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Autorité des marchés financiers  
800 square Victoria, 22e étage,  
Tour de la Bourse, C.P. 246  
Montréal, Québec  
H4Z 1G3

Attention: Jacinthe Bouffard, Directrice de la supervision des OAR

Dear Ms. Bouffard:

**Re: Canadian Trading and Quotation System Inc.  
("CNQ") – Application for Authorization for  
Securities Trading Activities**

Canadian Trading and Quotation System Inc. hereby applies under section 169 of the *Securities Act* (Québec), L.R.Q. ch. V-1.1 for an order from the Autorité des marchés financiers ("AMF") authorizing CNQ to carry on securities trading activities in Québec. The Ontario Securities Commission would be CNQ's sole lead regulator in accordance with the *Memorandum of Understanding about the Oversight of Exchanges and Quotation and Trade Reporting Systems* entered into by the AMF's predecessor, the Commission des valeurs mobilières du Québec and other Canadian securities commissions.

***Background and Overview***

CNQ was recognized as a quotation and trade reporting service by the OSC on February 28, 2003. It is the first new marketplace to be recognized since the implementation of National Instrument 21-101 – Marketplace Operation. On May 7, 2004, the OSC recognized CNQ as a stock exchange. A copy of the recognition order and subsequent amendments are attached as Exhibit "L." CNQ is exempted from recognition as a stock exchange by the Alberta Securities Commission and the British Columbia Securities Commission.

CNQ's head office is in Toronto, and we have an office in Vancouver.

## ***The CNQ Market Structure***

Like the other Canadian exchanges, CNQ operates an electronic, automated marketplace for participating investment dealers to trade equity securities of qualified reporting issuers. Investment dealers (“Dealers”), who must be Canadian registrants and members in good standing of the Investment Dealers Association of Canada, agree with CNQ to be bound by CNQ’s rules (including the Universal Market Integrity Rules) and be subject to CNQ’s enforcement and discipline jurisdiction. CNQ has contracted with Market Regulation Services Inc. (“RS”) to provide market regulation services to CNQ’s marketplace, including market surveillance, timely disclosure policy administration, trade desk compliance and investigations and enforcement.

### *Listed Marketplace*

CNQ’s listed market is a marketplace primarily for small-capitalization companies. Although it has multiple market makers, it is a central order book auction market, not a dealer market.

Issuers (“Listed Companies”) that are reporting issuers in good standing in a Canadian jurisdiction and that meet CNQ’s minimum standards for listing can apply to CNQ to list their securities. If they are not already, Listed Companies become Ontario reporting issuers upon listing. As described below, CNQ Listed Companies prepare and post an enhanced disclosure record on CNQ’s website [www.cnq.ca](http://www.cnq.ca) (the “Website”) and agree to follow CNQ’s policies and submit to CNQ’s jurisdiction to suspend or delist their securities. Investors are able to directly access a CNQ Listed Company’s trading data and disclosure record on the Website.

### *Alternative Market*

CNQ has received the approval of the Ontario Securities Commission to trade securities of issuers listed on other Canadian exchanges, without listing them on CNQ, to provide a competitive alternative to the only Canadian exchange trading venues. Securities would be eligible to trade if they were not suspended or delisted by the exchange on which they are listed.

The concept of “unlisted trading privileges” is unknown in Canada, but it is well-established in the United States. For decades, regional exchanges have traded NYSE-listed securities on an unlisted basis and competed for order flow. More recently, this has been extended to Nasdaq-listed securities. Today, even the NYSE trades some Nasdaq-listed securities and Amex-listed Exchange Traded Funds on an unlisted basis.

National Instruments 21-101 Marketplace Operation and 23-101 Trading Rules (collectively, the “ATS Rules”) create a framework for competitive trading of listed securities on Alternative Trading Systems. The Alternative Market furthers the goals of the ATS rules by fostering competition without compromising market integrity.

Trading on the Alternative Market will be subject to the Universal Market Integrity Rules and will be overseen by Market Regulation Services Inc. (“RS”).

In order to alleviate possible investor confusion with the CNQ listed market, we will establish the Alternative Market as a separate and distinct trading list with a distinct name, Pure Trading, similar to what the TSX Venture Exchange did with its NEX market. Trading information for the Pure Trading market will appear on its own website ([www.puretrading.ca](http://www.puretrading.ca)), which is distinct from the website for the listed market ([www.cnq.ca](http://www.cnq.ca)).

