

**PRESENT AT THE CREATION:
NEW CENTURY, NEW TRADING
SYSTEMS**

**REMARKS BY
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The Canadian Club of Toronto

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Good afternoon, Ladies and Gentlemen.

I would, of course, welcome any opportunity to address a gathering of the historic Canadian Club of Toronto. But this invitation comes at a particularly eventful time, following almost immediately the unveiling by various Canadian stock exchanges of their proposal to re-align their businesses.

To illustrate just how current, and hot, this topic is, last Wednesday I spent 12 hours of quality time in Frankfurt. The purpose of this whirlwind trip was to meet with heads of the securities regulators in the major world markets. The principal topic of discussion was the world's securities trading systems -- the challenges facing them -- the drastic measures that some will need to take to survive.

Unquestionably, the stock exchanges in their markets are facing many of the same issues that we face in Canada: competition from alternative electronic exchanges; fragmentation of markets; the staggering cost of technology; the difficulties faced by member-owned exchanges in responding to these threats.

As our discussions progressed, it became clear that some jurisdictions are far ahead of Canada in addressing these issues. But we are not at the back of the pack. Equally clear, however, was that securities trading will move away from those markets that are too slow in responding to those which have their act together.

That is why I'm here today; to talk about a crucial aspect of our capital markets and the state of its health as we count down to the millennium.

And there is, perhaps, no better venue than the Canadian Club to place the stock exchange proposal into a larger -- and in many ways uniquely Canadian -- context.

That context includes the world of trading and the changes it will experience as we turn the corner into the new century. It also includes the position of Ontario in relation to Canada's capital markets and of Canada's capital market in relation to its international competitors.

Canadians have two clear choices:

- we can have our own capital market in this country, one that serves Canadian companies seeking to raise capital and serves investors wishing to invest in those companies, (in other words a capital market which serves the needs of this country),

or

- we can have a capital market controlled and directed by other countries, in which only premium Canadian companies and major-league Canadian investors will be able to participate.

I believe that the survival of an independent capital market in Canada very much depends on making those choices now, and on the speed and efficiency with which we implement needed change.

Let's begin by looking at the main trends that are impacting Canadian markets in general and Canadian money managers in particular. I'll be referring to the work that was done on behalf of the Canadian exchanges, work which has motivated some of the proposals you've been reading about lately and, consequently, the invitation for me to be here today.

I might add that Canadian money managers have no choice but to respond to these trends. Given their responsibilities to their clients, they simply cannot incur unnecessary costs or sacrifice efficiency in order to support Canadian service providers.

The first trend is globalization. As noted in the TSE's 'Blueprint for Success', issued last Fall, evidence of globalization is widespread, with issuing companies continuing to expand operations internationally and increasingly sourcing world markets for the capital they need to expand. At the same time, globalization is creating integrated global players in the financial services industry. In short, nationality has become much less of a defining characteristic of capital markets.

The next trend has been referred to as "deconstruction". In our new "wired world", the exchange of information has become instantaneous and virtually cost-free. This drives the creation of new business models and has led to the emergence of more and more niche or "value" players. For example, we have seen recently the emergence of highly efficient single purpose trading systems.

Another trend is reflected in the strategic alliances and consolidations occurring at stock and derivatives exchanges in the U.S. and Europe. These moves have yielded greater economies of scale, which is particularly critical given the costs faced by these exchanges in order to compete in the next century.

A fourth trend is the growth of institutional investors, who now account for over 80% of

equities trading in Canada. This group places a premium on anonymity, confidentiality, liquidity, minimum transaction costs and market depth. They will choose those markets that offer these features.

Finally, technology is now enabling markets to compete for order flow regardless of geographic location.

These trends underscore the need in this country for one homogeneous capital market.

It is the only way we can achieve the liquidity, depth, and economies of scale by which our market can be competitive. Unquestionably, market liquidity is becoming such a major issue that Canada can no longer afford the luxury of regional differences and fragmented markets.

The greatest liquidity and depth of a market is achieved by creating the largest possible pool of buyers and sellers, coming together at the same point in cyberspace, to buy and sell the widest possible range of securities.

Fragmentation is the natural enemy of liquidity.

The subdivision of the Canadian market, already small by global standards, into smaller disconnected pools of investors means that orders will take longer to be filled and large orders will be difficult to fill at realistic prices.

Technology has opened the world to Canadian investors who can now look for the best execution of their trade, whether it occurs inside or outside Canada.

Independent service providers must compete for business by demonstrating their efficiency and cost competitiveness. It is simply not fair -- and quite frankly unrealistic -- to ask or expect money managers to favour independent service providers if they have to pay a premium. Those money managers would be punished by their own clients for making such choices.

