

COR#02/015

**Recognition Order**

**Market Regulation Services Inc.**

**Section 24(1) of the *Securities Act*, RSBC 1996, c. 418**

Market Regulation Services Inc. (RS Inc.) has applied for recognition as a self-regulatory organization.

RS Inc. will be a regulation services provider under National Instrument 21-101 *Marketplace Operation Rule* and National Instrument 23-101 *Trading Rules* (together the ATS Rules).

RS Inc. has agreed to provide regulation services to The Toronto Stock Exchange Inc. and the Canadian Venture Exchange, Inc. under the ATS Rules, as agent for each of them. In this capacity, RS Inc. will administer the exchanges' market conduct and trading requirements and monitor and enforce compliance with these requirements by the exchanges' members, their directors, officers, employees, affiliates and representatives.

RS Inc. also intends to act as regulation services provider for quotation and trade reporting systems and alternative trading systems under the ATS Rules.

RS Inc. has agreed to the terms and conditions set out in Schedule A.

Based on the application of RS Inc. and the representations and undertakings RS Inc. has made to the Commission, the Commission is satisfied that the recognition of RS Inc. would not be prejudicial to the public interest.

The Commission recognizes RS Inc. as a self-regulatory body under section 24(1) of the Act subject to the terms and conditions set out in Schedule A. Recognition will continue until the Commission revokes it.

February 1, 2002

Douglas M. Hyndman  
Chair

**SCHEDULE A**

**TERMS AND CONDITIONS**

**1. CORPORATE GOVERNANCE**

- (a) To ensure diversity of representation, RS Inc. will ensure that:
  - (i) its board is composed of individuals that provide a proper balance between the interests of the different entities desiring access to its regulation services; and
  - (ii) a reasonable number and proportion of its directors are independent directors.
- (b) RS Inc.'s governance structure will provide for:
  - (i) fair and meaningful representation on its board and any committees of its board; and
  - (ii) appropriate qualifications, remuneration, conflict of interest provisions and limitation of liability and indemnification protections for its directors and officers and employees generally.
- (c) In addition, RS Inc. will ensure that:
  - (i) at least 50 percent of its directors, other than the President of RS Inc., are independent directors, and an independent director is a director that is not
    - (A) an associate nor a director, officer or employee of a marketplace participant that is a dealer, a marketplace to which RS Inc. provides regulation services, a shareholder of RS Inc. or an affiliated entity of any of them, or
    - (B) employed by RS Inc. or associated with it;
  - (ii) at all times, one of its directors is an individual who is associated with or has experience with the Canadian public venture capital market;
  - (iii) at all times, at least one of its directors represents alternative trading systems (ATSS);

- (iv) its board delegates the selection of independent directors and of the director representing ATs (whether that director is an independent director or not) to its Governance Committee, which is composed of all the independent directors of RS Inc.;
- (v) it provides the Commission with notice of all appointments to its board;
- (vi) the President of RS Inc. is deemed to be neither an independent nor a non-independent director;
- (vii) the quorum for its board is a simple majority of directors, with at least one representative from each shareholder and at least 50% of the independent directors present;
- (viii) it does not, without prior Commission approval, make changes to its corporate governance structure, articles, by-laws or any shareholders' agreement; and
- (ix) it reviews its corporate governance model within 12 months of recognition and periodically after that to ensure that the model appropriately reflects the evolution of the equity markets and promptly reports to the Commission the results of its reviews.

**2. FEES**

- (a) RS Inc. will have a fair, transparent and appropriate process for setting fees. These fees will:
  - (i) be allocated on an equitable basis among marketplaces and marketplace participants; and
  - (ii) balance the need for RS Inc. to satisfy its responsibilities without creating barriers to access.
- (b) RS Inc. will ensure that it:
  - (i) charges fees on a cost recovery basis;
  - (ii) does not, without prior Commission approval, make any significant changes to its fee model; and

- (iii) reviews its fee model within 12 months of recognition and periodically after that to ensure that it continues to meet the requirements of this section and promptly reports to the Commission on the results of its reviews.

**3. ACCESS TO SERVICES AND DUE PROCESS**

- (a) RS Inc.'s requirements will permit all marketplaces to access its regulation services if they satisfy the criteria RS Inc. has established for this purpose.
- (b) RS Inc. will:
  - (i) establish written criteria for granting access to its regulation services;
  - (ii) not unreasonably prohibit or limit access to its regulation services; and
  - (iii) keep records of:
    - (A) each grant of access to its regulation services and, for each entity granted access the reasons for granting access, and
    - (B) each denial or limitation of access and the reasons for denying or limiting access.
- (c) In addition, RS Inc. will enter into a written agreement with any marketplace authorized to operate under the ATS Rules that satisfies RS Inc.'s criteria for access and requests access to its regulation services; the agreement will provide that:
  - (i) RS Inc. will monitor the conduct of marketplace participants and the activities of marketplaces;
  - (ii) RS Inc. will enforce the requirements governing the conduct of marketplace participants;
  - (iii) the marketplace will transmit the audit trail information required under Part 11 of National Instrument 21-101 *Marketplace Operation*;
  - (iv) the marketplace will comply with all orders or directions made by RS Inc.; and

