Summary of comments and responses
RS Inc. fee model

List of commentators

We received the following comment letters in response to the Request for Comments on the fee model of Market Regulation Services Inc. (RS Inc.) published on January 11, 2002 (BCN 2002/03).

1. BMO Nesbitt Burns Inc.

2. Jennings Capital Inc.

Summary of comments and responses
RS Inc. fee model

Reference	Commentators and Comments	ASC/BCSC Response
Question 1 - Is the fee model proposed by RS Inc. fair and reasonable? If not, please provide alternatives.	**BMO Nesbitt Burns Inc. (“BMO”)** -The proposed fee model is the TSE's traditional volume driven model. This diverges greatly from the market-by-market approach in the original proposal. The argument in support of the original proposal is more compelling and would result in a more equitable allocation of market regulation costs given participants areas of specialization. **Jennings Capital Inc. (“JC”) -** Dealers should not be subject to an annual fee; only a variable standard fee based on volumes.	We acknowledge that the methodology of charging on a volume (or user) basis as opposed to the market-by-market approach differs significantly from the original fee model that was published for comment. However, we do not necessarily agree that the argument in favour of a market-by-market methodology is more compelling. We are of the view that a methodology based on usage (i.e., higher volume users pay more) is a sound methodology on which to base the fee model. We have included a term and condition in the recognition order that requires RS Inc. to review its fee model within 12 months of the recognition date and periodically after that. We are of the view that the stated rationale for the fixed annual fee (i.e., that marketplace participants benefit from being associated with marketplaces that are well regulated and should bear at least a modest portion of the cost regardless of how much they trade) is reasonable.

Question 2 - Are the proposed costs for market regulation services for 2002 fair and reasonable? Are all of the elements mentioned above necessary? If not, please provide alternatives.	**BMO -**An application of the proposed variable standard fee to BMO Nesbitt Burns trading activity in 2001 results in an estimate that the cost of market regulation to this firm will increase by more than 50%. Further investigation is required to disclose RS Inc.'s assumptions respecting total trading volumes, to prepare comparative estimates for cost allocations under both proposals and to determine the historical market regulation costs for the TSE and the CDNX. Confirmation is requested that RS Inc. will rebate variable fees in the event that volumes exceed estimates and that trading activity data for each marketplace will be provided to participants. **JC -** An independent auditor should confirm that costs are direct with no profit	As a term of its recognition, RS Inc. is required to allocate its fees equitably among marketplaces and marketplace participants and to ensure that its fees are charged on a cost recovery basis. RS Inc. is also required to review its fee model within 12 months of recognition (i.e., by February 13, 2003). As part of this requirement, RS Inc. must investigate the costs of obtaining services from third parties comparable to those provided by the TSE and to track the time it spends providing the services to each marketplace that retains it. as a Regulation Services Provider. All services must be tracked so that the reasonableness of the fee model can be assessed. Further, RS Inc. is required to keep track of the time spent on additional services it provides to a marketplace to assess how the time correlates to the fees charged for those services to ensure that the marketplace is not being subsidized by fees paid by other marketplaces. We are comfortable with RS Inc.'s assumptions respecting the forecast of trading volumes. Although its estimates of trading volumes were conservative, RS Inc. will not have a contingency fund in 2002 in the event its expenses exceed its revenues. Consequently, we are of the view that a conservative trading volume forecast is prudent in the circumstances of a start up entity. We are of the view that it is not appropriate to require RS Inc. to rebate variable standard fees in the event that volumes exceed the estimates. This is because RS Inc. may believe it more prudent to use excess funds in other ways (e.g., to pay down debt). Staff does not wish to interfere with legitimate business decisions of RS Inc. with respect to allocation of excess revenues. In June/July 2001 the TSE retained an independent auditing firm to review its internal cost allocation methods. The report concluded that the allocation method, including the 15% mark up on the services provided by the TSE, was reasonable. Further, the TSE advises that it has not built in any contingency factor in the charges - the costs charged are the actual direct costs based on estimated 2002 expenses. If the TSE's costs end up

	direct with no profit component. Costs for TSE/CDNX members should be reduced.	being greater than estimated, the TSE advises that it cannot raise its fees to cover the deficiency. The TSE advises that the fees it will be charging to RS Inc., including the mark up, are lower than the fees that the TSE and CDNX charged to their participating organizations and members for the same services in 2001. In 2001 the cost was $11.1 million. In 2002 the cost is estimated to be $9.7 million, including the 15% mark up charged by the TSE.
Question 3 - Will these connection costs create barriers to entry for ATSs and other marketplace participants?	No comments received on this question.	n/a
Question 4 - Please comment on whether a mark up of 15% charged by the TSE to RS Inc. for services provide by the TSE to RS Inc. is appropriate. If not, please suggest an alternative means for RS Inc. to obtain these services.	**BMO** -There should not be a 15% mark up for services provided to RS Inc. by the TSE. Regulation should not be treated as a profit centre. Furthermore the reasonableness of the rates cannot be determined since the TSE is the sole provider of these services. **JC -** There should not be a 15% mark-up for services provided to RS Inc. by the TSE. Regulation should not	We have to weight the concern about the 15% mark up charged by the TSE against the conflicts associated with the TSE retaining its market regulation function and providing market regulation services to ATSs, its direct competitors. We also note that a number of the systems provided by the TSE are highly specialized, state of the art market surveillance tools that cannot be bought "off the shelf". We have imposed the following requirements: i) the TSE is required to track the costs attributed to the services it provides to RS Inc. and to clearly document the basis for the cost allocation. The TSE must report back by February 13, 2003; and ii) RS Inc. must investigate the costs of obtaining comparable services from third parties and track the time spent providing services to each marketplace that retains it. RS Inc. must report back by February 13, 2003.

	be treated as a profit centre.	