



British Columbia Securities Commission

BCSC Oversight Review of TSX Venture Exchange Inc.

July 7, 2006

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Executive Summary

In December 2005, the British Columbia Securities Commission (BCSC) completed an oversight review of TSX Venture and its regulatory functions to ensure compliance with the terms of its recognition order and National Instrument (NI) 21-101 *Marketplace Operation*.

BCSC staff are generally satisfied with TSX Venture's operations related to listed issuer compliance and disclosure, the granting of trading access (except direct market access), buy-ins, the outsourcing of regulatory services, and reporting procedures related to material system failures and changes.

For direct market access (DMA), TSX Venture formalized its DMA rules on May 31, 2004, and implemented its DMA client tracking system in March 2005. As such, some of its monitoring and detection procedures are still under development and undergoing further refinement. TSX Venture has qualified individuals to review, approve, and process DMA requests. It has met many of the BCSC's imposed conditions and implemented many of the required monitoring and detection procedures adequately. However, BCSC staff do have some concerns about a number of aspects of TSX Venture's operations relating to sponsored DMA.

Introduction

1. Background

In 1999, Canada's markets were consolidated. The Toronto Stock Exchange (TSX formerly TSE) assumed the role of the exchange for senior equities. The former Alberta and Vancouver stock exchanges formed the Canadian Venture Exchange (CDNX) for junior equities. The BCSC recognized CDNX as an exchange in British Columbia under section 24 of the *Securities Act* on November 26, 1999.

In 2001, TSX Inc. (formerly Toronto Stock Exchange Inc.) acquired CDNX and on July 31, 2001, the BCSC ordered the continued recognition of CDNX as an exchange in British Columbia effective on the closing of the acquisition. On September 3, 2002, the BCSC ordered the continued recognition of the renamed TSX Venture Exchange Inc. (TSX Venture) as an exchange in British Columbia to reflect the reorganization that preceded the public listing of its indirect parent, TSX Group Inc. (TSX Group).

The head office of TSX Venture is located in Calgary and it maintains local offices in Vancouver, Winnipeg, Toronto, and Montreal. The lead regulators for TSX Venture are the BCSC and the ASC. Each securities commission reviewed the functional areas of TSX Venture for which it is responsible.

2. Objectives of the review

The purpose of this report is to present the results of the BCSC's first oversight review of TSX Venture, since the reorganization, and to make recommendations relating to TSX Venture's regulatory responsibilities. The ASC will report its results separately.

The objectives of the oversight review are to ensure:

- staffing, resources, and training are adequate to appropriately perform regulatory functions
- compliance with the terms of the BCSC recognition order and NI 21-101
- regulatory processes are efficient, effective, consistent, and fair

3. Scope of the review

The ASC and BCSC each reviewed the functions relating to their areas of responsibility:

Lead Regulator	Functional Area	Specific Functions Reviewed
BCSC	Compliance	<ul style="list-style-type: none"> Listed issuer surveillance Director and officer suitability
	Trading	<ul style="list-style-type: none"> Access to trading Direct market access
	Clearing and Settlement	<ul style="list-style-type: none"> Rule for clearing and settlement arrangements Buy-in process
	Systems	<ul style="list-style-type: none"> Notification to the Commission of material system failures and changes
	Miscellaneous	<ul style="list-style-type: none"> Outsourcing of regulatory services Oversight of RS
ASC	Corporate Governance	<ul style="list-style-type: none"> Includes rule making
	Corporate Finance	<ul style="list-style-type: none"> Relating to minimum or continuing listing/quoting requirements; tier maintenance requirements; sponsorship; continuous disclosure; and trading halts, suspensions and de-listing procedures Significant waivers of Capital Pool Company policy
	Financial Viability	<ul style="list-style-type: none"> Includes fees
	Miscellaneous	<ul style="list-style-type: none"> Documentation and record keeping

BCSC staff did not examine the following areas because other lead regulators already cover these areas in their oversight reviews:

- TSX Venture's systems that support order entry, order routing, execution, data feeds, trade reporting and trade comparison, and capacity and integrity requirements
- TSX Venture's automated clearing and settlement process and the related processes at the Canadian Depository for Securities (CDS)
- Market regulation functions that were transferred to RS

The review period for the areas examined was January 1, 2004 to September 30, 2005 except for the following:

- Regular access to trading for traders – extended to January 9, 2006 to include the testing of two deficient trader applications
- Direct market access – extended to October 31, 2005 to include the testing for accuracy and completeness of the DMA client list provided to RS

- Buy-in process – extended to January 4, 2006 to examine the process for two recent trade days

4. Prioritization of findings

The report findings are prioritized into high, medium, and low priority using the following criteria:

High – issue considered significant and TSX Venture should take corrective action immediately.

Medium – TSX Venture should resolve the issue within a reasonable timeframe.

Low – BCSC staff brought issue to management’s attention for review and consideration. There is no specific timeframe for corrective action.

Compliance and Disclosure Overview

1. Introduction

TSX Venture’s Compliance and Disclosure department (C&D) has offices in Calgary and Vancouver. C&D also uses one staff member from TSX Venture’s Listed Issuer Services (LIS) department in Montreal for files where the listed issuer is headquartered in Quebec or where a listed issuer or individual requests communication in French.

The primary responsibility of C&D is to:

- monitor the conduct and activities of listed issuers for compliance with TSX Venture rules
- conduct investigations of the potential violations of its requirements by listed issuers or related individuals
- impose appropriate sanctions where it has concluded that there have been violations of TSX Venture requirements

2. Purpose and scope

The purpose of this part of the oversight review was to assess:

- the adequacy of the reporting structure, staffing and training
- the efficiency of communication with other TSX Venture departments
- the sufficiency of reporting to the BCSC
- the efficiency and effectiveness of communication with other regulatory bodies or self-regulatory organizations
- the fairness and efficiency in the hearing process following an exchange decision affecting an issuer or related party

BCSC staff interviewed the Team Managers (Vancouver and Calgary), corresponded with the Director, reviewed C&D internal policies and procedures, and reviewed a sample of C&D files.

3. Reporting structure

Information from TSX Venture

C&D has one Director who is located in Vancouver. The offices in Calgary and Vancouver each have a Team Manager who reports to the Director. These offices also have Managers, Analysts, and Assistant Analysts who report directly to the Team Manager. The LIS staff member in Montreal, who is a Manager, reports to the Director.

Staff in each C&D office meet independently every second week to discuss monthly and bi-weekly statistics, capital pool company (CPC) milestones, active files, higher risk files of interest, and files that are to be closed. The two offices meet together monthly, or as necessary (by teleconference). The staff member in Montreal attends the consolidated monthly meetings, which the Director chairs.

The Team Managers and the Director meet weekly, or as necessary, to update all active files, industry issues, procedural issues, and staff workloads. When the Director is absent from the office, she designates each Team Manager as the acting director in their respective offices.

Findings

BCSC staff considered the reporting structure in C&D to be adequate. Frequent staff meetings help to ensure that there is adequate reporting up to senior management by staff.

Staff's recommendations

No action is necessary.

4. Staffing and training

Information from TSX Venture

TSX Venture informed BCSC staff that C&D is operating at a full complement of staff and that there are no vacancies. The Vancouver office is comprised of the Director, a Team Manager, three Managers, two Analysts, and an Assistant Analyst. During the review period, the Vancouver office increased its staffing level by adding an Analyst and an Assistant Analyst in order to address increased workloads. One Manager left at the end of September 2005 and was replaced in December 2005.

The Calgary office is comprised of a Team Manager, three Managers, a Senior Analyst, and an Assistant Analyst. The Director spends a portion of her time in the Calgary office.

C&D does not have a formal training program for new staff. Instead, the Team Managers conduct training on a one-on-one basis and then closely supervise the files assigned to new staff. C&D also pairs new staff with existing staff in a buddy system to provide them

with training and mentoring. New staff are assigned low risk and less complex files to begin with. C&D sends new staff to the Public Companies course offered by Simon Fraser University or to the TSX Venture Exchange Success Program workshops and encourages all staff to attend industry events. Last, since professional development is part of each staff member's performance assessment they will have to demonstrate that they have completed some relevant education each year.

Findings

BCSC staff considered the staffing level in the Vancouver office to be reasonable; however, BCSC file testing of 31 listed issuer compliance and individual suitability reviews completed within the Surveillance Information Notes and Correspondence (SINC) database revealed delays in the handling of a number of files. In eight files, C&D identified the reason for the delay as heavy workload. The Calgary office handled six of these files and staff in Montreal handled two of these files. The delays in the handling of the SINC files relate primarily to the excessive time between resolution of the substantive issues on the file and the actual closing of the files.

BCSC staff considered the training and continuing education provided to staff to be adequate.

Staff's recommendations

BCSC staff recommend that TSX Venture consider whether staffing levels in Calgary and Montreal are adequate or whether higher workloads are temporary, or whether work can be completed more efficiently.

Priority: Low

5. Communication with other TSX Venture departments

Information from TSX Venture

The Vancouver LIS and C&D departments participate in a monthly joint department staff meeting. The Manager, National Policy, attends these meetings and provides updates on new policy initiatives. At these meetings, C&D staff can identify policy issues that they would like the Manager, National Policy to look at. These policy issues may result in a formal request for a policy change or a new policy. C&D also uses this forum to update LIS staff on new C&D policies, changes in procedure, and any new C&D initiatives.

C&D has an internal referral procedure that describes how and when LIS staff should make referrals to C&D. C&D tracks these referrals in the SINC database.

Findings

BCSC staff reviewed a number of SINC files. The files that LIS referred to C&D complied with the internal referral procedure. A number of these files contained evidence of good ongoing communication between C&D and LIS during the time that the files were open.

Staff's recommendations

No action is necessary.