- (v) if the marketplace is an ATS, the ATS will conduct its trading activities in compliance with the requirements set by RS Inc.
- (d) In connection with giving access to its regulation services, RS Inc. will ensure that:
  - (i) its requirements, the limitations or conditions it imposes on access, and the decisions it makes to deny access are fair and reasonable;
  - (ii) the parties are given notice and an opportunity to be heard or make representations; and
  - (iii) it keeps a record, gives reasons and provides for appeals of its decisions.

#### **4. FINANCIAL VIABILITY**

- (a) RS Inc. will maintain sufficient financial resources for the proper performance of its regulation functions.
- (b) RS Inc. will operate on a not-for-profit basis.
- (c) RS Inc. will have a risk management policy that will allow it to identify issues that may prevent it from allocating sufficient financial and other resources to carry out its regulation functions in a manner that is consistent with the public interest and the terms and conditions of the order.
- (d) Each month, RS Inc. will compare the revenues and expenditures incurred by RS Inc. with the revenues and expenditures forecasted for that month in RS Inc.'s annual operating plan.
- (e) If the actual numbers compared to the forecasted numbers result in a deficit of 15% or more for a period of three months, RS Inc. will report to the Commission and the President of RS Inc. will deliver a letter advising the Commission of the reasons for the deficit and the steps being taken to address any issues arising from the deficit.
- (f) If the actual numbers compared to the forecasted numbers result in a deficit of 25% or more for a period of three months, RS Inc. will report to the Commission and will not, without the prior approval of the Commission, make any capital expenditures or pay any bonuses to any directors and officers not already reflected in the financial statements, or make any loans, dividends or other distributions of assets to any related

company or shareholder until the deficiencies have been eliminated for at least six months.

- (g) RS Inc. will provide the Commission with a copy of its annual operating plan each year once it is approved by its board.

**5. CAPACITY TO PERFORM REGULATORY FUNCTIONS**

- (a) RS Inc. will maintain its ability to perform its regulation functions including setting requirements governing the conduct of ATs and their subscribers, monitoring the conduct of marketplace participants and the activities of marketplaces, and enforcing the requirements governing the conduct of marketplace participants and ATs.
- (b) In particular, RS Inc. will:
  - (i) provide the Commission with an annual report in the form and with the information specified by the Commission from time to time;
  - (ii) not, without prior Commission approval, make significant changes to the manner in which RS Inc. performs its regulation services, functions, and processes and to its organizational structure, including any significant changes to its staffing complement by function and location;
  - (iii) have the necessary financial, technological and other resources to efficiently and effectively provide its regulation services;
  - (iv) adopt policies and procedures designed to ensure that confidential information about its operations or any marketplace or marketplace participant is maintained in confidence and not shared inappropriately with other persons, and use reasonable efforts to comply with these policies and procedures;
  - (v) promptly report to the Commission misconduct or apparent misconduct by a marketplace, a marketplace participant or others if:
    - (A) RS Inc. reasonably expects investors, one or more marketplaces, marketplace participants or their customers, the Canadian Investor Protection Fund, or RS Inc. to suffer serious damage as a consequence, or

- (B) RS Inc. has reasonable grounds to believe that fraud may be present;
- (vi) promptly report to the Commission any material deficiencies in RS Inc.'s supervision or internal controls;
- (vii) notify the public and media of:
  - (A) each disciplinary or settlement hearing by promptly issuing a press release that includes the names of the parties and identifies the nature of the alleged violation, and posting on its website a copy of the notice of hearing no later than the day on which the notice of hearing is issued, and
  - (B) the terms of each settlement and the disposition of each disciplinary action by promptly issuing a press release that includes the names of the parties, the findings and the sanctions imposed and posting on its website a copy of the settlement agreement or decision;
- (viii) ensure that disciplinary and settlement hearings are open to the public and media except when required for the protection of confidential matters and establish written criteria for making a determination on confidentiality;
- (ix) notify the Commission of all information required in Appendix C to the Memorandum of Understanding for the oversight of RS Inc. among the regulators recognizing RS Inc., as amended from time to time (MOU);
- (x) not complete any transaction that would result in RS Inc. ceasing to perform its regulation services, discontinuing, suspending or winding-up all or a significant portion of its operations, or disposing of all or substantially all of its assets without:
  - (A) providing the Commission at least six months prior notice of its intention, and
  - (B) complying with any terms and conditions the Commission may impose in the public interest for the orderly discontinuance of its operations; and

- (xi) not assign, transfer, delegate or sub-contract the performance of all or a substantial part of its regulation services or any function set up to perform these services, to any party without the prior approval of the Commission.