### ***Business Components***

#### *Listed Market*

There are two fundamental components of the CNQ listed market: the Trading System and the Enhanced Disclosure model of regulation.

#### **1) The Trading System.**

The Trading System (the “System”) is a screenbased, automated electronic marketplace. The System provides Dealers order display, including price and volume, recent trade history and other market information. The System is open for trading during regular Canadian trading hours on all business days. Dealers are able to access the System on a secure basis and are able to configure the display of the System to their individual preferences.

The System is a fully automated electronic marketplace. Dealers with access are able to enter into the System orders to buy or sell securities. Orders are queued in the marketplace according to priority rules (price and time). When a match is made a trade occurs and is confirmed to the respective Dealers and to the Canadian Depository for Securities Limited (“CDS”) clearinghouse for settlement.

CNQ grants limited exclusive order entry privileges to dealers willing to become market makers in an Listed Company’s stock. In consideration for providing continuous quotations (that is both an order to buy and an order to sell) of minimum size, often as principal, CNQ, on a stock-by-stock basis, restricts order entry by non-market makers. A non-market maker not enter (i) a tradeable order that would trade through more than one price level or (ii) a non-tradeable order that would improve the bid or offer. These orders must be given to a market maker who is obligated to execute or expose client orders according to the order handling rules. In listed issues without market makers any CNQ Dealer may enter orders into the order book which then functions as a pure auction market.

#### **2) Enhanced Listed Company Disclosure and Market Data**

CNQ’s Website provides investors a central resource to obtain information about Listed Companies, the CNQ marketplace and CNQ. Enhanced disclosure of Listed Company information on [www.cnq.ca](http://www.cnq.ca) enables investors to make better-informed investment decisions.

In order to enhance the disclosure by Listed Companies and provide investors with more meaningful and timely information CNQ requires Listed Companies to prepare and post on the Website a prospectus-like base disclosure document

(the "Listing Statement"), quarterly and monthly updates and reports, press releases and notices of transactions (similar to the documentation provided confidentially to the other exchanges by exchange listed issuers). Listed Companies post the required (and other permitted) disclosure documentation ("Listed Company Information") on a password protected, secure basis to the Website. This is discussed more fully under "Listed Company Regulation" below.

The Website displays both the Listed Company Information and market data from the System. Investors can access timely and meaningful disclosure concerning Listed Companies, trading information and market data at the CNQ Website.

#### *Pure Trading Market*

The Pure Trading market will be functionally similar to the listed market with several differences. These include:

- Stocks will not have market makers; all dealers will have unrestricted order entry capability;
- Crossing will be permitted on the posted bid and offer;
- Eligible clients will be able to access the market through a dealer just as they can access the TSX; and
- It is anticipated that continuous trading will begin prior to the TSX opening and end after the TSX close.

The Pure Trading website will contain market data, but will not contain information about issuers traded other than a list of which issuers are traded.

### ***Corporate Governance***

CNQ was incorporated under the *Business Corporations Act* (Ontario) ("OBCA") on November 24, 2000. CNQ's articles of incorporation under the OBCA and subsequent amendments are included in Exhibit "A" of our current Form 21-101F1 (the "Form") previously filed with the Autorité. Its corporate by-laws and amended and restated unanimous shareholders agreement ("USA") are also included in the Exhibit.

#### *Ownership*

CNQ is a private issuer. A list of all holders of more than 5% of the common or Class A shares is contained in Exhibit "E" of the Form.

#### *Independent Directors*

CNQ believes that arrangements with respect to the appointment, removal from office and functions of the persons ultimately responsible for making or enforcing the rules of CNQ, namely, the governing body, are such as to ensure a proper balance between the interests of the different entities desiring access to the facilities of CNQ and companies seeking listing on CNQ.

The constating documents of CNQ provide that its Board will have a minimum of 5 and a maximum of 13 directors. In order to ensure a diversity of representation on the Board, the recognition order provides that at least 50% of

the Board shall be independent directors. An "independent" director is one is not an associate or nor a partner, director, officer, employee or shareholder of a CNQ Dealer, an officer or employee of CNQ or an affiliate, a person owning or exercising control over 10% or more of the outstanding voting securities of CNQ (a "significant shareholder") or any affiliate or associate of any such person.

