1.1.3 Notice of Commission Order – Application to Vary the Recognition Order of Canadian Trading and Quotation System Inc.

**APPLICATION TO VARY
THE RECOGNITION ORDER OF
CANADIAN TRADING AND QUOTATION SYSTEM INC.**

NOTICE OF COMMISSION ORDER

On September 9, 2005, the Commission issued an order (Variation Order) pursuant to section 144 of the *Securities Act* (Ontario) varying the financial viability terms and conditions of the current order recognizing Canadian Trading and Quotation System Inc. (CNQ) as an exchange (Recognition Order). A copy of the Variation Order is published in Chapter 2 of this bulletin.

The Recognition Order contained terms and conditions that required CNQ to maintain certain financial viability ratios at specified levels. These ratios are based on those developed for mature entities. The Commission issued the Variation Order to amend these terms and conditions to require CNQ to provide monthly reporting, to better reflect the fact that it is in its start-up phase.

A. Financial Viability Terms and Conditions

The Commission has imposed terms and conditions of recognition on recognized market infrastructure entities (Recognized Entities) in relation to, among other things, their financial viability, which include the following:

(a) a general requirement to maintain sufficient financial resources for the proper performance of its functions;

(b) assessment of the entity's financial position, through maintaining prescribed financial ratios at specified levels; and

(c) submission of quarterly and year-end financial statements and financial ratio calculations.

The objective of financial viability requirements is to provide the Commission and its staff with an "early warning" process to identify when a Recognized Entity may be at a higher risk of failure. The Commission started imposing these terms and conditions on Recognized Entities in 2000. CNQ is the first Recognized Entity that is in the start-up phase. As more experience is gained in monitoring the financial viability of Recognized Entities and, in particular, monitoring of start-up operations, staff have found imposing similar terms and conditions on start-up entities as mature entities may not be appropriate, as the former generally are not in the same financial position as the latter. Staff have, therefore, revisited the approach in monitoring the financial viability of Recognized Entities in different phases of operations.

B. Start-Up vs. Mature Operations

Staff note that entities in start-up phase typically incur operating losses during their first few years of business. Their continued success generally depends on their ability to generate new business and the availability of cash to fund their operations. Start-ups generally fund their operations with cash initially injected by their founders, and through the issuance of securities or debt. Their operating results are not as predictable as those for a mature entity. This makes setting financial ratio thresholds difficult, and therefore, reduces the usefulness of financial ratios as early warning signals.

Staff are of the view that, in order to effectively assess the financial viability of a start-up, we need to understand and be informed of any changes in its operations in a timely manner. Staff believe that it is more effective to monitor a start-up's financial results on a more frequent basis, through the review of its interim and annual financial statements and any significant variance between its budgeted and actual results, and through discussions with management of any unexpected developments. Staff, therefore, propose that for the start-up period, a Recognized Entity would provide its monthly and quarterly financial statements and its analysis of any significant variance between its actual and budgeted financial results. Staff would review this information and make necessary inquiries to management of the Recognized Entity.

Once a Recognized Entity matures, financial ratios are useful early warning signals of its financial health. After its start-up phase, a Recognized Entity generally has more stable operating results, which enable the use of ratios for trend analysis. In addition, thresholds could also be meaningfully set because the entity's operating results are more predictable.

As a result, staff are of the view that Recognized Entities that are in the start-up phase will be subject to financial viability terms and conditions that require them to file monthly financial statements and variance analyses to allow staff to closely monitor their financial situation; Recognized Entities that have matured operations will be subject to financial viability terms and conditions that require maintenance of financial ratios at specified levels and less frequent submission of financial statements.

C. CNQ Variation

Since CNQ is still in its start-up phase of operations, staff have proposed that its financial viability should be monitored under the new approach for start-up phase entities. The Commission agrees with this new approach. It has, therefore, issued an order varying the Recognition Order of CNQ to amend the financial viability terms and conditions.