The billing for my remarks today centred on trading systems in the new millennium. Making predictions is risky and I am reminded of the quote often attributed to Yogi Berra -- "Even the future ain't what it used to be".

Nowhere is this truer than the changes to equities trading made possible by new technologies. Already, there are numerous alternative electronic trading systems operating or coming on-stream in major world markets.

But in Canada we have refused to embrace these technologies. Our response has been to stop alternative trading systems at the border. We must move out of this denial phase. This Canadian response reminds me of another old quote:

“Denial. It’s not just a river in Egypt.”

Given today’s trading technology and the increasing comfort level which consumers and investors have with it, I would suggest that the status quo within capital markets no longer exists.

In fact, I challenge anyone to define the status quo when it comes to access to information. In recent weeks, Canada has seen its first Direct Public Offering via the Internet. Individual investors can now access real-time market information and trade execution previously available only to investment professionals. This is just the beginning, particularly in light of the advent of alternative trading systems.

The issue of alternative trading systems is urgent. It was dealt with in the U.S. many years ago and we are long overdue in addressing it here. For over 10 years market participants in Canada have been discussing the appropriate regulatory framework for alternative, electronic trading systems.

The time for talk is over. Alternative trading systems are coming.

A year ago, the Canadian Securities Administrators, the group of Canadian provincial and territories securities commissions, hosted a public forum on this topic.

The forum examined the nature, cause and extent of fragmentation -- and the accompanying lack of transparency -- which may be related to the number of exchanges in Canada, the trading rules of the Canadian exchanges, the electronic trading and information systems already operating in Canada, and the so-called “upstairs” market. The term “upstairs market” refers to the practice of crossing large blocks of shares, usually for institutional customers, without offering the shares through the order book of the exchange.

In the United States more than two decades ago it was decided there was room for many exchanges in the American market, and that this would enhance competition and spur innovation.

To make sure all investors could reach any of these exchanges, the U.S. industry was required to create a National Market System. As a result, any investor in the United States can access any exchange using his or her broker, whether or not that broker is a member of the exchange where the trade is executed.

Makes sense, doesn’t it?

In contrast, Canada has 5 equities exchanges, yet no national intermarket trading system has been implemented.

This has led the Canadian Securities Administrators to develop a series of proposals for

a Canadian Alternative Trading System, proposals which are now being discussed with exchanges and other electronic system providers across the country. Although the final design must await the results of these discussions, I believe it is crucial to the survival of our capital market to ensure that new rules permitting alternative trading systems result in a pan-Canadian system; a system that provides:

- real time transparent quote information and
- market integration that enables investor access between markets.

Our target is to publish the proposal sometime this Spring, with the expectation that the new system will begin to emerge by mid-2000.

Our objective is to promote one, homogeneous capital market in this country.

I might add that while alternative trading systems have been a reality in the U.S. for more than a decade, they still only account for between 5 and 8% of the listed equities trading and about 25 or 30% of NASDAQ trading.

Alternative trading systems are about choice. If money managers or investors don't have that choice, they will take their business elsewhere.

I referred earlier to the Toronto Stock Exchange's 'Blueprint for Success', unveiled in October of last year. It is a bold step beyond the status quo.

To compete in today's global economy, exchanges need to make massive expenditures on technology. They need to refocus their efforts to maintain business and attract new market participants. To this end, the OSC has supported the TSE in the development of a new strategic plan.

A key element in the TSE 'Blueprint' is demutualization. You may now be familiar with the term "demutualization" which is frequently used in the media to describe the process underway at four of Canada's largest insurance companies. In the stock exchange context, "demutualization" is the first step in converting from a member-owned and member-governed entity into a for-profit, shareholder-owned corporation.

Demutualization will allow the TSE to forge a new management and governance structure. It will facilitate raising risk capital and in promoting a review of the TSE's traditional businesses it will allow it to explore new business opportunities.

Whether this is the correct blueprint will be decided by the members of the Exchange. However, the goal of a nimbler decision-making framework is certainly worthwhile. As I suggested earlier, innovation has been painfully slow in our capital market. This sentiment was expressed at the time of the TSE's Blueprint announcement by Barbara Stymiest, Chair of the TSE. Barbara said:

"The world is moving too fast. We don't have time to work committee after committee to reach a consensus. Closing the [trading] floor ... took four years and a lot of money being spent to accomplish something that probably should have been done in six months to a year. I think that's a classic example of a consensus-driven model." End of quote.

I wish to commend the TSE for its Blueprint for Success. While reasonable people may have different views on the details, it is far preferable than attempting to maintain a status quo which, as I have suggested, no longer exists.

