

**ALBERTA SECURITIES COMMISSION
NOTICE AND REQUEST FOR COMMENTS**

**APPLICATION FOR RECOGNITION OF MARKET REGULATION SERVICES INC.
REVISED FEE MODEL**

1. Introduction

Market Regulation Services Inc. (RS Inc.) has filed an application for recognition as a self-regulatory organization (SRO) in Alberta, British Columbia, Manitoba, Ontario and Québec (the “Application”). RS Inc. proposes to operate as a regulation services provider under the Alternative Trading System (ATS) rules (ATS Rules) and will administer and enforce market integrity rules for the marketplaces that retain its services. As part of its Application, RS Inc. has developed a fee model to pay for the cost of providing market regulation services.

The Application and additional related documents were initially published for comment on October 12, 2001 (the “October Notice”). (See ASC Notice dated October 12, 2001, which can be found at the Alberta Securities Commission public website at www.albertasecurities.com under “What’s New” - historical database for 2001) The comment period closed on November 9, 2001.

Subsequently, RS Inc. revised its fee model from a “market by market” approach to a “volume” approach for the reasons described below. Under the new model, RS Inc. would charge participants that use its regulation services based on their trading volumes. While an increase in the costs for market regulation to market participants was expected, the exact amount of the increase was unknown at the date of publication of the October Notice. RS Inc. has recently advised that the overall cost of market regulation for dealers and other market participants will increase as described below. As RS Inc.’s proposed fee model differs substantially from the fee model described in its Application published for comment and new information is now available, the Commission together with the British Columbia Securities Commission (BCSC) is requesting comment on the new fee model proposed by RS Inc.

2. Background

In 1999 the Canadian Securities Administrators (CSA) published the ATS proposal (ATS Proposal) that proposed that market regulation for a marketplace trading equities be done by an "approved agent" and indicated that all exchanges in Canada would be approved agents. Some commentators expressed concerns that requiring ATSS to have their markets regulated by exchanges with whom they compete would create conflicts of interest. Other commentators argued for consolidating market regulation in a single agency.

In July 2000, the CSA republished the ATS Proposal and, without taking a position on how market regulation should be performed for the equity market, invited the industry to propose alternatives for market regulation for the equity market. The request for comment invited industry participants to consider possible solutions. The CSA made it clear that it was willing to participate in discussions but was looking to the industry to propose alternatives for market regulation in the equity market. In response to the July 2000 request for comment, eight commentators argued in favour of either direct regulation by the CSA or regulation by an independent self-regulatory organization. The TSE and the Investment Dealers Association of Canada (IDA) proposed to create RS Inc. as a jointly-

owned, separate corporation that would apply to be recognized as a self-regulatory organization and would act as a regulation services provider under the ATS Rules. The CSA received no other proposals for market regulation for the equity market.

3. General Comments

We are seeking comment on all aspects of the proposed fee model. We also request specific comment on the questions identified below.

Under the ATS Rules, exchanges and quotation and trade reporting systems (QTRS) may monitor the conduct of their members and users directly or indirectly, through a regulation services provider, but ATSs must contract with a regulation services provider for this service. The Canadian exchanges are acceptable regulation services providers under the ATS Rules, but both The Toronto Stock Exchange Inc. (TSE) and the Canadian Venture Exchange Inc. (CDNX) have applied to their recognizing regulators for approval to retain RS Inc. as their regulation services provider. Assuming approval of the exchanges' applications, RS Inc. would be the only regulation services provider for the Canadian equity market.

In providing comments on the fee model for RS Inc., please keep in mind that there are currently no alternatives to RS Inc. to provide independent market regulation services to ATSs in the Canadian equity market. Without RS Inc., ATSs wishing to trade equity securities under the ATS Rules would have to contract with a Canadian exchange that is willing to act as a regulation services provider and that will be in competition with them.

4. Summary of Revised Fee Model of RS Inc.

RS Inc.'s fee model is premised upon RS Inc.'s operation as a not-for-profit corporation and is designed only to recover its costs of regulating the marketplaces it regulates. The fee model is formulated to achieve the following objectives:

- RS Inc. must be able to recover the total cost of regulation under varying market conditions,
- the fees must be neutral (ie., cost recovery only), must be allocated on an equitable basis among marketplaces and marketplace participants, and must not discriminate in favor of any type of trading business or marketplace or create barriers to entry,
- the fees must be easy to calculate and transparent to market participants and the public, and
- cross-subsidization of other markets must be minimized.

RS Inc.'s stated purpose for its fee model is to have one national regulation fee for all participants. Upon establishment of RS Inc., the TSE and CDNX will significantly reduce their current fees for market regulation. The proposed fees to be charged by RS Inc. consist of three components:

a) Application Fee

Each marketplace (exchange, ATS and QTRS) that wishes to contract with RS Inc. for the provision of regulation services will be charged a one-time application fee in the amount of \$25,000.

b) Annual Fee

A fixed annual fee of \$5,000 will be charged to each dealer, portfolio manager and institutional investor that trades directly in a marketplace. This fee is payable by such market participants only once annually even though the participant may be a user of more than one marketplace.

