

**SROCC Meeting  
Montreal, June 8, 2010  
Remarks for Tom Kloet  
FINAL**

Good afternoon and thank you very much for the kind introduction, Mr. Okubo.

It is a pleasure for me to join you this afternoon here in Montreal, home to the Montreal Exchange, a leader in the derivatives business, and itself a member of the SROCC.

We are very pleased that Canada is hosting the IOSCO Annual Conference. Since its formation in the 1980s, IOSCO has become the recognized body for establishing regulatory benchmarks for international securities markets. Clearly the SRO Consultative Committee provides meaningful input to IOSCO policy setting. Your work is very important to securities markets globally and we value this opportunity to meet with you today.

I am also pleased to be speaking on behalf of the broader TMX Group, a diversified, global exchange company, and raise some issues that I believe are relevant to us all.

To put my remarks in the context of today's gathering, I want to take a few brief moments to offer an overview of TMX Group, and hopefully lend context to some of the concerns we hold as a major player in the world of exchanges.

Our roots date back some 157 years with the birth of the Toronto Stock Exchange. While we evolved over the years, it's been in the past decade that the very nature of our organization has changed dramatically.

Today, TMX Group consists of:

- Toronto Stock Exchange and TSX Venture Exchange which represent our cash equities business
  - In 2009 on TSX, average daily volume was 473 million shares and we set an all time record of \$65 billion raised by our issuers during the year despite the economic slow down.
  - TSX Venture Exchange, our junior board, is the only public venture capital exchange of such a size and scope in the world.

- The Montreal Exchange is our derivatives business including our neutral and highly regarded derivatives clearing house called CDCC. We will be using the CDCC clearing technology platform to develop a central counterparty and netting solution for Canada's fixed income market, as requested by the Investment Industry Association of Canada. MX is also the majority owner of the Boston Options Exchange.
- We also own the Natural Gas Exchange, our electronic platform providing trading, clearing and settlement services for natural gas, electricity and crude oil contracts in both Canada and the United States.
- We are in the fixed income business with Shorcan, which is an inter-dealer bond broker.
- Our market data operation is diversified in content to match the diversification of our operations – providing data on equities, derivatives, fixed income and energy products.

- And finally we offer issuer services such as investor relations and corporate communications – advice and expertise on how to market issuers’ equities and increase liquidity.

So, as I said, TMX Group can rightly be viewed as a global exchange group with diversified operations and a wide variety of products.

And while diversification has expanded the scale of our business, we have taken recent steps to extend its scope as well. We have taken an international focus and our teams have spent a good deal of time on the job travelling to countries in South America, Asia and Europe and of course extensively through the United States.

Those efforts have paid off: we currently have 287 international issuers listed on TSX and TSX Venture. We are an important gateway to North American capital. In fact, about 40% of our trading volume now comes from outside of Canada, demonstrating both the size and reach of the capital pool our issuers have to access, and the quality of the companies listed on our markets.

Now with that brief overview of TMX Group, I'll spend the remainder of my talk on the regulatory issues facing the equities listing and trading business.

TMX Group has a strong reputation in the market for expertise, integrity and transparency. We believe we are an integral aspect of Canada's international reputation for creating and maintaining a solid financial system with the proper checks and balances that have allowed us to weather the recent economic recession as effectively as we did and prepare for the recovery.

The work of public exchanges like ours has evolved over the years in lock step with regulations that guide our actions, bring discipline to the market, and protect investors and issuers alike. That careful regulation, and our adherence to it, is a public bond that we view as sacrosanct. For at its very base, our primary function is to provide issuers with a venue to raise growth capital and provide a liquid, reliable secondary market on which to trade equities.

But I fear that, in some aspects, the industry has lost sight of that public bond of late, and has forgotten its importance as the underpinning of our entire financial system. Appropriate regulation has taken a back seat as the debate over market structure has centered on competition and the drive to reduce costs for market intermediaries. Among the outcomes of this environment has been the proliferation of alternative trading systems, or ATs, which now handle significant volumes of stock trades in the United States and about 25 per cent here in Canada.