6. Reporting to the Commission

Information from TSX Venture

Referrals from C&D to the BCSC are automatic by virtue of C&D blind copying all correspondence to BCSC enforcement staff. If the ASC requests it, C&D will blind copy correspondence on a particular file to ASC enforcement staff. Where C&D believes a matter should be brought specifically to the attention of senior BCSC staff, it will be done at the discretion of the Director, usually on the recommendation of a Team Manager, once a file has been closed. However, if the matter under review is particularly serious, C&D may refer the matter to either Commission while the file is still under review by C&D. In this case, the Director will refer the matter to the Director of Enforcement at the BCSC or to the Director of Enforcement or the Executive Director at the ASC.

TSX Venture provides written quarterly reporting to the BCSC and ASC comprised of a status report on listed issuers under review, ongoing director and officer suitability reviews, and statistics relating to suspensions, halts, de-listings, personal information forms, and SINC cases. TSX Venture, BCSC and ASC discuss these reports at quarterly oversight meetings.

Findings

Terms 13 and 14 of the recognition order require that TSX Venture:

- provide notice to the BCSC of any violation of securities legislation of which it becomes aware in the ordinary course operation of its business
- advise of all significant issues arising from issuer non-compliance with its rules and the action taken or being taken by it to deal with the situation

BCSC staff reviewed the written quarterly reporting that TSX Venture provides to the BCSC and considered the reporting adequate, efficient and in compliance with the terms of the recognition order. Based on the sample of SINC files reviewed, BCSC staff considered the files that C&D referred to the BCSC to be appropriately referred. C&D reported open SINC files to the BCSC in a timely way prior to making a formal decision to refer a matter.

Staff's recommendations

No action is necessary.

7. Liaison with other regulators

Information from TSX Venture

C&D makes referrals to other regulators and self-regulatory organizations at the discretion of a Team Manager or the Director. C&D commonly refers matters to RS for further investigation where there may have been a violation of the Universal Market Integrity Rules (UMIR) or TSX Venture rules. These referrals usually involve possible

insider trading and price manipulation. C&D will also refer a listed issuer to RS for closer review if it has concerns about a listed issuer's ongoing disclosure record and has placed them on its "watch-list".

Findings

BCSC staff reviewed a number of SINC files in which C&D made referrals to other regulators or self-regulatory organizations and considered these referrals appropriate and timely. In addition, C&D opened a number of files that RS referred to it and handled these files efficiently.

Staff's recommendations

No action is necessary.

8. Hearings

Information from TSX Venture

Term 7(c) of the recognition order requires TSX Venture to make decisions under its rules about its listed issuers, persons associated with its listed issuers and applicants for listing and to provide for a review or appeal process for these decisions.

TSX Venture rules provide that where TSX Venture makes a decision that:

- a director, officer, insider, promoter, lawyer, employee, or consultant or other agent relied on by a listed issuer is not acceptable to TSX Venture, or
- to place conditions on such person's continued acceptability

the issuer or individual may apply for a review of the decision. This review is conducted by a Listed Company Review Panel appointed by TSX Venture.

In January 2004, TSX Venture determined that it could no longer provide the review process, as it then existed due to the failure to amend the appeal rules to apply in the context of a demutualized (for profit) exchange. TSX Venture advised the BCSC of the problem, redrafted the hearing rules and obtained BCSC approval to new hearing rules in December 2004. TSX Venture has delayed appointing a Listed Company Review Panel roster (from which panel members are selected) until certain ongoing legal issues, presently before the British Columbia Court of Appeal, are decided. Because of the delay in appointing the Listed Company Review Panel roster, TSX Venture determined that it could not provide an independent hearing and review and currently advises individuals of their right to appeal to the BCSC or ASC instead.

TSX Venture informed BCSC staff that, during the review period, it did not receive any requests, from persons affected by its decisions, for a Listed Company Review Panel to hear their matter. The only request for review of a TSX Venture decision was made directly to the ASC, which heard the matter. TSX Venture did not conduct any hearings during the 12-month period prior to the review period.

Findings

As required under the hearing rules, TSX Venture has appointed a hearings officer and has struck an appointing committee to appoint Listed Company Review Panels once a Listed Company Review Panel roster is established. BCSC staff were unable to assess the fairness and efficiency of the hearing process since TSX Venture did not conduct any hearings during the review period.

Staff's recommendations

No action is necessary at this time. BCSC staff will assess the fairness and efficiency of the hearing process in the next oversight review.

Compliance and Disclosure Processes

1. Introduction

Term 7(b) of the recognition order requires TSX Venture to perform issuer regulation functions, including monitoring the conduct and activities of its listed issuers for compliance with its rules. Term 7(c) of the recognition order requires TSX Venture to make decisions under its rules about its listed issuers, persons associated with its listed issuers and applicants for listing and to provide for a review or appeal process for these decisions. The core processes of C&D are:

- tier maintenance requirement (TMR) reviews
- reinstatement reviews
- capital pool company reviews
- listed issuer surveillance files
- director and officer suitability reviews (these are a subset of listed issuer surveillance files)
- personal information form reviews (a component of director and officer suitability reviews)

2. Purpose and scope

The purpose of this part of the oversight review was to assess:

- the sufficiency and effectiveness of each of the core processes of C&D and compliance with terms 7(b) and 7(c)
- the adequacy of performance measurements and whether they were met

3. Tier maintenance reviews/inter-tier movement

(a) Process

Information from TSX Venture

TSX Venture has a two-tiered system for its listed issuers, each of the tiers having minimum listing requirements based on a company's financial performance, resources, and stage of development. The industry segments within each tier

recognize the different financial and operating needs of companies operating in different industry sectors. Tier 1 is for senior companies with the most significant resources and tier 2 is for early-stage companies. Tier 1 issuers have fewer filing requirements.

Listed issuers must meet prescribed TMR set out in TSX Venture Policy 2.5 *Tier Maintenance Requirements and Inter-Tier Movement* in order to remain on their assigned tier. TSX Venture may downgrade listed issuers that fail to meet TMR from tier 1 to tier 2 or from tier 2 to NEX (a separate board of TSX Venture that provides a trading forum for listed issuers that have fallen below tier 2 listing requirements).

C&D has documented its process for TMR reviews in a written procedure. This procedure is refined as needed by the Director and President who determine whether TSX Venture needs to target particular types of issuers and how the TSX Venture will apply the TMRs.

C&D staff conduct TMR reviews in accordance with applicable TMR checklists. If C&D staff note a deficiency during the review, they will advise the listed issuer and put the issuer on notice that if the deficiency is not resolved within a prescribed time TSX Venture will downgrade the listed issuer.

Findings

The TMR review procedure is a short document that describes the frequency and sources of TMR reviews and the actions to be taken by C&D staff when deficiencies are identified. The procedure incorporates comprehensive checklists that list each TMR that must be met by issuers in each industry classification within each tier. BCSC staff considered the procedure to be adequate.

Staff's recommendations

No action is necessary.

(b) Tier maintenance review files

Information from TSX Venture

BCSC staff chose a sample of 20 files from a population of approximately 1700 TMR reviews that C&D conducted during the review period.

Findings

C&D assigned TMR review files to staff with appropriate levels of education and experience and, where determinable, the decisions in the TMR review files were appropriate and consistent with TSX Venture Policy 2.5. However, a number of files did not include completed checklists or other documentation sufficient to permit BCSC staff to evaluate whether:

- the review was handled in a timely manner
- C&D staff's analysis was adequate

- discretion was exercised appropriately
- management reviewed and approved the conclusions reached by C&D staff

Staff's recommendations

BCSC staff recommend that TSX Venture ensure that C&D staff responsible for TMR review files include adequate documentation of the work performed, the decisions made, and the rationale behind decisions and actions taken. BCSC staff also recommend that management document their review and approval on each file or establish alternative procedures to ensure their staff have properly conducted their TMR reviews. In addition, sufficient information should be recorded in the files to enable assessment of the timeliness of completion of TMR reviews.

Priority: Medium

4. Reinstatement reviews

(a) Process

Information from TSX Venture

Under the listing agreement that TSX Venture has with each of its listed issuers it is authorized to halt, suspend or delist the shares of a listed issuer at any time if it considers it to be in the public interest. Where TSX Venture halts or suspends the shares of a listed issuer, it may subsequently reinstate those shares to trading. TSX Venture Policy 2.9 *Trading Halts, Suspensions, and Delisting* sets out the requirements that listed issuers must meet in order for TSX Venture to reinstate its shares to trading. C&D has a written reinstatement review procedure. C&D also maintains a suspension report that lists all suspended issuers together with the reasons (including cease trade orders) for the suspension. Where a reinstatement review involves a reverse take-over or a change of business, LIS handles the files.

Reinstatement reviews begin either on receipt of an application from a listed issuer for reinstatement or where C&D staff proactively contact a listed issuer to advise that they may apply for reinstatement to trading. The reinstatement review procedure includes a comprehensive checklist that sets out the items requiring review prior to reinstatement.

Findings

The reinstatement review procedure is a short document that generally describes the procedure for conducting a reinstatement review. The procedure incorporates a comprehensive checklist that sets out the items requiring review by C&D staff. BCSC staff considered the procedure to be adequate.

Staff's recommendations

No action is necessary.

(b) Reinstatement review files

Information from TSX Venture

BCSC staff chose a sample of 15 files from a population of 224 listed issuers that TSX Venture reinstated to trading during the review period and 54 listed issuers with a suspended status at the time the BCSC conducted its review.

Findings

C&D staff conducted reinstatement reviews in a timely manner soon after listed issuers became eligible for reinstatement. Once the reviews were completed, TSX Venture promptly reinstated listed issuers to trading. Generally, the files were well documented and contained evidence of appropriate management input and direction. However, several of the files did not have a completed checklist or other documentation sufficient to permit BCSC staff to evaluate the decisions and actions taken.