Allow me to quote Ms. Stymiest once more. In referring to the proposal for the realignment of stock exchanges across Canada -- or, in other words, the proposal that got me invited to lunch today, Barbara said it was, and I quote:

"Not the strategic answer to ensure the success of all the three new exchanges, but it was a must-do tactical manoeuvre to get each exchange positioned to respond ... to deal with global competition and the high costs of new technologies." End of quote.

I think most of you know by now what the highlights of that proposal are:

- the Toronto Stock Exchange will operate a national exchange for senior equities in Canada;
- the Montreal Exchange will operate a national derivatives market; and
- the Vancouver and Alberta Stock Exchanges will merge and the combined exchange will operate a pan-Canadian exchange for junior securities.

The proposal offers a number of distinct benefits including:

- improved economies of scale,
- increased expertise through specialization,
- improved standard setting, and
- improved surveillance capacity.

The consolidation of junior securities trading in one exchange alone should provide more depth, liquidity, and transparency to this market. It should also provide a comprehensive system of surveillance and listed company oversight, and a broader market for junior companies trying to raise capital. In short, it holds out the prospect for broadening the base of the Canadian junior capital market.

My own view is that Canada needs a national junior capital system that better serves the needs of small Canadian businesses seeking to raise capital.

Staff of the Canadian Securities Administrators are now working on this proposal. They are prepared to work with the Exchanges to make any necessary adjustments to permit each of the new exchanges to operate effectively nation-wide. They will be guided, however, by the need to ensure that the interests of the investing public are properly safeguarded.

The CSA is very familiar with the challenges that this proposal would present to all the players. Similar challenges were faced in setting up the Canadian Securities Regulatory System, a "virtual national securities commission". The success of this endeavour is living proof that the outcome envisaged by the exchanges is achievable.

And what is the outcome they envisage? It is securities exchange systems that operate nationally while recognizing and allowing for unique regional differences and requirements.

These same regional differences must first be addressed, however, before the overall exchange proposal can become a reality. Anxiety levels are particularly high in the city of Montreal where market participants are carefully weighing the benefits of creating a world-scale derivatives market against the transfer of equity trading to exchanges operating nationally from their home offices in Toronto and the West.

With the backing of Mr. Landry, the Quebec Minister of Finance, the Commission des valeurs mobilières du Québec has accepted responsibility for determining whether the participation of the Montreal Exchange in this pan-Canadian system is in the public interest. Under the leadership of my colleague, Jean Martel, the Chair of the Quebec Commission, opinion leaders and other market participants will be encouraged to contribute their views to this process.

My hope is that the Montreal Exchange will remain as one of the cornerstones of this new system. Canada must have a sophisticated derivatives system that is far more extensive than at present. The existing high levels of sophistication in derivatives trading already present in Montreal combined with development capital from the other exchanges makes Montreal the logical choice for developing this capability.

Like any Canadian business enterprise, our exchanges are facing the challenges of global competition and the high costs of new technologies. They need to address the fact that, increasingly, Canadian companies list both at home and on a U.S. exchange, as do some European companies. Foreign interlisting by Canadian corporations means that some trading moves to the U.S. exchange, -- a trend that is hurting the Canadian exchange's liquidity.

With improvements in technology, transactions have increasingly moved off the exchange to the upstairs market described earlier in my remarks.

With challenges like this and more, an exchange must choose a flexible strategy.

We, in Ontario, support the move by the exchanges to address their business challenges. As regulators, we favour in principle any initiative designed to ensure a strong and globally competitive market system that will benefit Canada's capital markets and all participants.

In reviewing these proposals, however, we will also be looking to ensure that the interests of the public are safeguarded. Improved market efficiency, depth and liquidity are clearly in the public interest.

Let me make a final comment on the prospects for our capital market at the turn of the century.

I'm heartened by the sense of urgency and innovation which has characterized proposals emanating from various key players, the exchanges, the Self-Regulatory Organizations and the industry associations.

Now we must see the follow through.

There is nothing abstract about the challenges we face if we are to maintain a capital market in this country.

Our trading environments must be capable of providing the liquidity and depth demanded by investors.

They must provide alternatives that balance the need for transparency on price discovery with the need for anonymity.

They must be cost-competitive, as technologically efficient and as reliable as any competitor anywhere in the world.

The surveillance and enforcement systems in place must be second to none.

These objectives can only be achieved through the elimination of the waste and inefficiencies that are the by-product of fragmented systems.

We need one homogeneous capital market for Canada.

It is no longer a question of whether we can achieve it.

We must achieve it.

Thank you.