These trading systems face much less rigorous regulatory oversight compared to full exchanges, and their stated purpose is to provide cheaper trading fees, principally for their owners and dealers. To date, it's certainly the case that the interests of issuers are seldom articulated in the debate surrounding this aspect of market structure.

Nothing has brought greater focus to this paradigm of imbalance than the events of May 6 when markets in the United States and Canada were thrown into turmoil and the interests of both issuers and shareowners were trampled in the melee that ensued.

But before examining the events of May 6, let's take a bit of a historical perspective. Through the economic crisis, while credit markets failed, banks ceased lending and many financial institutions went hat in hand to governments for survival, organized, transparent stock and derivatives exchanges performed well. While the news wasn't always good, buyers and sellers met in the market, trades were cleared and settled, and price discovery was orderly. May 6 changed that perception, and issuers and the public have lost some confidence in our markets.

So what happened on May 6?

What caused the violent gyrations in the market?

Well, fully one month later, we really still don't know the answer to that question. It's bad enough that we have a system where this sort of aberration could occur. But it's doubly disturbing that we don't have the means to accurately pinpoint the cause of what's now being called the "flash crash".

At one point on May 6<sup>th</sup>, the U.S. market was falling at 100 points a minute. Shares in Proctor and Gamble, a stalwart in global markets, dropped by 35 per cent before rebounding. Shares in Accenture PLC were trading at around \$41 at 2:30pm on May 6 and by 2:47 were down to a penny. Accenture rose again later in the day, but what does it say about the current system when a viable, highly reputed issuer could see its entire market cap wiped out in less than 30 minutes?

While the underlying cause of the May 6 volatility is still unknown, there is a general consensus in many circles that the existence of multiple markets working under very different rules greatly exacerbated the situation and was a central factor that led to the dramatic ups and downs.

Reporting on the events of May 6, The Wall Street Journal wrote: “Over the past two decades, stock trading has gone from a relatively transparent network of human ‘market makers’ executing buy and sell orders at a handful of exchanges to an almost entirely computer-driven system fragmented among dozens of players. And regulators don’t have the ability to directly monitor many of these new players.”

On May 10, The Journal gave a further analysis to the situation by outlining what happened. The Journal wrote:

“As stocks took their sudden nose dive [May 6], The NYSE’s hybrid model swung into action. The exchange shut down computer trading of some stocks for a minute or so at a time and handed it over to humans – the traders on the floor of the exchange. That hand-over is designed to slow the market, as humans help find the right price for volatile stocks while applying the brakes.

The Journal continues...

“But the NYSE is the only major exchange with such a system. The rest of the market’s computerized exchanges kept trading, which built up a huge volume of sellers with virtually no buyers. Instead of bringing sanity back to a volatile market, the NYSE floor traders looked a bit like rodeo contestants trying to jump back on to bucking broncos.”

The premise that the current market structure worsened the situation on May 6 is further strengthened by what happened here in the Canadian market. Our market did see some unacceptable gyrations but far less than in the United States, largely because market fragmentation is less acute in Canada than it is south of the border.

But my underlying concern is ... where in all of this are the interests of the issuer and the investor taken in hand? It is hard to see where it is.

The current market structure with its proliferation of uncoordinated market venues is inherently flawed and the events of May 6 brought this into plain view. While the concept of individual stock circuit breakers may help, the covenant between issuer and listing venue is violated when other markets can ignore the agreed rules of engagement between the issuer and its listing venue.

So how do we mitigate the situation?

A very appropriate first step is to take the rules the issuer signed up for when they listed with an exchange and apply them to all market places that then choose to trade that listed stock. When the issuer signs with a listing exchange, they accept as a covenant the rules of engagement that define the ways and circumstances in which their shares will be traded. For that covenant to hold true, all players who trade in the stock must adhere to the same rules – whether it means a stock is in a “go slow” mode, subject to a freeze or some other market protection mechanism.

Because transparency has not been a principle applied to the growth of competitive markets, what we are witnessing is a market structure where few investors have seen the rules of some marketplaces and issuers are rightfully asking why a trading venue that they don't know, and didn't sign up for, can distort their share price.