Staff's recommendations

BCSC staff recommend that TSX Venture ensure that C&D staff responsible for reinstatement reviews include adequate documentation of the work performed, the decisions made, and the rationale behind decisions and actions taken.

Priority: Medium

5. Capital pool company reviews

(a) Process

Information from TSX Venture

Under TSX venture Policy 2.4 *Capital Pool Companies* (CPC Policy), TSX Venture may suspend a CPC from trading where the CPC has not completed its qualifying transaction (QT) within 24 months of its listing date. TSX Venture has documented its procedures for tracking CPCs, which have not completed their QT, in a written procedure. This procedure changed partway through the review period (April 13, 2005) because of changes to the CPC Policy. Prior to April 13, 2005, TSX Venture would suspend a CPC that had not filed a letter of intent relating to its QT at 18 months from the listing date and would then transfer the CPC to NEX or delist it at 24 months if it had not completed its QT.

After April 13, 2005, TSX Venture extended the timelines for completion of a QT from 18 to 24 months. If a CPC had not completed its QT by 24 months, TSX Venture would suspend the CPC and give it 90 days to transfer to NEX or delist. Under the old procedure, TSX Venture sent notices to CPCs at 15, 17, 18, and 20 months from the listing date. Under the new procedure, TSX Venture sends notices to CPCs at 18, 21, 23, and 24 months from the listing date. C&D staff track CPCs in a CPC Monitor List, which contains the listing date and the 24-month deadline.

Findings

The CPC procedure is a short two-page document that generally describes the old procedure and the new CPC procedure. The procedure sets out the steps to take on certain milestone dates and when to send notices to the CPC. The process itself is largely a tracking and monitoring of milestone dates; therefore, there is no need for a detailed procedure and BCSC staff considered it to be adequate.

Staff's recommendations

No action is necessary.

(b) Capital pool company files

Information from TSX Venture

BCSC staff chose a sample of 8 files from a population of 31 CPC files where the CPC had not completed its QT and it had an 18-month anniversary date that fell before the end of the review period.

Findings

C&D staff handled CPC reviews in accordance with the written procedure and exercised discretion appropriately when agreeing to requests from CPCs for extensions of deadlines. The outcomes in the files reviewed were appropriate and the files contained adequate documentation supporting the conclusions. In almost all instances, C&D staff issued notices in accordance with the timing under both the old and the new procedures, as applicable.

Staff's recommendations

No action is necessary.

6. Listed issuer surveillance files

(a) Process

Information from TSX Venture

C&D monitors listed issuer conduct for compliance with TSX Venture rules and makes decisions under those rules about listed issuers and persons associated with the listed issuers. C&D staff complete compliance files within TSX Venture's SINC database. The sources of SINC files include:

- internal referrals from LIS
- proactive listed issuer reviews
- media stories
- external referrals from securities commissions and other regulatory authorities
- complaints from members of the public or from listed issuers

During the review period, C&D did not have a formal written policy and procedure for handling SINC files. There was, however, a written procedure for

opening and closing SINC files. Instead of a formal written procedure, C&D informed BCSC staff that they relied on extended and closely supervised training of staff who handle SINC files. Subsequent to the review period, C&D implemented a checklist that itemizes how SINC files are to be closed. C&D staff also have access to standard template documentation for aspects of the process. Last, there is a comprehensive technical user manual for the SINC database.

In the Vancouver office, the Team Manager assigns the SINC files to Managers for handling or handles them himself in certain circumstances. Similarly, in the Calgary office the Team Manager assigns SINC files to Managers or, where the files are lower risk, to a Senior Analyst, or handles them herself.

C&D staff must make a formal written recommendation to management in three situations:

- where staff propose material restrictions on an individual's involvement with a listed issuer
- where they recommend that the individual is unsuitable
- where they propose to interrupt trading of a listed issuer's securities

Initially, C&D staff provide these recommendation memos to a team manager for review and sign off. Next, the memo is forwarded to the Director and second team manager for review. Where a recommendation is something less than 'unsuitable', or is not sufficiently unique to require review by all three members of senior management, it may be considered by the applicable Team Manager and the Director only. In all other situations, staff are not required to prepare formal recommendation memos and may receive verbal confirmation of management's approval of a proposed plan of action or recommended outcome.

Findings

Because each SINC file is, to a greater or lesser extent, unique, the process does not lend itself to a checklist style procedure. For the higher risk director/officer suitability reviews, C&D has recently developed a written policy (in draft at the time of the review) which reflects existing practice on how C&D fulfills procedural fairness obligations. For the lower risk files, C&D staff have access to the TSX Venture policies in the *Corporate Finance Manual*, standard template documentation, and guidance from senior staff who are well qualified and, as a group, have considerable industry experience. BCSC staff considered this adequate.

Staff's recommendations

No action is necessary.

(b) SINC files

Information from TSX Venture

BCSC staff selected a sample of 31 files from a total population of 351 SINC cases. C&D categorizes SINC files into 17 different file types, which relate to the type of infraction being investigated or the type of review being undertaken. BCSC staff selected sample files from each file type and files that were opened as a result of both internal and external referrals.

Findings

Generally, the SINC files reviewed were thorough and well documented. In some cases, C&D staff prepared detailed summaries and chronologies for the files. Based on the documentation in the files supporting the conclusions, BCSC staff considered that the investigative work was sufficient and the conclusions and resolutions were reasonable. C&D handled internal and external referrals appropriately. C&D correspondence to listed issuers and individuals was both timely and professional. C&D staff demonstrated adequate knowledge and good judgment in the handling of these files. The file review also revealed examples of good communication between staff in C&D and in LIS.

However, in 11 files there was a significant delay in closing the SINC files. TSX Venture informed BCSC staff that these delays resulted from staff turnover, heavy workload, or a low priority being placed on the closing of the file.

C&D's service standard for SINC cases relates to the timely closure of SINC files. Of the 351 SINC cases, C&D closed 342 during the review period. Of the 342 files, 244 (71%) were not closed within the time period set out by the service standard. Therefore, Compliance & Disclosure is not meeting its service standard for SINC cases. It is possible that some of the 244 files were resolved within the service standard but not closed.

BCSC staff consider that, as currently drafted, the service standard is not meaningful, as it does not distinguish between cases that were resolved within the time period but were closed later and cases that were not resolved or closed within the time period. As SINC file closure is largely an administrative task it may not be the best milestone to use to evaluate C&D performance in connection with SINC files.

Staff's recommendations

BCSC staff recommend that C&D consider modifying the service standard for closing files so the performance measurement is more meaningful.

Priority: Low

7. Director/Officer suitability review

(a) Process

Information from TSX Venture

C&D conducts suitability reviews of current or proposed directors and officers of listed issuers as a result of disclosure in personal information forms (PIFs), results of background checks, complaints and referrals, both internal and external. C&D informed BCSC staff that during the review period, there was no formal written policy and procedure for director and officer suitability reviews due to the complexity and uniqueness of each suitability review. Instead, C&D relies on extended and closely supervised training of its staff. No checklists for file handling exist; however, staff use template paragraphs for correspondence to ensure consistency between reviews. To further ensure consistency in suitability decisions, C&D recently developed a precedent index of closed files that raise similar issues to those that may be raised in existing files that staff are working on. The precedent index was not in existence during the review period. C&D also recently created a written policy (in draft during the review) which reflects existing practice on how C&D fulfills procedural fairness obligations.

C&D staff assigned to the SINC files are responsible for the file record and ensuring that materials are saved in SINC and, if necessary, in a paper file. Guidelines are contained in a Case File Standards and Procedures document and in the policy on procedural fairness, which contains a section entitled 'Preparing the Record'.

Senior management (comprised of the two Team Managers and the Director) review all staff recommendations unless the staff recommendation is something less than a recommendation of unsuitable or the file is not sufficiently unique to justify a review by all three members of senior management. In those cases, only the Director and the applicable team manager will review the file. The Director signs all letters with a finding that an individual is unsuitable. Letters that impose restrictions may be signed by a team manager or by a manager with the team manager's consent.

Findings

Due to the uniqueness of each suitability review, the process does not lend itself to a checklist style procedure. However, C&D does now have several useful resources in place for staff handling suitability reviews including the precedent index and the policy describing procedural fairness in suitability reviews. The policy is a very clear, comprehensive, and well-written procedure that provides a framework within which staff can conduct suitability reviews. In addition, C&D staff that handle SINC files are well qualified and, as a group, have considerable industry experience. BCSC staff considered this process adequate.

Staff Recommendations

No action is necessary.

(b) Director/Officer suitability files

Information from TSX Venture

BCSC staff selected a sample of 18 files from a total population of 164 director and officer suitability reviews.

Findings

Generally, the suitability review files were well documented and, in some cases, C&D staff prepared detailed summaries and chronologies for the files. Based on the documentation in the files supporting the conclusions, BCSC staff considered that the investigative work was sufficient and the conclusions and resolutions were reasonable. C&D correspondence to listed issuers and individuals was both timely and professional. C&D staff demonstrated adequate knowledge and good judgment in the handling of these files. When recommendation memos were prepared, they were thorough and well written.

BCSC staff reviewed a total of 49 SINC files (of which 18 were suitability reviews). In all cases where written recommendations were required under internal C&D policy, BCSC staff located a recommendation memo and evidence of its approval by management. However, in 15 SINC cases with lesser recommendations (including three suitability reviews) BCSC staff were unable to locate staff recommendations. BCSC staff acknowledge that internal C&D policy only requires written recommendation memos in certain limited circumstances; however, BCSC staff believe that C&D should always document recommendations. BCSC considers a written record to be particularly important in situations where C&D staff have identified multiple compliance deficiencies but determine that they are either not material or that there are mitigating circumstances, such that no action is warranted other than a warning letter.

Staff's recommendations

BCSC staff recommend that C&D document SINC case recommendations and the reasons for them in all cases.

