fees with little control in the absence of an international competition regulatory body.

Other concerns have been raised that Canada should go global itself without merging with other exchanges. It is great to think big, but it is another matter to figure out what strategically makes sense. The CMX and potential new NYSE-German Bourse mergers will provide access to companies to trade in multi-trillion-dollar markets. Most large companies will be looking to these huge exchanges — it is a pipe dream that the TMX could be a major global player on its own.

Instead, the TMX could operate as a regional player catering to small- and medium-sized businesses in Canada. There is nothing wrong with having niche regional players. With sufficient domestic competition, regional stock exchanges could play a useful role in helping smaller companies get better access to investors.

If anything, we should try to pursue regulatory and tax harmonization to enable investors and issuers to participate in international markets more cheaply and to make stock exchanges more competitive. For example, withholding taxes and dividend tax relief tend to be restricted to resident companies, helping trap domestic savings in a country.

Most studies have shown a "home bias" toward investments in the sense that investors hold a much greater share of their investments in domestic equity markets compared with the domestic share of international markets. For example, about three-quarters of Canadian investments are invested at home, even though Canada's stock market is roughly 3.5% of international markets. In contrast, the Dutch are the least biased to investing at home, with 32% of assets invested domestically (the Dutch share of international markets is 1.4%).

The politicization of the Toronto-London merger has demonstrated the critical need for a reassessment of our foreign takeover legislation in Canada. The Harper government urgently needs to develop a set of rules and transparent processes to guide foreign takeovers reviews. Nothing wrong in considering a separate expert body to review publicly takeovers and mergers as an alternative to politicians making these decisions behind closed doors, as in the case of BHP's takeover of Potash.

Without clear-cut standards and less ad hoc blocking of takeovers, Canada is at risk at losing its hard-won image as a good place to do business, which is currently being achieved with sound economic policies. We have become capital exporters ourselves, benefiting from globally integrated markets. More politically motivated obstacles to foreign takeovers here shall eventually sully our reputation.

Financial Post
Jack M. Mintz is the Palmer Chair of Public Policy, School of Public Policy, University of Calgary.

Posted in: FP Comment Tags: Jack Mintz, London Stock Exchange, mergers, TMX Group