Competition benefits no one in the long run if it remains under-regulated in an industry in which regulated discipline and transparency is its very lifeblood.

As you in the room know, exchanges around the world have demutualized over the past decade or so -- often guided to do so by their regulators. Among the impetus for the trend to demutualize was to improve marketplace transparency and governance by removing restrictive ownership by brokerage houses (meaning getting rid of the “club”) and making them public companies.

Many of the alternative trading systems are in fact controlled by professional trading entities or dealers. So what we are seeing is the effective remutualization of the trading process with its inherent potential for conflict and manipulation.

Simply put, a small collection of brokerage firms should not be controlling equity trading markets. My company made that decision 10 years ago when we demutualized but other markets in Canada are now heading back into the same problematic structure.

I believe this situation needs to be addressed by regulators to ensure that competition benefits all participants in the financial markets, not merely a select few.

At TMX we are also calling for a total rethink of the manner in which the ATSs are overseen. We are calling for changes that would see all ATS trading rules – current and future – be put forward for public comment in the same fashion that the rules governing exchanges are subject to public scrutiny and input.

I must tell you that as an executive with many years experience in this business, I am confounded by the fact that historically there has been no formal process like this, no means of checks and balances, when it comes to the regulation of the ATS market.

The even-handed, sagacious application of rules and regulations is a basic tenet of the financial industry. How then, can we have allowed this situation to develop? We are taking a huge risk and placing that burden of risk squarely on the backs of issuers and of individual investors who don't know where or how their trade will be executed.

The events of May 6 clearly demonstrated that these disparate rules and regulations are not understood by many issuers or investors. ATs in Canada have gained relevant share, and shielding their current and future rules from the public comment process is a stark violation of the public interest mandate of the Canada's securities commissions.

Merely doing so on a going forward basis is not enough. That approach would perpetuate an already unacceptable public policy position and will lead to more confusion as issuers and investors attempt to make sense of events such as we saw on May 6.

And finally, we believe that individual investors should be given the choice of which venue their trade will be executed upon. This should obviously be done subject to best price requirements. But it is only common sense that the actual investor should be able to make the decision on what venue his business will be conducted.

The investor is paying a fee for the transaction and should have the right to ensure it is conducted on the venue that provides him with the most protection and is guided by clearly and publicly articulated rules and regulations. Why should the venue decision be made solely by the broker or ATS owner whose interests may be inconsistent with the investor?

I want to make it clear that TMX's position on this issue is not sabre rattling on the part of established exchanges bristling at the prospect of competition. Competition in the equities business has been here for sometime, it is here to stay and will continue to grow. That's a simple fact of life for us at TMX. We have reacted to that competition, diversified our business and we ourselves continue to grow.

Applying exchange rules to the ATS market will not stop that market from growing; but it will stop it from growing in a direction that's very clearly not in the public interest. Regulating the ATS market on a "level playing field basis" won't hamper competition; it will strengthen competition by ensuring all trading venues are playing from the same rulebook. It will result in competition that drives innovation into new products and efficiencies for end-users, rather than trading rule arbitrage.

Remember: the system stays strong only if the interests of issuers and investors are served before the interests of those who merely process transactions. That's assured in a regulated environment but not in one where little or no public scrutiny is possible.

While events like those that occurred on May 6 can shake our faith in the integrity of the markets, they can often shed new light on systemic flaws and weaknesses. By demonstrating the common will to eliminate those flaws and shore up those weaknesses going forward, we build new strength into the market.

And strengthening the market is something to which we are all committed. May 6<sup>th</sup> did serve to bring widespread attention to the challenges of regulating markets in the era of high-volume electronic trading, and I think it served as a very effective wake-up call for regulators that the situation requires their attention – and soon. TMX Group welcomes and strongly supports the Canadian Securities Administrators' and the Investment Industry Regulatory Organization of Canada's call for review of both the May 6 market event and the broader regulatory and policy issues the event raised. We stand prepared to assist in any way and to share our insights as steps are taken to redress this area of deep concern.

Thank you for the opportunity to speak with you today and I wish you the best for the remainder of your session.