Priority: Medium

(c) PIF reviews

Information from TSX Venture

TSX Venture will not accept the involvement of any person with a listed issuer in the capacity of an insider, or any person performing investor relations activities for a listed issuer, without first receiving and reviewing a personal information form (PIF) submitted by that person.

C&D's procedure for processing PIFs is set out in a *PIF Procedures Manual*. The manual itself was not in existence during the review period; however, the contents of the manual existed in various forms during the entire review period.

RS is responsible for forwarding the names of all insider and investor relations appointments announced for listed issuers to C&D. If C&D does not have an existing PIF on file for an individual, C&D staff send a request to the individual for a completed PIF. When C&D receives a PIF, staff check it for completeness and, if necessary, send a deficiency letter. Once the PIF is complete, C&D staff send a research request form to RS.

When C&D staff receive the RS research report back, they review the report and flag items of detriment and concerns that they need to follow up. Staff update the PIF database to show when they receive the RS report and when they clear the PIF and close the file. If staff determine that a review/decision is required at a higher level then they refer the file to a manager for review. Based on the manager's review, staff may request a second, more comprehensive, RS research report at a higher level. Once a manager has reviewed the file and makes a decision, the file is closed. Staff may open a SINC file at that point depending upon the findings.

BCSC staff chose a random sample of 50 files from a total population of 6216 files in which C&D staff had sent a research request and had received an RS report during the review period. BCSC staff reviewed these files to determine the timeliness of handling of these files by C&D staff. From this sample, BCSC staff chose a sample of seven files to review whether:

- the files were adequately documented
- the final decisions were appropriate
- the reviews were timely
- internal service standards were met

Findings

BCSC staff found that all of the final decisions in the files were reasonable and that staff exercised discretion appropriately in determining which files to elevate for review by a manager.

However, BCSC staff noted issues with timeliness in completing four of the seven files reviewed. BCSC staff acknowledge that some of the delays could be the result of deficient PIFs necessitating follow up and that the individuals involved may not have been responsive in providing requested information. However, C&D staff did not document the files sufficiently to enable BCSC staff to determine whether this was the case.

BCSC staff also acknowledge that during the review period, there were staffing issues. C&D took steps to address the increased workload resulting from an increasing volume of PIFs by hiring an analyst dedicated to working on PIF

reviews in September 2004. C&D's average handling time for PIF reviews dropped by 90% after this analyst was hired.

The service standard for PIF reviews relates to the timely review of PIFs once received by C&D. BCSC staff were not able to assess whether C&D staff met the service standard because PIF review files do not document the date when the PIF is initially reviewed.

Staff's recommendations

BCSC staff recommend that C&D assess its PIF review process to ensure that it handles PIF reviews in a timely manner. BCSC staff also recommend that C&D management ensure that staff enter adequate notes into the database to track correspondence sent and received from individuals under review.

Priority: Low

BCSC staff also recommend that C&D consider modifying its service standard. In the case of an incomplete or deficient PIF, a better performance measure may be, how quickly C&D staff send initial correspondence to the individual requesting resolution of deficiencies, and once all deficiencies are resolved, how quickly a research request is sent to RS (the latter performance measure would also apply to PIFs received without deficiencies). C&D could also measure how quickly they close files after receiving a research report from RS.

Priority: Low

Access to Trading

1. Introduction

According to the joint regulatory oversight framework for TSX Venture, dated November 26, 1999, the BCSC is the functional regulator for the trading function. However, with the transfer of the market regulation to RS on March 1, 2002, the only areas remaining at TSX Venture are access to trading and fees.

Brokers and dealers desiring access to the trading facilities of TSX Venture must apply for membership or participating organization (PO) designation, and register their traders with the Exchange. Further, TSX Venture must certify that the applicant's electronic connection(s) to its trading facilities allows TSX Venture to reliably communicate with the entity through the electronic gateway.

In addition, a member's or PO's clients that meet TSX Venture's eligibility requirements may want access to trade directly on the Exchange. TSX Venture must approve the member or PO for sponsored DMA before eligible clients receive DMA privileges to trade.

2. Purpose and scope

The BCSC has reviewed access to trading. The ASC has reviewed TSX Venture's fee setting and fee allocation process for listed companies, members, POs, and other market participants.

(a) Regular access to trading

The purpose of this part of the oversight review was to verify:

- TSX Venture had established written standards for granting access to trading (NI 21-101(5.1) *Access Requirements*), and that they were separate from the TSX (term 25 of the recognition order).
- decisions to grant, deny, or impose conditions on access to the trading facilities were fair, reasonable, and consistent with its standards or requirements (terms 6(b)(i), 23, 24, and 27(a) of the recognition order; and NI 21-101 (5.1)).
- all relevant records supporting decisions to grant, deny, or impose conditions on access were retained according to requirements (terms 26(a)(b) and 27(c) of the recognition order, and NI 21-101(11.3)(1)(b) *Record Preservation Requirements*).
- adequate notice, and an opportunity to be heard or make representations were given to the parties (term 27(b) of the recognition order).
- The application review and approval process was promptly completed and adequately documented.

(b) Direct market access

The purpose of this part of the oversight review was to verify:

- the one-time approval of existing DMA providers was completed according to Exchange requirements (NTM #2004-018 *TSX Venture Exchange Rule Amendments - Connection of Eligible Clients of Members*).
- compliance with the BCSC's conditions imposed on DMA rules (dated December 6, 2004).
- the application review and approval process for new DMA providers complied with Exchange requirements (Rule C.2.52(1)(a), (1)(b), (2), (3), and (4)(b)), and was promptly completed and adequately documented.
- TSX Venture's ongoing monitoring and detection procedures were adequate and timely.
- the coordination with RS to investigate and enforce breaches of DMA rules by eligible clients was adequate and efficient.

BCSC staff corresponded with management and staff of TSX Venture and TSX Group to gain an understanding of the processes related to the granting of access to trading and direct market access. Further, BCSC staff reviewed the *TSX Venture Exchange Rule Book, Rules of the Toronto Stock Exchange*, various regulatory notices, written procedures, written standards for granting access, trade data from March 1 to September

30, 2005, access application files, system connectivity review files, executed system interconnect agreements, a DMA investigation file, and the DMA client tracking system.

3. Benchmarks or performance measures

Information from TSX Venture

TSX Venture does not have formal or informal benchmarks or performance measures for its trading access application review and approval process, including direct market access. TSX Venture explained that as a for-profit organization, it would not be competitive if it did not promptly approve a worthy applicant.

Findings

BCSC staff believe that benchmarks or performance measures are important resource management and monitoring tools. They will provide management and staff with timely feedback on performance, and can help an organization perform up to its potential.

Staff's recommendations

BCSC staff recommend that the TSX Venture consider establishing benchmarks or performance measures for its process and sub-processes related to its review and approval of trading access applicants, including members, POs, traders, and direct access providers.

Priority: Low

4. Regular access to trading

(a) Written standards for granting access and an opportunity to be heard

Information from TSX Venture

TSX Venture uses the IDA standards to identify which members or POs are granted access. A successful candidate must be an IDA member in good standing, and have suitable partners, directors, and officers. TSX Venture does not have an appeal process that is specific to the application process. For trader applicants, TSX Venture refers to the *Rules of the Toronto Stock Exchange*, Rule 4-405 *Approved Traders*.

For gateway (i.e., Securities Trading Access Message Protocol or STAMP) certification, TSX Markets, a division of TSX Inc. (a subsidiary of TSX Group), informed the BCSC that it planned to formalize these standards in early 2006. They will document the minimum system functionality required for acceptance.

Findings

BCSC staff reviewed the *TSX Venture Exchange Rule Book*, the *Rules of the Toronto Stock Exchange*, and TSX Venture's application packages for membership, POs, and traders. TSX Venture did not have written standards for approved traders that were separate from those of the TSX, as required by term 25 of the recognition order. Further, the standards for membership were incomplete,

as they did not include the standards for imposing conditions on members and the applicant's right to be heard.

Under term 27(b) of the recognition order, TSX Venture is required to notify parties and give them an opportunity to be heard or make representations. These requirements are in the *Rules of the Toronto Stock Exchange*. The TSX has a process where the applicant is notified and provided with a statement of the reasons for the imposed conditions or rejected application. In the TSX process, the applicant is then entitled to a hearing. TSX Venture should have a similar process.

For its STAMP certification process, BCSC staff acknowledge that TSX Markets has undertaken to document these standards. In the next oversight review, BCSC staff will examine the reasonableness and consistency of the STAMP certification decisions.

Staff's recommendations

BCSC staff recommend that TSX Venture includes written standards for granting access to trading in its rulebook as required by the recognition order. Further, BCSC staff recommend that TSX Venture harmonizes its standards for granting access with those of the TSX, by including the standards for imposing conditions on members, and the applicant's right to be heard.

Priority: Medium

(b) Membership or participating organization application review and approval process

Information from TSX Venture

TSX Venture informed BCSC staff that it relies on the IDA to identify worthy candidates and retains RS for conducting the background checks on individual directors, officers, or partners of the applicant.

The access approval process includes an application review and a system connectivity certification. TSX Venture will only permit trading access to its members or POs that have had their system connectivity certified by it. The applicant completes the application form; and personal information forms for each director and officer, and each holder of more than 20% of the applicant's securities. To assess the suitability of the applicant, and its directors, officers, and significant shareholders, a TSX Markets' account manager reviews the application, the IDA's confirmation of membership in good standing, and the results of RS's background checks. After the review, the account manager recommends acceptance or denial of the application to the President of TSX Markets. He evidences his acceptance by signing TSX Venture's Member or PO Agreement. Until January 26, 2005, TSX Venture also required its members to accept the applicant into membership through a balloting process.

