Canada has been swept up in the global wave of consolidation in the stock exchange sector with the ongoing battle for control of TMX Group Inc. (TMX). TMX’s aborted merger with London Stock Exchange Group plc (LSEG) and the current proposed take-over by Maple Group Acquisition Corporation (Maple) illustrate the trends driving consolidation in the global exchange industry and the political and regulatory challenges posed by stock exchange mergers.
A Flurry of Deals

Between October 2010 and November 2011 the following transactions were announced:

• Singapore Exchange’s (SGX) US$8.8 billion proposed acquisition of Australian Securities Exchange (ASX), which was ultimately rejected by the Australian government.

• Moscow Interbank Currency Exchange’s acquisition of Russian Trading System Stock Exchange.

• LSEG’s proposed merger with TMX, which did not proceed when it became clear that the transaction would not receive the requisite approval of two-thirds of TMX shareholders in the face of a competing and currently outstanding bid by Maple, a consortium of 13 of Canada’s leading financial institutions and pension plans.

• Deutsche Börse Group’s proposed US$9.7 billion merger with NYSE Euronext, which has received shareholder approval but remains subject to regulatory approval. Nasdaq OMX Group Inc. (Nasdaq) and IntercontinentalExchange, Inc. (ICE) also made a hostile bid for NYSE Euronext with a view to breaking up the proposed Deutsche Börse merger, but that bid was blocked by the U.S. Department of Justice on anti-trust grounds.

• BATS Global Markets, Inc.’s acquisition of Chi-X Global Inc.

• Tokyo Stock Exchange Group Inc.’s proposed acquisition of Osaka Securities Exchange Co.

• LSEG’s proposed acquisition of a 50% stake in FTSE International Limited (FTSE), raising LSEG’s ownership of FTSE to 100%.

• TMX’s acquisition of a 16% minority stake in the Bermuda Stock Exchange.

In addition, LSEG has confirmed that it has entered into exclusive discussions with clearing house LCH.Clearnet regarding a potential transaction.

Trends Driving Consolidation

This latest round of stock exchange consolidation has been driven by increased competition, the globalization of capital markets and the benefits of economies of scale in developing capital-intensive technology platforms for trading, clearing and settlement. In particular, traditional stock exchanges have been losing significant market share in their cash equities businesses to alternative trading systems, and are looking to diversify and acquire higher margin derivatives and clearing and settlement businesses. The emergence of large-scale, global exchange groups with commensurate resources
to invest in technology and research has also made it increasingly difficult for stand-alone exchanges to maintain competitive platforms. Thus squeezed from above by global exchange groups and from below by alternative trading systems, it is not surprising that many stand-alone exchange groups are exploring strategic alternatives.

**Political and Regulatory Challenges**

Stock exchange mergers raise significant political and regulatory challenges. In cross-border transactions, potential foreign ownership of critical elements of a country’s financial infrastructure raise concerns about the loss of sovereignty and control over domestic capital markets. Local regulators have expressed reservations regarding their ability to exercise effective and ongoing oversight of the resulting entities. Consolidation of trading, clearing and settlement operations, with the resulting concentration of ownership, also raises significant competition law issues.

**The Battle for TMX**

Despite a carefully structured governance package, the proposed merger of TMX and LSEG raised concerns regarding foreign ownership across the Canadian political spectrum and among market participants. The proposed transaction was not unique in this respect: SGX’s proposed acquisition of ASX was ultimately turned down by the Australian government, largely as a result of concerns over foreign ownership. The proposed merger of Deutsche Börse with NYSE Euronext also elicited U.S. concerns regarding foreign ownership of a high profile institution.

Maple’s take-over bid for TMX has raised a different set of concerns. Maple has also proposed the acquisition of Alpha Trading Systems (Alpha), which is a Canadian alternative trading system and a competitor of TMX, as well as the acquisition of CDS Clearing and Depository Services Inc. (CDS), which manages the trade clearing and settlement of securities in Canada and is currently run on a not-for-profit basis. The combined entity would follow the “vertical silo” model of Deutsche Börse and Hong Kong Exchanges & Clearing, in which both trading and clearing are brought under the umbrella of one entity. Proponents of the Maple/TMX transaction have argued that this will result in substantial efficiencies and will improve risk management. However, the proposals have also led to Canada’s Competition Commissioner expressing “serious concerns” alongside those expressed by various market participants regarding monopolistic pricing powers if TMX and Alpha are combined and CDS is run on a for-profit basis.
Other stock exchange mergers have also raised significant anti-trust concerns. The Deutsche Börse/NYSE Euronext merger has not yet received European anti-trust approval due to the fact that the combined entity will have an over 90% share of European stock futures trading and European stock options trading. It has been reported that European competition officials have warned NYSE Euronext and Deutsche Börse that their proposed merger will not be approved unless they are willing to sell off one of the combined group’s main derivatives businesses. As noted above, the U.S. Department of Justice blocked the combined Nasdaq/ICE hostile bid for NYSE Euronext on anti-trust grounds.

It is unclear what, if any, concessions Maple and TMX will have to make to address regulatory concerns. Public hearings were held by the Quebec and Ontario securities regulators on the proposed transaction in late November and early December, respectively. The deal is still subject to review by the Competition Bureau, and a final decision from the regulators is expected in the first quarter of 2012.

Our View for 2012

The trends driving consolidation in the global stock exchange industry are expected to continue in 2012. Major stock exchange groups that did not announce or were unsuccessful in completing a transaction over the past year may join the fray. Deal making activity will be influenced by the outcomes of the Deutsche Börse/NYSE Euronext and Maple/TMX transactions. If the Maple/TMX transaction is completed along with the acquisition of Alpha and CDS, there will be significant changes in Canada’s financial infrastructure. Capital market participants, both in Canada and around the world, will keep a close eye on developments in this rapidly changing industry.