Accordingly, CNQ's independent directors are individuals who are not connected with its significant shareholders or marketplace participants.

#### *Corporate Governance Committee*

CNQ's Corporate Governance Committee is responsible for assisting the Board of Directors in fulfilling their various responsibilities to CNQ including:

- developing CNQ's approach to corporate governance issues and compliance with applicable laws, regulations, rules, policies and orders with respect to such issues;
- assessing the effectiveness of the Board as a whole, its committees, and that of individual members;
- proposing nominees to the Board;
- recommending resignation or removal of directors and officers;
- approving CNQ's code of ethics and conflict of interest policies; and
- orienting new directors.

#### *Shareholder Vote to Confirm Directors*

Under the OBCA and CNQ's by-laws, CNQ's shareholders elect the directors by a simple majority, provided that if a vacancy occurs on the Board and a quorum of directors remains in office, the directors may appoint a qualified person to hold office for the unexpired term of his or her predecessor. If a vacancy results in CNQ having a greater number of independent directors than non-independent directors (or vice-versa), the Board must take steps to remedy the situation as quickly as possible.

#### *Audit Committee*

The Audit Committee assists the Board in fulfilling its oversight responsibilities including

- reviewing quarterly and annual financial statements
- reviewing CNQ's accounting policies
- reviewing the performance of the external auditor; and
- monitoring CNQ's financial condition.

Directors who are employees or officers (other than a non-executive Chair of the Board of Directors) are not eligible to sit on this Committee.

#### *Regulatory Advisory Committee*

The Regulatory Advisory Committee assists the Board of Directors in fulfilling their various responsibilities to CNQ including:

- reviewing and approving proposed amendments to rules and policies with a view to determining whether such amendments are in the public interest;
- reviewing CNQ's employee trading policy and making appropriate recommendations to the Board; and
- monitoring CNQ's relationships with its regulator(s) and regulation services provider.

#### *Human Resources and Compensation Committee*

The Human Resources and Compensation Committee assists the Board of Directors in fulfilling their various responsibilities to CNQ including:

- reviewing, approving and if appropriate, recommending to the Board of Directors the compensation of the Chief Executive Officer, the President and other members of the senior management team;
- administering CNQ's compensation and benefit plans for employees and the Board, including the stock option plan and other compensation plans or structures that may be adopted by CNQ from time-to-time;
- recommending to the Board amendments to CNQ's compensation and benefit plans for employees and the Board, including the stock option plan and other compensation plans or structures that may be adopted by CNQ from time-to-time; and
- reviewing CNQ's policies of general application to employees other than CNQ's Employee Trading Policy, which shall be reviewed by the Regulation Committee of the Board and CNQ's Code of Ethics and Conflict of Interest policies, which shall be reviewed by the Corporate Governance Committee.

#### *Fitness*

CNQ will ensure that each significant shareholder, officer and director is a fit and proper person whose past conduct affords reasonable grounds for belief that the business of CNQ will be conducted with integrity and in the public interest.

#### ***Fees***

Any and all fees imposed by CNQ are equitably allocated. They do not have the effect of creating barriers to access and are balanced with the criteria that CNQ have sufficient revenues to satisfy its self-regulatory responsibilities.

CNQ's process for setting fees is fair, appropriate and transparent.

CNQ's current fee schedule is set out in Exhibits M and N of the Form.

Trades on CNQ are subject to the regulation fees set by RS in addition to CNQ fees.

#### ***Access***

A dealer is eligible to become a CNQ Dealer if it is a Canadian registrant and a member in good standing of the Investment Dealers Association of Canada. CNQ may refuse to accept an applicant, or accept an applicant subject to terms and

conditions if it believes that the dealer will not comply with CNQ Requirements, is not qualified by reason of integrity, solvency, training or experience, or it is otherwise not in the public interest to accept such dealer.

Any dealer who is refused acceptance, or granted acceptance on terms and conditions will be provided with the reasons for the decision and has a right of appeal to the CNQ Board and then to the OSC.

Once accepted, a CNQ Dealer must comply with all CNQ Requirements.

### ***Dealer Regulation***

CNQ has retained RS as a regulation services provider to provide, as agent for CNQ, regulation services approved by the OSC. A copy of the agreement with RS is contained in Exhibit "Q" of the Form. CNQ annually assesses the performance by RS Inc. of its regulation functions and report to the Board, together with any recommendations for improvement.