The system connectivity review and approval process occurs parallel to the application review process. The Director, Market Services at TSX Markets is responsible for the STAMP certification process, which confirms that an electronic gateway will allow reliable communication between TSX Venture and its member or PO. The connectivity review involves set up of the member or PO in the TSX Venture Gateway Test Environment for certification. TSX Market Services analyzes the test results to assess the system's functionality. When acceptable, TSX Markets' Manager of Market Services issues the STAMP certification confirmation letter with the list of the certified functions.

Findings

(i) Duplication of effort of partner, director, and officer suitability reviews in membership or PO applications

During the review of a member or PO application, TSX Venture conducts a suitability review of the applicant's directors, senior officers, and partners. Similarly, the IDA's membership review and approval process includes a suitability and proficiency review of the applicant's partners, directors, and officers. As TSX Venture requires its applicants to be IDA members in good standing, there appears to be some duplication in this aspect of the review process, at least for recently approved IDA members.

(ii) Membership and PO application files

BCSC staff selected a sample of 5 membership and PO application files for review from a population of 11 approved files. According to TSX Venture, there were no rejected applications or conditions imposed during the review period. BCSC staff reviewed the files for completeness of the file documentation, including evidence of review; consistency and reasonableness of the decisions made; evidence that access was enabled after proper approval; and compliance with established procedures.

BCSC staff noted that all five new member and PO files had a completed application with supporting materials on file. The applicant file that did not have a pre-existing approved connection did contain evidence that the STAMP certification process was completed and the connection certified. However, in several instances, there was inadequate documentation on file to support the decision made. Specifically:

- three of the five files had incomplete RS investigative research reports (or background checks) for some of the directors and officers of the applicant with no record of subsequent follow-up on these pending items. One file was missing the RS investigative research report.
- two of three files either did not have any or was missing at least one of the members' ballots.
- one of the five files did not have an IDA letter of good standing on file.
- one of the five files did not have the reviewer's recommendation memorandum on file.

- one of the five files did not have evidence of senior management approval, as the signed PO's Agreement was not on file.

Due to the incomplete files, BCSC staff could only assess one account manager's recommendation and two senior management decisions. All three decisions were reasonable.

Further, BCSC staff were unable to confirm that access was enabled after approval of the application, as none of the five files had a record of the application's approval date.

Where there was sufficient file documentation for BCSC staff to assess compliance with established procedures, BCSC staff found two instances of non-compliance:

- in the only case where a complete set of RS investigative research results was on file, the reviewer's recommendation to accept the applicant was dated two business days prior to the receipt of the last RS investigative research result.
- in one of two cases, where member ballots were required, the member's trading number was effective one business day prior to the receipt date of the last ballot.

BCSC staff were unable to assess the prevalence of non-compliance due to incomplete documentation. Incomplete documents may suggest inadequate record retention procedures or non-compliance with established procedures.

Staff's recommendations

BCSC staff recommend that TSX Venture examines its partner, director, and officer suitability review process with the IDA to identify and eliminate duplicate procedures, or to better coordinate their efforts.

Priority: Low

BCSC staff recommend that TSX Venture ensures that there is adequate documentation on each file to support a decision to grant, deny, or limit access. Further, evidence to demonstrate that the access was properly pre-authorized such as approval dates and access activation dates should be on file.

Priority: Medium

A comprehensive set of written procedures and the use of checklists, promotes awareness of the process, facilitates compliance with established procedures, leads to reasonable and consistent decisions, and ensures accountability. BCSC staff recommend that TSX Venture formalizes its procedures for reviewing and approving membership/PO applications, and enabling access.

Priority: Medium

(c) Trader application review and approval process

Information from TSX Venture

TSX Markets' Manager of Market Quality informed BCSC staff that the trader application review and approval process begins with receipt of a TSX-V trader application from an IDA member firm. He or his staff reviews the application to ensure:

- the application is complete and properly signed.
- a copy of the IDA registration letter confirming the individual's current registration is on file.
- evidence of completion of the Trader Training Course (TTC) and that the applicant meets the minimum proficiency requirements of TSX Rule 4-405 *Approved Traders* is on file.

When acceptable, the reviewer approves the application by initialing and dating the first page of the application, updates the trader database, and emails an approval confirmation to the member's contact person. The member contacts TSX Trading Services to arrange for the new trader's access.

Findings

(i) Trader application review and approval process

The TSX Venture has procedures in place, but these procedures are not documented. The procedures were adequate except for those related to confirming the completion of the Canadian Securities Course (CSC). TSX Venture requires proof of completion of the TTC; however, the same is not required for completion of the CSC. BCSC staff acknowledge that proof of completion of the CSC is unnecessary if reliance is placed on the completion of the TTC and the two-year experience requirement. However, for applications where TSX Venture's decision is based on the applicant completing both the TTC and the CSC, then proof of completion of both courses should be obtained to support the decision.

BCSC staff reviewed a sample of 20 trader application files for completeness of the file documentation, consistency and reasonableness of the decision, compliance with established procedures, and evidence that access was enabled after approval. All 20 files had a completed application and supporting materials, and sufficient documentation to support the decision made. In all except one, the approval confirmation email was on file, the decision was reasonable and consistent, and the reviewer complied with established procedures. In all except one case, there was evidence to show that access was enabled after approval.

Ten applications were not initialed or dated by the reviewer to evidence their review and approval. BCSC staff do not consider these to be systemic problems. However, formalizing the procedures and the use of checklists should help to ensure adequate performance in this area.

(ii) Categories of approved traders

TSX Markets' Manager of Market Quality informed BCSC staff that, since harmonizing its trader categories with those of the TSX, the category of assistant approved trader no longer existed. Previously, individuals that met the educational requirements but lacked the two-year experience were approved as assistant approved traders. These traders required supervision by an approved trader and were prohibited from operating or having any interest in a non-client or inventory account. As such, the *TSX Venture Rule Book* may be outdated, as it still refers to the assistant approved trader category.

Staff's recommendations

BCSC staff recommend that TSX Venture revises its procedures to obtain and retain the proof of completion of the CSC for all trader application approvals that require it.

Priority: Low

BCSC staff recommend that the reviewer consistently initials and dates the sign-off section of the trader application.

Priority: Low

A comprehensive set of written procedures and the use of checklists, promotes awareness of the process, facilitates compliance with established procedures, leads to reasonable and consistent decisions, and ensures accountability. BCSC staff recommend that TSX Venture formalizes its procedures for reviewing and approving trader applications, and enabling access.

Priority: Low

BCSC staff recommend that TSX Venture reviews its rulebook to determine whether references made to the assistant approved trader category are still relevant.

Priority: Low

5. Direct market access

(a) Written procedures for direct market access

Information from TSX Venture

At the time of the review, the TSX Venture's initial acceptance, and detection and monitoring procedures for DMA were still undergoing development and further refinement. TSX Venture informed BCSC staff that the Office of the General Counsel and TSX Markets planned to meet in early 2006 to finalize and document the DMA procedures and staff accountability.

Findings

TSX Venture's internal DMA procedures for initial acceptance, and detection and monitoring were located in various correspondence and documents. BCSC staff

understands that TSX Venture plans to finalize its procedures in a central document.

Staff's recommendations

No action is necessary at present. BCSC staff will assess the adequacy of the DMA procedures manual in the next oversight review.

(b) Requirements for granting direct market access

Information from TSX Venture

The TSX implemented the original version of DMA rules in 1985. Subsequent amendments occurred in 1994, 1996, 1999, and 2000. On May 31, 2004, TSX Venture incorporated the TSX's DMA rules into the *TSX Venture Exchange Rule Book*.

Findings

In the *TSX Venture Exchange Rule Book*, DMA requirements are in rules A.1.01 *Definitions*, C.2.51 *Designation of Eligible Clients*, C.2.52 *Conditions for Connections*, and C.2.53 *Responsibility of Members*. The rules define the classes of entities that are eligible for DMA through a TSX Venture member or PO, and detail the requirements and responsibilities for providing DMA. The rules were consistent with those of TSX and were adequate.

Staff's recommendations

No action is necessary.

(c) BCSC conditions imposed on TSX Venture's DMA rules

(i) Compliance with BCSC condition 1 – confirm existing DMA clients were subject to properly executed agreements

Information from TSX Venture

Under BCSC's non-object decision dated December 6, 2004, TSX Venture's proposed DMA rules were subject to three conditions. The first condition required TSX Venture to confirm by January 21, 2005, that all existing DMA clients were subject to properly executed interconnect agreements. To satisfy this condition, TSX Venture notified all head traders and chief compliance officers to submit all of their executed system interconnect agreements to the Exchange by January 14, 2005. TSX Venture completed a review of each type of agreement to ensure the agreements properly referred to TSX Venture and to ensure the agreements contained all the required provisions of Rule C.2.52(3) *Standard Form of Agreement*.

Findings

BCSC staff selected a sample of 10 TSX Venture-accepted agreements and reviewed for compliance with the first condition. The sample included one

agreement where TSX Group staff noted deficiencies and required the PO to submit a revised agreement. TSX Group staff found the remaining agreements in the sample to be acceptable upon initial review.

BCSC staff reviewed the documentation retained for the selected sample and found that four out of nine agreements were not properly executed, as the member did not sign three of the agreements and the client did not sign the fourth agreement. BCSC staff was unable to assess one agreement, as the member submitted the standard form agreement instead of executed agreements.

Further, 5 out of 10 exchange-accepted agreements did not contain all of the standard provisions of TSX-V Rule C.2.52(3):

- three of the five agreements were missing two of the required provisions:
 - C.2.52(3)(g) – the member’s responsibility to train the eligible client in the Exchange Requirements dealing with the entry and trading of orders and other applicable Exchange Requirements.
 - C.2.52(3)(h) – the member’s responsibility to ensure revisions and updates to Exchange Requirements relating to the entry and trading of orders are promptly communicated to the eligible client.
- three of the five agreements did not completely address the latter part of C.2.52(3)(e) – the member’s right to change or remove an order in the Book and to cancel any trade made by the eligible client for any reason.