## **6. CAPACITY AND INTEGRITY OF SYSTEMS**

- (a) RS Inc. will:

- (i) on a reasonably frequent basis, and in any event, at least annually,
  - (A) make reasonable current and future capacity estimates for its critical systems,
  - (B) conduct capacity stress tests to determine the ability of its critical systems to perform its regulation functions in an accurate, timely and efficient manner,
  - (C) develop and implement reasonable procedures to review and keep current the development and testing methodology of those systems,
  - (D) review the vulnerability of those systems to internal and external threats including physical hazards and natural disasters, and
  - (E) establish reasonable contingency and business continuity plans;
- (ii) annually
  - (A) arrange for an independent review and report, in accordance with established audit procedures and standards, of its critical systems technology plans to ensure that it has appropriate processes in place to manage the impact of change in technology on itself and parties interfacing with it (this will include an assessment of RS Inc.'s controls for ensuring that each of its critical systems complies with paragraph (i) above), and
  - (B) ensure that senior management conducts a review of the report containing the recommendations and conclusions of the independent review; and

- (iii) promptly notify the Commission of material systems failures and changes.

**7. PURPOSE OF RULES**

- (a) RS Inc. will establish rules, policies, or other similar instruments (“Rules”) that are:
  - (i) not contrary to the public interest; and
  - (ii) necessary or appropriate to govern and regulate all aspects of its business and affairs.
- (b) More specifically, RS Inc. will ensure that:
  - (i) the Rules are designed to:
    - (A) ensure compliance with securities legislation,
    - (B) prevent fraudulent and manipulative acts and practices,
    - (C) promote just and equitable principles of trade,
    - (D) foster cooperation and coordination with entities engaged in regulating, clearing, settling, processing information about, and facilitating transactions in, securities, and
    - (E) provide for appropriate discipline;
  - (ii) the Rules do not:
    - (A) permit unreasonable discrimination between those granted access to the regulation services of RS Inc., or
    - (B) impose any burden on competition that is not necessary or appropriate in furtherance of securities legislation; and
  - (iii) the Rules ensure that its business is conducted in an orderly manner so as to afford protection to investors.

## **8. RULES AND RULE-MAKING**

- (a) RS Inc. will file with the Commission all Rules and amendments to the Rules adopted by its board.
- (b) RS Inc. will comply with the joint rule review protocol established by the Commission and other regulators recognizing RS Inc., as amended from time to time (Protocol).
- (c) RS Inc. will administer and enforce the Rules applicable to marketplaces for which RS Inc. acts as the regulation services provider as well as any other rules of a marketplace as agreed to between RS Inc. and that marketplace.

## **9. FINANCIAL STATEMENTS**

- (a) RS Inc. will file annual audited financial statements with the Commission prepared under Canadian GAAP and accompanied by the report of an independent auditor within 90 days after the end of each financial year.
- (b) RS Inc. will file quarterly financial statements with the Commission prepared under Canadian GAAP within 60 days after the end of each financial quarter.

## **10. DISCIPLINE RULES**

- (a) RS Inc. will appropriately discipline any person or company subject to its regulation for violations of securities legislation, the Rules, and any other rules of a marketplace as agreed to between RS Inc. and that marketplace.
- (b) RS Inc. will have general disciplinary and enforcement provisions in its Rules; these provisions will apply to any person or company subject to its regulation.

## **11. INFORMATION SHARING**

- (a) RS Inc. will share information and will otherwise co-operate with the Commission and its staff, other Canadian securities regulatory authorities, Canadian exchanges, other regulation services providers, and other recognized self-regulatory organizations.

**12. ADDITIONAL INFORMATION & COMPLIANCE WITH OVERSIGHT**

- (a) RS Inc. will provide the Commission any additional information the Commission may require from time to time.
- (b) In particular, RS Inc. will file the information required in Appendix B of the MOU within the time periods set out below:
  - (i) If RS Inc. makes a changes to information contained on the cover page and in Exhibits A, B, D (other than as a result of any issuance, transfer or cancellation of shares to permit ATSS to become shareholders of RS Inc. under the provisions the unanimous shareholders' agreement among RS Inc. the Toronto Stock Exchange Inc. and the Investment Dealers Association of Canada), F, I and K of Appendix B, it will file an amendment at least 45 days before making the change; and
  - (ii) If RS Inc. makes a change to any other information that is required by Appendix B except for a change to Exhibit J, it will file an amendment within 30 days after the end of the calendar quarter in which the change takes place.

Once recognized, RS Inc. must file a new Rule or a change to a Rule under the Protocol and financial statements within the time periods prescribed in these terms and conditions.