The rationale for the fixed annual fee is that marketplace participants benefit from being associated with marketplaces that are well regulated and should bear a portion of the costs regardless of how much they trade.

c) Variable Standard Fee

The fee model also provides for a variable standard fee based on the volume of shares traded by a marketplace in the amount of \$0.0002672 per share or 26.72 cents per 1,000 shares traded during the course of a specified period to be charged to market participants on each side of the trade (ie., so that it does not distinguish among markets).

The rationale for the variable standard fee is to ensure that marketplace participants bear a proportionate share of market regulation costs based on their trading volume as opposed to the types of securities they trade (ie., junior vs. senior issuers) and to distribute the costs of regulation equitably across the marketplaces regulated by RS Inc. RS Inc. has advised that this fee is based on a conservative volume forecast that may be adjusted periodically by RS Inc.

Question 1:	Is the fee model proposed by RS Inc. fair and reasonable? If not, please provide alternatives.
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5. Impact of RS Inc. Fee Model

In 2002, the overall cost of market regulation for TSE/CDNX members and participating organizations will increase by approximately \$3.0 million from \$16.9 million to \$20 million, or approximately 17.9%. Several aspects of RS Inc.'s structure and operations account for this cost increase:

- a) The establishment of RS Inc. as a separate independent corporation. The costs associated with incorporation were not included in the 2001 fees and now include costs for an independent board of directors, audit fees, insurance, translation, separate premises and financing charges. These amounts represent approximately 60% of the cost increase.
- b) Investment in information technology. Approximately 25% of the cost increase is as a result of further information technology investment necessary to maintain effective systems, new information technology initiatives will enable RS Inc. to continue to perform its surveillance and investigative role.
- c) Other Changes. RS Inc. has also made provision to facilitate the introduction of new marketplaces and extended trading hours. These changes, together with the costs of meeting regulatory requirements, represent approximately 15% of the cost increase.

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.
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6. Connection Fee

Although not part of RS Inc.'s fees, new marketplaces (ATs and QTRSs) will be required to reimburse RS Inc. for the costs of providing a connection to its systems. In the first year these connection costs for an individual ATs will not exceed \$91,700 and may be less, depending on the number of ATs that contract with RS Inc. for regulation services, as basic connection costs of approximately \$270,000 can be shared by up to six ATs.

An ATs may also have to incur additional costs to enable RS Inc. to provide regulation services to it depending on the compatibility of its existing systems with RS Inc. For example, the costs necessary to enable RS Inc. to receive trading information in STAMP format and to retain such data in a format consistent with the SelectR protocol. These additional costs will vary depending on an ATs's existing systems.

Question 3:	Will these connection costs create barriers to entry for ATs and other marketplace participants?
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7. Services Provided By the TSE

As identified in the October Notice, to facilitate RS Inc.'s immediate startup, the TSE proposes to provide certain corporate support and information technology services to RS Inc. and on an ongoing basis, unless replaced by another service provider. RS Inc. has agreed to pay the TSE the full cost of these services plus a mark up of 15%.

RS Inc. retained an independent consultant to review the TSE's pricing principles for these services. The consultant's report concluded that the TSE's pricing principles are reasonable until RS Inc. can identify comparable market rates for the services provided by the TSE. RS Inc. will be entitled to obtain these services from other service providers, if it so chooses.

In addition to these services, the TSE will provide RS Inc. with surveillance software and access to proprietary regulatory databases, which will enable RS Inc. to regulate all marketplaces to which it provides its services, for a nominal consideration and without any charge for the cost of their development.

The TSE advises that the fees that the TSE will be charging to RS Inc. for these services in 2002, including the mark up, are lower than the fees that the TSE and CDNX charged POs and members for the same services in 2001. In 2001, the cost was \$11.1 million. The cost will be \$9.7 million in 2002, including the mark up. Without the mark up, the overall increase in costs to the industry would be lower. The TSE's fees do not contain a built-in contingency and cannot be increased if the TSE's costs increase in 2002. The TSE's mark up represents 5% of the overall cost of market regulation for TSE and CDNX participating organizations and members.

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.
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8. Comment Process

The ASC requests comments in writing on or before January 25, 2002. Please address your comments as follows:

Alberta Securities Commission
British Columbia Securities Commission
c/o Glenda A. Campbell or Patricia M. Johnston
4th Floor, 300 Fifth Avenue, S.W.
Calgary, Alberta
T2P 3C4

We will be sharing your submission with the BCSC and will not be able to maintain its confidentiality.

January 11, 2002