However, BCSC staff found adequate file documentation for exchange-rejected agreements. The reviewer documented the identified deficiencies on separate notes to the agreement, and dated and initialed these notes. Email correspondence with the member and the final accepted agreement were also on file. In contrast, for agreements accepted in their original form, there was no file documentation of the review conducted, the identity of the reviewer, the date of the review, or the decision made. Finally, all nine agreements and their amendments, were dated before BCSC’s imposed deadline.

In conclusion, BCSC staff found that TSX Venture did not adequately satisfy BCSC’s first condition. An improperly executed agreement that does not have all the required provisions can undermine TSX Venture’s regulatory control over the trading activities of DMA clients.

Staff’s recommendations

BCSC staff recommend that TSX Venture ensures that the system interconnect agreements for all existing DMA clients are properly executed and have all the provisions required by Rule C.2.52(3). Further, the TSX Venture should evidence its review and decisions in all cases.

Priority: High-Medium

(ii) Compliance with BCSC condition 2 – plan to discharge responsibility to ensure compliance by DMA clients

Information from TSX Venture

The second BCSC condition required TSX Venture to provide by February 4, 2005, a plan of the approach to ensure compliance with DMA rules and UMIR by eligible clients.

Findings

BCSC received TSX Venture's plan within the specified deadline. This plan underwent further refinement during the oversight review. TSX Venture informed BCSC staff that the Office of the General Counsel and TSX Markets planned to meet in early 2006 to review the process, and document the procedures and staff responsibilities.

Staff's recommendations

BCSC staff recommend that TSX Venture submit its completed internal written procedures for DMA monitoring and detection to BCSC staff for review.

(iii) Compliance with BCSC condition 3 – implement a unique client trader identification (ID) system

Information from TSX Venture

The third BCSC condition required TSX Venture to implement by March 6, 2005, a system of unique client trader IDs for its DMA accounts. TSX Venture informed BCSC staff that it implemented the system by March 5, 2005. TSX Venture provided BCSC staff with a current list of all trader IDs enabled on the system for each of its DMA providers, a list of DMA client trader IDs for each member or PO that provided DMA on TSX Venture, and its trade data from March 1 to September 30, 2005.

Findings

BCSC staff reviewed the materials to ensure TSX Venture implemented its unique client trader ID system within the BCSC deadline and had assigned unique trader IDs to DMA accounts.

BCSC staff noted that for six of the seven DMA providers, TSX Venture had implemented the unique client trader ID system within the established deadline. In the remaining case, TSX Venture permitted the member to implement an alternative tracking system within the established deadline. Otherwise, implementing the new ID system at this member would have required a complete overhaul of the member's system, and it would not have been ready by the deadline. The alternative system tracks the orders at the account ID level instead of the trader ID level. With either system, the audit

trail is intact. Later, the member revamped its system and by October 2005, converted to the unique client trader ID system.

BCSC staff also found that the assigned DMA client trader IDs were unique although a DMA client may have more than one trader ID with a member or with different members. However, TSX Venture records all trader IDs assigned to each DMA client.

Staff's recommendations

No action is necessary.

(d) DMA provider application review and approval process

(i) One-time approval of existing DMA providers

Information from TSX Venture

On June 1, 2004, TSX Venture issued the Notice to Members (NTM) #2004-018 *TSX Venture Exchange Rule Amendments - Connection of Eligible Clients of Members* describing the one-time approval process for TSX-approved members and POs that also wanted to provide DMA through TSX Venture. Such a member or PO was deemed TSX Venture-approved when the member or PO filed:

- a compliance letter setting out a list of their TSX Venture DMA clients, and
- a written confirmation that any executed system interconnect agreement that permitted access under TSX's DMA rules extended to TSX Venture's DMA rules.

TSX Venture's members and POs had to submit both items by June 18, 2004. At the time, there were seven TSX-approved members and POs.

Findings

BCSC staff reviewed the confirmation and compliance letters for all seven members and POs to ensure confirmation and compliance letters were on file for each DMA provider and the letters were received by the deadline.

Each member and PO provided the required written confirmation and DMA client list. However, four of the seven letters were received after the June 18, 2004 deadline. Three members/POs were late by 3-4 business days. One member was late by 13 business days.

TSX Venture informed BCSC staff that the undertaking was greater than originally anticipated and that the delay was unavoidable. Its account managers monitored the process closely.

BCSC staff acknowledge the extent of the undertaking and consider that TSX Venture has adequately completed the one-time approval process according to NTM #2004-018.

Staff's recommendations

No action is necessary.

(ii) New DMA provider applications

Information from TSX Venture

TSX Venture has a two-part approval process. For system connectivity, the member or PO discusses its proposed connection with the Manager of Market Services, TSX Markets. The Manager reviews a schematic that outlines the proposed connection and shows the order flow to the Exchange. The Manager also uses a checklist to ensure that the member or PO will comply with Rule C.2.52(2) *System Requirements*. This connectivity review is only conducted when the member or PO initially applies as a DMA sponsor. Further, TSX Venture must complete the STAMP certification and approval process for members or POs that do not have pre-existing Exchange approved connections.

In the second part of the approval process, Legal Counsel of Market Policy & Structure at the Office of the General Counsel reviews the draft system interconnect agreement, an agreement between a member or PO and a DMA client, to ensure all requisite terms outlined in Rule C.2.52(3) *Standard Form of Agreement* are included in the agreement. This is followed by an email or letter confirmation of acceptance to the member or PO. The interconnect agreement is reviewed and approved when the member or PO first connects, and when the member or PO amends their standard agreement.

Further, under Rule C.2.52(4)(b), TSX Venture must review the member's or PO's proposed training materials for eligible clients prior to their use.

After the approval process, the member or PO sends a request to the Manager of Market Services for gateway access to trade on TSX Venture. Trading Services sets up the access; assigns the trader ID(s) for the DMA account(s); and communicates the processed request to the member or PO, the Manager of Market Services, and Legal Counsel of Market Policy & Structure. TSX Markets then updates its record of DMA client trader IDs.

Findings

During the review period, there was only one newly approved DMA service provider and no rejected applications. BCSC staff reviewed the file to ensure compliance with established procedures; reasonableness of the decision, adequacy of the file documentation; and timeliness of the process.

The system connectivity review was inadequately documented. There was evidence of the completion of the STAMP certification process and the approval of the member's system connectivity; however, there was no evidence on file that the member's system satisfied the requirements of Rule C.2.52(2). As such, BCSC staff was unable to assess the reasonableness of the decision. Further, as there was no evidence on file of the member's request for system connectivity, BCSC staff were unable to determine the timeliness of this process.

BCSC staff found that the system interconnect agreement review and approval process was properly completed and adequately documented. The decision rendered was reasonable and timely.

DMA privileges were promptly enabled after the completion of the two-part approval process, two business days after receipt of the request. However, it was implemented without TSX Venture's review of the member's training materials. There was no evidence on file that training materials were submitted and reviewed as required by Rule C.2.52(4)(b).

BCSC staff is concerned that TSX Venture did not review the training materials for adequacy. Properly trained and knowledgeable DMA clients are critical to maintaining the integrity of the marketplace.

Staff's recommendations

TSX Venture should formalize the procedures and responsibilities, and use checklists or other similar tools.

Priority: Medium

TSX Venture should document and retain on file all work performed to support the decision to approve, reject, or impose conditions on access.

Priority: Medium

TSX Venture should record the date of the member's or PO's request for system connectivity so that it can effectively monitor this process.

Priority: Low

(e) Assignment and termination of unique client trader IDs and access privileges

Information from TSX Venture

TSX Venture's unique trader ID system was implemented on March 5, 2005. TSX Venture requested that the seven members and POs that provided direct access on the TSX Venture submit all of their executed system interconnect agreements for review by January 14, 2006. TSX Venture assigned unique trader ID(s) to each DMA client that it considered had a properly executed and compliant system interconnect agreement in place. TSX Venture asked its members and POs to

terminate the DMA for clients with system interconnect agreements that it considered unacceptable.

TSX Venture relied on its members and POs to ensure the DMA client continued to meet its eligibility requirements and was adequately trained on the system and all pertinent rules. Further, the members and POs were responsible for disabling the old trader ID system on their system and informing TSX Venture so that the Exchange could disable the corresponding access privileges and trader IDs. If the member or PO neglected to disable the old trader ID system, DMA clients could have DMA without being on the unique trader ID system.

For new DMA clients, the members or POs must directly request access from TSX Venture. The access privileges must be set up on the member's or PO's (or vendor's) system as well as on the Exchange's system. TSX Venture assigns one or multiple unique trader IDs to the new client. The member or PO is responsible for ensuring that a properly executed and compliant system interconnect agreement is in place; and the client meets and continues to meet the eligibility requirements of the Exchange, and is properly trained and will be updated on the system and all pertinent rules.

To terminate direct access for an existing DMA client, the member, PO, or vendor must disable the access privileges on their system and inform TSX Venture to do the same. Otherwise, the trader ID and the corresponding access privileges may remain enabled on the trading engine and the member or PO may reassign the ID and the associated access privileges to another DMA client without the Exchange's knowledge.

Findings

BCSC staff acknowledge the importance of tracking the order entry and trading activities of DMA accounts. Having a unique client trader ID system helps to achieve this objective. However, TSX Venture relies heavily on its members and POs to communicate completely, accurately, and promptly all changes to their DMA client roster. TSX Venture relies on its members and POs to enforce certain DMA requirements, such as client eligibility requirements and training, to properly implement the new DMA client trader ID system, and to disable the old IDs and access privileges. Its reliance may jeopardize the effectiveness of the DMA client trader ID system and its control over access to trading by DMA clients.

