

Why the Toronto Stock Exchange faces an uncertain future



Linda
Fuerst

A crucial vote of TMX Group Inc. (TMX) shareholders to consider the proposed merger of TMX Group with the London Stock Exchange Group PLC (LSEG) was abruptly aborted on June 29 after it became apparent that the requisite two-thirds majority approval would not be forthcoming. At issue was the ownership of the Toronto Stock Exchange, operated by TMX's subsidiary, TSX Inc. and other TMX subsidiaries which provide listing and trading markets, clearing facilities and other services to the Canadian and international financial community. With the termination of the LSEG/TMX bid, the spotlight now shifts to a rival bid for TMX by Maple Group Acquisition Group. Under the failed LSEG/TMX bid, TMX shareholders would have received a \$4 special dividend and a 45 per cent interest in Mergesco, the new company to be created by the merger. Mergesco would have owned the various exchanges and related businesses currently owned by the merging entities, including the Toronto Stock Exchange, the Calgary based TSX Venture Exchange, the Montreal Exchange (which operates as a derivatives exchange) owned by TMX subsidiaries, and the London Stock Exchange and Borsa Italiana owned by LSEG. Although the exchanges currently owned by TMX would have continued under the oversight of Canadian securities regulators, the chief executive officer of Mergesco would have been drawn from LSEG. According to TMX, the proposed merger would have benefitted it and its Canadian shareholders in a number of ways, including through reduced cost of capital for Canadian companies, the creation of more products and services for Canadians and an improved ability of the Canadian exchanges currently owned by TMX to entice foreign investors to list in Canada. In addition to both shareholder and court approval of the proposed plan of arrangement, the LSEG/ TMX merger would have required the blessing of various provincial securities regulators and Investment Canada, none of which had been obtained as of June 29. The primary issue for the securities regulators was not whether the LSEG/TMX bid offered the best deal for TMX shareholders, but whether the proposal, which would have required the regulators to lift current share ownership restrictions prohibiting any single person or company from owning or exercising control over more than 10 per cent of TMX's shares, was in the public interest. The Ontario Securities Commission's hearing, which was scheduled to proceed on July 21 and 22, has now been cancelled. It is unclear whether the commission would have been prepared to lift the 10 per cent ownership restriction to allow the merger to proceed. The proposed transatlantic merger was closely scrutinized in the press. Some commentators rejected TMX's characterization of the deal as a "merger of equals" and suggested that it was, in reality, a takeover of TMX and a "sellout" of a vital Canadian asset to the British. Many rejected the notion that an international merger was necessary for TMX to maintain its competitive position and, in particular, its dominance in the mining and energy sectors. Fears were also expressed that the merger would result in a loss of jobs and a "hollowing out" of the Canadian financial sector, particularly in Montreal. These concerns appear to have been at least partially responsible for the decision by a consortium ultimately composed of 13 of Canada's leading financial institutions and pension funds, including National Bank Financial Inc., CIBC World Markets Inc., Canadian Pension Plan Investment Board, Caisse de dépôt et placement du Québec, Ontario Teacher's Pension Plan Board, Manulife Financial and GMP Capital, to mount a rival bid under the banner of the Maple Group. Unlike the LSEG/TMX offer, which did not include any cash component, Maple Group is offering \$50 for each TMX share. Under the terms of the Maple Group bid, existing TMX shareholders would end up owning approximately 40 per cent of Maple Group's outstanding shares, with the balance owned by the 13 members of the Maple Group consortium, and no single shareholder owning more than 10 per cent of Maple Group's total outstanding shares — avoiding the need for a waiver by the securities regulators of the 10 per cent share ownership restriction. However, the Maple Group offer is complicated by its

plan to create a stronger, integrated exchange and clearing group by combining TMX with each of Alpha Group, which owns and operates an alternative trading system that competes with TSX Inc., and CDS, which provides trade clearing, settlement, depository and custodial services. According to Maple Group, the integration would enable TMX “to achieve the scale and efficiency it needs to be successful in an increasingly competitive marketplace.” The planned combination of TMX with each of Alpha Group and CDS raises anti-trust issues and requires Competition Bureau approval. That is because certain members of the Maple Group consortium have a significant equity ownership interest in Alpha Group. Some members of the consortium (and also TMX) have ownership interests in CDS. Bureau approval, if granted, may take many months to obtain and will likely come with strings attached in the form of a consent order incorporating certain restrictions on the operation of the new combined enterprise. The bureau will consider the effects on the equities trading market in Canada, of the “horizontal” combination of TMX with Alpha, and to what extent it is likely to prevent or lessen competition. While there are other trading platforms in Canada, such as Chi-X Canada, an alternative equities system marketplace and the Canadian National Stock Exchange (CNSX), the fact that the Maple Group transaction is estimated to give the new entity control over more than 80 per cent of the equities trading market in Canada likely will be of concern to the bureau. The proposed “vertical” combination of TMX with CDS likely will prove to be more problematic from an antitrust perspective. Maple Group is reported to be in discussion with the bureau over the terms of the proposed merger and has apparently attempted to address some of the concerns about the impact on the market for CDS’s services by promising to charge the same rates to all customers of clearing services, including the entities that are part of the consortium. Until guidance concerning the likely outcome of the bureau’s review of the transaction is forthcoming, the fate of the Maple Group offer, and of the TMX, will remain in limbo.

Linda Fuerst is a commercial litigator and a partner at Lenczner Slaght Royce Smith Griffin LLP in Toronto.