The IDA has agreed to monitor and enforce compliance with the CNQ mark-up and sales practice rules. CNQ is proposing to repeal these rules as they are duplicative of IDA rules.

CNQ performs all other regulation functions not performed by RS or the IDA, such as assessing market maker performance in the listed market.

### ***Issuer Regulation***

#### *Listed Market*

CNQ is primarily a market for small-cap companies; it has entry-level listing standards (minimum working capital, active business, minimum public distribution and integrity of principals) that allow the refusal of companies whose financial condition, capital structure or insiders give rise to market integrity concerns. CNQ Listed Companies are also subject to ongoing enhanced disclosure requirements detailed below.

#### **Enhanced Disclosure Model of Regulation**

CNQ's regulatory model is different, but we submit no less effective, than the other exchanges'. Rather than review transactions by listed companies, CNQ requires enhanced disclosure and certification from Listed Companies. CNQ does have rules governing transactions and the Listed Company is required to ensure it complies with the rules. There is no CNQ pre-clearance of transactions required with the exception of fundamental changes (reverse take-overs),<sup>1</sup> although, as noted below, CNQ does after-the-fact reviews to ensure compliance.

The enhanced disclosure requirements minimize the abuses that have been seen with small-cap companies in the past. CNQ Listed Companies are required to publicly disclose information over and above that mandated by applicable securities law or other exchanges, and must post and update that information on

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<sup>1</sup> Policy 8 of the CNQ Issuer Policies.

the Website, which is a central repository of Listed Company and trading information for investors.

In order to qualify for listing, CNQ Listed Companies must prepare and post a prospectus-like base disclosure document (“the Listing Statement”), and provide monthly progress reports and quarterly updates. The Listing Statement itself must be refiled annually, just like an Annual Information Form. Press releases must be posted, along with advance notice of corporate transactions (similar to the documentation provided to the other exchanges by listed issuers, which is considered public but which is not easily available for viewing).

In addition to disclosure requirements, management of CNQ Listed Companies is required to post monthly a certificate that the Listed Company is in compliance with all applicable securities law and CNQ requirements. The certification is also required for any corporate transaction for which documentation must be posted. This requirement forces management to turn their minds to compliance with applicable rules and helps foster a compliance culture.

### **Enforcing Compliance**

CNQ has authority over CNQ Listed Companies and has review procedures in place to monitor and enforce Listed Company compliance with the Rules.

Applications for listing are reviewed by CNQ’s listing team. The Listing Statement is reviewed to ensure it is complete and that the company meets the minimum standards for listings. Insiders of applicants are required to complete Personal Information Forms which are forwarded to RS, which performs the same background investigations that it does for companies listed on the other exchanges.

Once listed, the Listed Company is subject to the same timely disclosure requirements as the other exchanges. Monitoring compliance with the timely disclosure rules and overall market integrity is done by RS. RS also investigates potential instances of insider trading and market manipulation.

CNQ undertakes periodic compliance reviews to determine Listed Companies’ compliance with applicable CNQ rules. These are on an ad-hoc basis (e.g., following up on a complaint from an investor or RS) and a systematic basis (periodically reviewing an Listed Company’s entire disclosure record). CNQ uses a risk analysis to prioritize reviews, similar to that used by the commissions in their continuous disclosure review programmes.

CNQ’s sanctions for Listed Company non-compliance include suspension from trading and delisting.

#### *Pure Trading Market*

CNQ will not regulate issuers traded on the Pure Trading market. They will be regulated by the marketplace on which they are listed (the “home market”). Cross-market trading halts will be administered by RS. If trading is suspended on the home market or if the issuer is delisted, that issuer will be suspended in the Pure Trading market. Trading will continue on the Pure Trading market if an issue is not trading for a reason that does not give rise to regulatory concerns (e.g. a trading system problem or an order imbalance).



## ***Capacity and Integrity of Systems***

CNQ is and the Pure Trading market will be subject to the requirements of Part 12 of National Instrument 21-101. The OSC has issued an order temporarily exempting CNQ from the requirement to have an independent audit for the trading system for the listed market on the basis that current volumes are well below capacity.