Staff's recommendations

BCSC staff recommend that TSX Venture prepares a plan to ensure its members and POs are disclosing their DMA clients accurately, completely, and promptly to the Exchange.

Priority: High-Medium

(f) Monitoring and detection of non-compliance by DMA clients

(i) DMA client listing provided to RS for market surveillance and enforcement

Information from TSX Venture

TSX Venture manually maintains a DMA client list categorized by member and PO. The list includes DMA clients with DMA privileges on the TSX Venture and/or the TSX. The member or PO initiates the process by sending a request for DMA privileges for an eligible client. TSX Venture confirms that the member or PO has been approved for sponsored DMA before providing the client with access privileges and a trader ID on the trading system. Authorized staff record the relevant information on the list. There is a similar process for requests to terminate DMA privileges.

TSX Venture informed BCSC staff that it sends updated lists to RS promptly after each change. TSX Venture also has established annual verification procedures to ensure the accuracy and completeness of this list by confirming against DMA client lists provided by its members and POs.

Findings

BCSC staff compared the October 31, 2005 DMA client list provided to RS (RS list) against the current trader IDs enabled on the trading system for all eight of TSX Venture's DMA providers. They examined the RS list for completeness, accuracy, and timely update and distribution.

BCSC staff found that TSX Venture's controls over completeness and accuracy of the list were inadequate because:

- the RS list was incomplete, as five of the DMA client trader IDs were missing from the RS list and, for two DMA client trader IDs, the name of the DMA client was not disclosed. (The name of the DMA client is important for effective market surveillance, as under the current ID assignment system, a DMA client may have more than one trader ID with one or more members and/or POs.)
- the RS list was inaccurate as it included two trader IDs that were not for a DMA client.

Further, the controls over timely update of the RS list were inadequate because:

- one DMA client trader ID was no longer used by a member but the ID was still enabled on the trading system.
- on one occasion, RS informed TSX Market Services that its list was outdated as it was missing the DMA client listing for a DMA provider.

Finally, BCSC staff was unable to test the controls over timely distribution of the list and updates to RS, as TSX Venture was only able to provide one

example of this distribution process. TSX Venture did not retain faxed copies of RS lists.

Adequate controls over the accuracy, completeness, and timely update and distribution of the RS list are critical to ensure that RS has the information necessary to regulate the market activities of DMA clients efficiently and effectively.

Staff's recommendations

BCSC staff recommend that TSX Venture examines its DMA client trader ID tracking and verification process for alternatives or enhancements that will improve TSX Venture's control over the accuracy, completeness, and timely update of the RS list.

Priority: High-Medium

Further, TSX Venture should retain evidence to demonstrate that it has promptly sent the DMA client list and updates to RS.

Priority: Medium

(ii) Annual verification of DMA client trader ID listing

Information from TSX Venture

TSX Venture informed BCSC staff that every year, it would require each of its members and POs to submit an updated list of DMA clients. TSX Venture verifies the accuracy and completeness of its records against these lists. Once completed, TSX Venture sends the verified list to RS for market surveillance and enforcement purposes. TSX Venture will conduct its first annual review in 2006.

Findings

BCSC staff did not examine the adequacy of the annual verification process, as the first annual verification would be completed outside BCSC's review period.

Staff's recommendations

No action is necessary. BCSC staff will assess the adequacy of the annual verification process in the next oversight review.

(iii) Annual review of system interconnect agreements

Information from TSX Venture

TSX Venture informed BCSC staff that it requires each of its members and POs to submit their system interconnect agreement to the Legal Counsel of Market Policy & Structure. The Legal Counsel reviews the agreement against the requirements under Rule C.2.52(3) *Standard Form of Agreement* for compliance. The first round review of interconnect agreements will commence in 2006.

Findings

BCSC staff did not examine the adequacy of the annual review of system interconnect agreements as the first review would be completed outside BCSC's review period.

Staff's recommendations

No action is necessary. BCSC staff will assess the adequacy of the annual review of system interconnect agreements in the next oversight review.

(iv) Biennial system connectivity review

Information from TSX Venture

TSX Venture informed BCSC staff that it would subject all of its members and POs sponsoring DMA to a system connectivity review at least once every two years. The review ensures the member's or PO's system continues to comply with the requirements of Rule C.2.52(2) *System Requirements* and (4) *Additional Requirements*.

Findings

During the review period, TSX Venture completed four biennial system connectivity reviews. BCSC staff examined all four files to ensure the review covered the applicable Exchange requirements, was conducted by qualified individuals, and was adequately documented; and the deficiencies were properly identified and resolved in a timely manner.

BCSC staff found the reviews covered all the applicable Exchange requirements. Qualified staff conducted the reviews. All four files had evidence of the work performed, the supporting materials reviewed, and any action items for the member or PO. However, BCSC staff found in two of the four files, it was unclear how a member's response satisfied one of the Exchange requirements under review. Further, in the only file with an identified deficiency, BCSC staff could not find any evidence on file of the follow-up performed to ensure the member had addressed the deficiency properly and in a timely manner.

Staff's recommendations

BCSC staff recommend that TSX Venture ensures that its files clearly and consistently evidence how a member's response does or does not satisfy each Exchange requirement reviewed. Further, for the deficiencies identified, the file should evidence the resolution process, which includes the Exchange's acceptance of the member's proposed action plan, the actions taken by the member to resolve the deficiency, and the Exchange's conclusion on whether the deficiency has been satisfactorily addressed.

Priority: Low

(v) Coordination with RS

Information from TSX Venture

The investigation and enforcement of potential breaches of DMA rules is a coordinated process between TSX Venture and RS. When RS suspects any breaches of DMA rules, it advises and consults with TSX Venture. RS commences its investigation on the matter upon receipt of TSX Venture's approval. At the conclusion of its investigation, RS reports its findings to TSX Venture. TSX Venture then determines whether RS should begin enforcement actions on the matter. If RS disagrees with this decision, TSX Venture and RS can jointly approach the BCSC for resolution of the disagreement.

During the review period, TSX Venture informed BCSC staff that there was only one investigation of a potential breach of DMA rules.

Findings

BCSC staff reviewed TSX Venture records of the case to assess the effectiveness and efficiency of its interaction with RS, and the appropriateness of the resolution. The time from case inception to the issue of RS's report of its findings was reasonable at approximately 12.7 weeks (3 months). However, it then took approximately 15 weeks for TSX Venture to communicate their decision of no further action to RS. The delay was caused by a miscommunication between RS and TSX Venture. TSX Venture informed BCSC staff that it made its actual decision shortly after receipt of RS's report.

Further, TSX Venture's case records were incomplete, as the case resolution and the proposed follow-up action were not documented in the file. In addition, TSX Venture should have documented the follow-up action actually performed.

BCSC staff also found TSX-V's resolution of the case inadequate. It appropriately dealt with the DMA client but did not address the member's misapplication of the eligible client rules, and the possibility that the member may have other DMA clients that do not qualify as eligible clients.

Staff's recommendations

BCSC staff recommend that TSX Venture clearly communicates its decision to RS regardless of whether any further action is required from them. Further, BCSC staff recommend that TSX Venture retains complete records of the case resolution and any follow-up action proposed and performed.

BCSC staff also recommend that TSX Venture ensures that the resolution adequately addresses all key findings of the investigation.

Priority: High-Medium

Clearing and Settlement

1. Introduction

CDS clears and settles all trades executed on TSX Venture. The TSX Venture system creates daily batch reports on orders and trade activity following the end of the day processing, and electronically transmits them to CDS. This CDS interface is highly technical and there is very little interaction and coordination with CDS except on an automated basis.

Member firm brokerage account systems transmit their records to CDS for automatic reconciliation with CDS's trade receipts from TSX Venture. If both sides of a particular trade wish to cancel or change trade particulars, CDS must obtain approval from TSX Markets.

Settlement of trades is usually trade date plus three days (T+3) and is handled exclusively by CDS and its system. All of TSX Venture's member firms and POs must be participants of CDS. Settlement is not enforced by CDS unless the buyer demands delivery on or after T+3. If the seller does not deliver within the required period, CDS looks to TSX Markets to execute a cash trade (overnight delivery) for the buyer and will cancel the original trade. Additional costs are charged to the seller who failed to deliver. This is known as a buy-in. It is the only non-automated process in the coordination of TSX Venture and CDS.

Buy-ins can result from a failed trade, failed settlement of a loan of securities, or failed delivery of securities from a reorganization of the issuer, an allocation of securities, or other similar obligations.

2. Purpose and scope

BCSC staff examined TSX Venture's role in the buy-in process. The other aspects of clearing and settlement are automated or are functions of CDS. These are under the oversight of the Ontario Securities Commission (OSC).

The purpose of this part of the oversight review was to verify:

- TSX Venture has rules that require its members and POs to have appropriate clearing and settlement arrangements in place (term 40 of the recognition order).
- compliance with the buy-in procedures and the requirements of TSX Venture's Policy Statement CR15 *Buy-In Procedures*.
- timeliness of the buy-in process.

BCSC staff corresponded with management and staff of TSX Group's Office of the General Counsel and TSX Markets to gain an understanding of the buy-in process at TSX Venture. Further, BCSC staff reviewed materials related to the TSX system interface with CDS, the *Buy-In Procedures Manual*, the *TSX Venture Exchange Rule Book*, trade data from March 1 to September 30, 2005 and for January 3 and 4, 2006, and buy-in records.

3. Clearing and settlement arrangements

Information from TSX Venture

TSX Venture Rule C.3.02 *Trades to be Cleared* and Rule C.3.03 *Trades to be Settled Through Clearing Corporation*, require members and POs to clear and settle their trades through the clearing corporation established by the Exchange. Rule A.1.01 *Definitions* identifies the clearing corporation as CDS.