### *Listed Market*

The CNQ trading system has been built to meet initial and medium term requirements. In general terms the system has been built to provide the highest possible availability, security and efficiency. All hardware and software components are duplicated within the architecture of the system so as to provide for complete redundancy in the event of failure of any single component. This principle of design is fully extended to all aspects of CNQ's marketplace operations to ensure that trading may continue at all times without interruption.

The initial system was sized to provide sufficient capacity for levels of trading much higher than what is expected.

### *Pure Trading Market*

CNQ is currently testing a new state-of-the-art trading system that is in use in other marketplaces worldwide. It is benchmarked to have much greater capacity and throughput speed than both the current CNQ trading system and, to the best of management's knowledge, any other Canadian exchange.

### *Future Capacity*

On an ongoing basis the capacities of each of the systems are (or will be) evaluated based on current and expected future market activity to ensure that the systems continue to provide more than sufficient capacity.

Once the trading system for the Pure Trading System is operational, the listed market will be migrated to the new trading engine.

### *Contingency*

CNQ's technology architecture for both the listed and Pure Trading markets, including the hosting environment and network connectivity, provide for complete redundancy and the highest levels of security for all components of the system. In essence, if one aspect of the system fails to function there is a duplicated component which will seamlessly take over that part of the operation. The system is monitored 24 hours a day, 7 days a week, to ensure that all components continue to operate and remain secure. At least one member of CNQ's technical staff is on call at all times to ensure that any repair is completed as soon as possible to maintain the established level of redundancy.

## ***Purpose of Rules***

CNQ has established rules, policies and other similar instruments (Rules) that are necessary or appropriate to govern and regulate all aspects of its business and affairs to:

- foster compliance with securities legislation;
- prohibit fraudulent and manipulative acts and practices;
- promote just and equitable principles of trade;
- foster cooperation and coordination with persons or companies engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in, securities; and
- provide for appropriate discipline.

Rule amendments, other than “housekeeping” amendments, are filed with the OSC and published for public notice and comment prior to implementation, except for limited circumstances where there is an urgent need to implement a Rule, in which case the Rule will be effective immediately, subject to withdrawal if the Commission disapproves the Rule, either before or following notice and comment. Housekeeping amendments are filed with the OSC and are effective immediately.

CNQ’s rules, policies and forms are contained in Exhibit “F” of the Form.

### ***Financial Statements***

CNQ files with the OSC unaudited quarterly financial statements within 60 days of each quarter end and audited financial statements within 90 days of year end, prepared in accordance with generally accepted accounting principles. The most recent audited financial statements are contained in Exhibit “O” of the Form.

CNQ provides its budget to the OSC on an annual basis within 90 days its fiscal year end.

### ***Discipline Rules***

CNQ has general disciplinary and enforcement provisions in its Rules that apply to any person or company subject to its regulation. CNQ has retained RS Inc. to act as agent for monitoring and enforcing compliance with its rules. CNQ Dealers are required to attorn to the jurisdiction of RS Inc.

### ***Due Process***

CNQ’s requirements relating to listing and access to the facilities of CNQ, the imposition of limitations or conditions on listing and access, denial or suspension of listing or access are fair and reasonable. Parties are given an opportunity to be heard or make representations; and CNQ keeps a record, gives reasons and provides for appeals of its decisions.

### ***Information Sharing***

CNQ is able and willing to share information and otherwise co-operate with the AMF and its staff, the Canadian Investor Protection Fund, other Canadian exchanges and recognized self-regulatory organizations and regulatory authorities responsible for the supervision or regulation of securities firms and financial institutions.

### ***Clearing and Settlement***

All trades on CNQ are cleared and settled through the Canadian Depository for Securities.

### ***Transparency Requirements***

CNQ complies with the pre-trade and post-trade transparency requirements set out in National Instrument 21-101 Marketplace Operation.

### ***Translation Programme***

If granted authorization by the AMF, CNQ undertakes to translate its rules, policies and forms into French and to provide services generally in French. We will do so on a timetable agreed with the Autorité.

### ***Conclusion***

We look forward to receiving your comments at your earliest convenience. If you have any questions or would like to discuss any aspects of this application, please contact Timothy Baikie at 416-572-2000 x 2282 or Robert Cook at 416-572-2000 x2470.

Yours truly,  
CANADIAN TRADING AND QUOTATION SYSTEM INC.

Timothy Baikie  
General Counsel & Secretary