Findings

Term 40 of the recognition order requires that TSX Venture have rules that require its members and POs to have appropriate arrangements in place for clearing and settlement. TSX Venture's rules adequately address this term.

Staff's recommendations

No action is necessary.

4. Buy-in process

(a) Written procedures and requirements for the buy-in process

Information from TSX Venture

TSX Venture provided BCSC staff with a copy of its *Buy-In Procedures Manual*, which documented its internal procedures.

Findings

BCSC staff reviewed TSX Venture's Policy Statement CR15 *Buy-In Procedures* found in the *TSX Venture Exchange Rule Book* and its internal *Buy-In Procedures Manual* to ensure the procedures were current and adequate. BCSC staff found the procedures comprehensive but outdated in two areas. The procedures manual still referred to an obsolete TSX buy-in form and the requirement for the member or PO to send the form to the Exchange. According to TSX Venture, members and POs must send all buy-in forms to CDS.

Further, the procedures manual and Policy Statement CR15 both indicated that TSX Venture required written cancellation of the buy-in notice. However, TSX Venture informed BCSC staff that only telephone requests were accepted.

Staff's Recommendations

BCSC staff recommend that TSX Venture keeps its internal and external written buy-in procedures and requirements current.

Priority: Low

(b) Timeliness and compliance with established procedures

Information from TSX Venture

TSX Venture provided BCSC staff with the trade data from March 1 to September 30, 2005, and from January 3 to 4, 2006.

Findings

From the TSX Venture trade data, BCSC staff randomly selected seven trade days that had buy-in transactions. Further, BCSC staff selected two recent trade days. They reviewed the resulting sample of buy-in transactions for timely receipt and posting of the buy-in lists, proper calculation of the buy-in price, proper allocation of the stocks between supplying brokers, and timely execution of the buy-in transactions on the trading engine.

(i) Buy-in price calculation:

The buy-in price calculation can be highly judgmental and prone to human error. As such, BCSC staff tested the executed buy-in prices for compliance with the guidelines in TSX-V Policy Statement CR15 *Buy-In Procedures*.

During the nine days selected, 33 stocks went through the buy-in process. BCSC staff found that 31 out of 33 of the buy-in prices were calculated in compliance with established procedures and Policy Statement CR15's price guidelines. The two exceptions were due to human error and the difference was immaterial. Further, BCSC staff considers a 6% error rate as acceptable for a manual process.

(ii) Buy-in process:

BCSC staff selected two recent trade dates, January 3 and 4, 2006. For each day, BCSC staff requested correspondence and documents showing TSX Venture's communications with CDS, and its buy-in procedures. BCSC staff reviewed for timely receipt and posting of the preliminary and final buy-in lists from CDS; proper cut-off of the buy-in orders; completeness of the buy-in orders included for execution; proper allocation of shares among members and POs (in accordance with established procedures); and timely and accurate execution of the buy-in transactions.

BCSC staff noted that on both trade days, the final buy-in list was received in a timely manner and posted prior to the deadline, the 3 p.m. cut-off was observed for buy-in orders, and all buy-in orders that met the cut-off time were included for execution. However, on one occasion, CDS caused the late posting of the preliminary buy-in list. The delay resulted in an insignificant 8-minute late posting of the list.

Over the course of the two recent trade dates, there was timely and accurate execution of the buy-ins.

BCSC staff found the buy-in process adequate and timely.

Staff's recommendations

No action is necessary.

Systems

1. Introduction

TSX Venture's system includes components that support order entry, order routing, order execution, data feeds, trade reporting and trade comparison, and capacity and integrity requirements.

The TSX and TSX Venture trading systems both operate as automated continuous auction markets where buy and sell orders in listed securities are queued and matched in price-time priority sequence. Approved traders of TSX Venture members and POs enter orders via trader PC workstations located at their brokerage firms.

On December 10, 2001, the TSX Venture trading system migrated to the TSX trading platform but operated independently from the TSX trading system. Users access the system through the Access Front End (AFE), and Message Routing and Delivery System (MRDS), which uses the STAMP to communicate with the trade workstations at the members and POs.

2. Purpose and scope

The purpose of this part of the oversight review was to verify timely notification to the Commission of all material system failures and system changes associated with TSX Venture as required by term 33(c) of the recognition order and NI 21-101 (12.1)(c) *System Requirements*.

The OSC is the lead regulator that oversees the TSX and its systems. As TSX Venture uses the systems operated by the TSX, BCSC staff did not examine TSX Venture's system security, capacity, or sustainability.

BCSC staff corresponded with TSX Group's Director of Corporate Certification and Audit and OSC's Technology Advisor of Market Regulation to obtain background materials, and to gain an understanding of processes for maintaining security, capacity, and sustainability of TSX Venture's systems and the reporting process for material system failures and changes. BCSC staff reviewed the *Automation Review Program (ARP)*, the *ARP Implementation at TSX*, the *Service Recovery Process, Independent System Review* (dated October 2004), and the quarterly *System Reporting Procedure* reports (for the review period).

3. Notification to the Commission of material system failures and changes

Information from TSX Venture

TSX Group informed BCSC staff that the *ARP*, the *ARP Implementation at TSX*, and its *Service Recovery Process* documented the procedures for reporting material TSX Venture system failures and changes to the Commission.

Findings

According to written procedures, TSX Group reports material system failures and changes related to TSX Venture and TSX directly to the OSC. TSX Group reports material system outages, delays, and slowdowns through the exception reporting process, which requires the initial notification to the OSC within one hour of the material incident. Further, TSX Group reports these events to the OSC through the periodic reporting process every quarter. TSX Group confirmed that it did not have any reporting procedures for the BCSC or ASC, and that the periodic reports were available to the BCSC and ASC upon request.

For material system changes, TSX Group reports to the OSC through the periodic reporting process every quarter. These quarterly reports include all planned material changes to production hardware, software, and connectivity systems for the next 12 months, and all material changes applied to these systems for the current reporting period. Again, there were no reporting procedures for the BCSC or ASC.

During the review period, TSX Group only reported material system failures and changes to the OSC. As such, TSX Venture did not comply with Term and Condition 33(c) of the recognition order, and NI 21-101(12.1)(c) *System Requirements*, which require prompt notification to BCSC and ASC of material system failures and changes.

Staff's recommendations

BCSC staff require to receive reports of material TSX Venture system outages, delays, slow downs, events, and changes, which are the same as or similar to those given to the OSC. BCSC staff do not expect TSX Group to isolate TSX Venture related items for reporting purposes. However, for simplicity, the BCSC and ASC will rely on the OSC's judgment on optional reports.

Priority: Medium

Outsourcing of Regulatory Services

1. Introduction

On March 1, 2002, RS began providing certain regulatory services to TSX Venture. RS's main function is to monitor, administer, investigate, and enforce UMIR. RS also provides several other services to TSX Venture according to Schedule A of its Regulation Services Agreement with TSX Venture. RS acts as agent of TSX Venture when it provides these services.

2. Purpose and scope

The purpose of this part of the oversight review was to verify:

- TSX Venture's annual assessment of RS's regulatory performance is adequate, timely, conducted by qualified people, properly reported to its Board and the Commission, and adequately followed-up. (term 11 of the recognition order)
- prior Commission approval of any other agreements to outsource regulatory functions other than those specified in the service agreement with RS. (term 10 of the recognition order)

BCSC staff corresponded with TSX Venture's Director of Compliance and Disclosure, and TSX Group's Director, Legal Counsel, Office of the General Counsel. BCSC staff reviewed the amended and restated *Regulation Services Agreement* with RS, and the 2004 *Report to the Boards of Directors of TSX Inc. and TSX Venture Exchange Inc. with respect to Market Regulation Services Inc* and related action plans or follow-up materials.

3. Oversight of regulatory services provided by RS

Information from TSX Venture

TSX Venture informed BCSC staff that staff from the Office of the General Counsel conducted the 2004 performance assessment of RS. Staff interviewed Exchange staff who received or were otherwise knowledgeable about RS's services, to assess RS's regulatory performance and formulate recommendations for improvement. Staff also interviewed RS staff, and reviewed applicable RS documents and reports.

Both Exchanges' staff and senior management reviewed and commented on a draft report. Staff revised the report to reflect these comments and presented the revised report to the both Boards for review and comment. RS received a copy of the revised report for its information. The final report reflecting comments from the Boards was then issued to the Boards, RS, BCSC, ASC, and OSC. RS responded to the report's recommendations by proposing certain action plans. The Exchanges coordinated with RS to implement the action plans.

TSX Venture informed BCSC staff that there are no guidelines or procedures in place for this process. For evidence of the work performed, the Director, Legal Counsel, informed BCSC staff that he keeps copies of his interview notes and the documents reviewed in the course of preparing the RS report.

Findings

TSX Venture complied with term 11 of the recognition order by assessing RS's regulatory performance for 2004, and reporting the results and recommendations to the Board and the BCSC. However, this process is neither formalized nor adequately documented. During the oversight review, TSX Venture informed BCSC staff that it will start to formalize the process during the course of the 2006 performance assessment.

Staff's recommendations

BCSC staff recommends that TSX Venture formalizes and documents the process by which it monitors the ongoing performance of regulatory functions by RS. The process should include the assessment methodology, staff responsibilities, file documentation guidelines (on the nature and extent of evidence retained to support the assessment), reporting procedures, and tracking and follow-up procedures on any outstanding issues. BCSC staff will examine the adequacy of this process in the next oversight review.

Priority: Medium

4. Outsourcing of other regulatory functions

Information from TSX Venture

TSX Venture confirmed that as at November 3, 2005, only RS provided regulation services on its behalf.

Findings

TSX Venture complied with term 10 of the recognition order, as it did not outsource any regulatory functions other than those specified in the service agreement with RS.

Staff's recommendations

No action is necessary.