

August 17, 2004

NASAA Trading and Exchanges Project Group Recommendation to Expand the Existing NASAA Model Secondary Market Trading Exemption for Qualifying Canadian Securities (That Currently Specifies the Toronto Stock Exchange) to Also Specify the Toronto Venture Exchange

Introduction and Background

On April 14, 2002, at the NASAA 2002 Spring Conference, the NASAA membership voted to adopt the recommendation of the NASAA Trading and Exchanges Project Group (the "Project Group") for a Model Secondary Market Trading Exemption for Qualifying Canadian Securities (the "Model Exemption"). Shortly thereafter, in August 2002, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") acted to include the NASAA Model Exemption as part of NCCUSL's adoption of the Uniform Securities Act 2002.

Currently, the NASAA Model Exemption provides secondary trading exemption status only for securities listed on the Toronto Stock Exchange ("TSX"), and does not include securities listed on the Canadian Venture Exchange, now called TSX Venture Exchange Inc. ("TSX Venture Exchange") following its acquisition by the Toronto Stock Exchange in 2001.

It is emphasized that the scope of the Model Exemption –and any extension thereof to the TSX Venture Exchange – relates solely to secondary market transactions. It does not operate to expand exemption status to primary offerings or to any offers or sales of newly issued securities by a qualifying issuer, as does an exchange-listing type of exemption.

In connection with the Project Group's development and consideration of the Model Exemption in 2002, there was some reluctance on the part of the U.S. members of the Project Group to include the TSX Venture Exchange under the Model Exemption because of historical problems associated with its predecessor, the Vancouver Stock Exchange. As a result, at that point in time, it was the Project Group's determination to move forward only with the recommendation for a Model Exemption that designated the (senior) Toronto Stock Exchange. Consideration of the ("junior") TSX Venture Exchange was put on a separate "track" for subsequent evaluation.

Now, following significant research and consultation, the Project Group has concluded that there are no longer any reasons to treat TSX Venture Exchange-listed securities differently from Toronto Stock Exchange listed securities for purposes of the Model Secondary Trading Exemption. Factors considered were the following:

1. TSX Venture Exchange-listed issuers are subject to substantially similar Canadian public reporting company requirements as issuers on the (senior) Toronto Stock Exchange under the current Model Exemption -- and which Canadian public reporting company requirements are at least equivalent to the U. S. system under Section 12 of the Securities Exchange Act of 1934 that currently enables issuers traded on the U.S. "junior" exchange [the Over-the-Counter Bulletin Board ("OTCBB")] to automatically qualify for secondary trading in U.S. jurisdictions solely on the basis of being a public reporting company.
2. Recent major organizational developments involving the TSX Venture Exchange, including the acquisition of the former CDNX (predecessor to the TSX Venture Exchange) by the Toronto Stock Exchange in 2001.

3. Creation in 2002 of Market Regulation Services, Inc. (“RS”) as an independent, arm's-length market regulator conducting the SRO functions for exchanges involved in equity trading throughout Canada, including the TSX Venture Exchange. Currently, RS is the only recognized regulation services provider in Canada.
4. Improvements and enhancements to the Canadian securities regulatory system discussed with particularity below.

Consequently, the Project Group recommends extending the Model Secondary Trading Exemption to include the TSX Venture Exchange. The following sets forth both the specifics of the recommendation, and the justification bases for such recommendation.

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The Project Group’s considerations in evaluating whether to extend the Model Exemption to the TSX Venture Exchange were the same ones used in developing the Model Secondary Trading Exemption in 2002. Those considerations are equally applicable to an extension of the Model Exemption to the TSX Venture Exchange. Namely, to ensure that the exemption would:

- I. Be consistent with the regulatory basis for secondary trading exemption status in almost all states and, importantly, under the National Securities Markets Improvement Act of 1996 (“NSMIA”) – namely, the public availability of information about the issuer. In that regard, Canadian provincial and territorial reporting company/continuous disclosure requirements for Canadian publicly traded issuers are applicable to all issuers listed on the TSX Venture Exchange.
- II. Provide additional investor protections by having the exemption apply only to those Canadian public reporting company issuers that also are subject to the substantive listing requirements of, and corresponding monitoring/oversight by, the TSX Venture Exchange (as the exchange designated for purposes of this recommendation).
- III. Require that the secondary market transactions be effectuated by broker-dealers registered under the federal Securities Exchange Act of 1934, as well as in the states in which U.S. customers are located, to thereby provide applicability of federal and state suitability and “know your customer” rules for the benefit and protection of U.S. customers.
- IV. Provide authority for a state administrator, following a hearing, to remove the designation of any exchange under the Model Exemption if such becomes necessary for the protection of investors.
- V. Recognize the principles and high standards of the securities regulatory regime in Canada (which is comparable to that of the United States), as well as recent significant regulatory developments in Canada.

I. Canadian Public Reporting Company/Continuous Disclosure Requirements

The Uniform Securities Act, as originally drafted in 1956, provided for a number of exempt transactions for nonissuer secondary market transactions, but did not provide for an exemption based on public reporting company status under Section 12 of the Securities Exchange Act of 1934 (the “Exchange Act”). However, in 1996, following development by the NASAA Secondary Market Exemption Committee of a model secondary trading registration exemption based on public reporting company status under Section 12 of the Exchange Act, the NASAA membership adopted Section 402(b)(2.2) as a model amendment to the Uniform Securities Act

Exempt Transaction section. That model exemption provides a self-executing exemption for nonissuer transactions in issued and outstanding securities if the issuer has a class of securities subject to registration under Section 12 of the Exchange Act and has been subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act for not less than 180 days before the transaction.

Additionally, public company reporting status under Section 13 or Section 15(d) of the Exchange Act is the regulatory basis for the NSMIA category of federal covered security for secondary trading purposes (under Section 18(b)(4)(A) of the Securities Act of 1933) that now is applicable in all states. As a result, for securities traded on the OTCBB (which can be likened to a “junior” exchange paralleling the TSX Venture Exchange), because OTCBB issuers are federal Section 12 reporting companies/Section 13 or 15(d) filers, OTCBB issuers automatically qualify for secondary trading in all U.S. jurisdictions based solely on such public reporting company status.

The Project Group’s 2002 Model Exemption was based on the public reporting company status of Canadian issuers under Canadian provincial and territorial “reporting issuer” provisions that are equivalent to the requirements of Section 12 of the Exchange Act. That same basis exists for TSX Venture Exchange issuers who are reporting companies under the Canadian public reporting company/continuous disclosure requirements.

II. TSX Venture Exchange/Listing Requirements and Oversight

In addition to the oversight of Canadian publicly traded issuers conducted by the provincial securities regulators in enforcing the Canadian public reporting company and continuous disclosure requirements, issuers that have securities listed for trading on the TSX Venture Exchange are subject to the oversight of both the TSX Venture Exchange and (as discussed in more detail in V.1 below) RS.

Listing on the TSX Venture Exchange requires the filing of a Listing Application (Annex A) and Listing Agreement (Annex B) and requires that the issuer meet certain specific minimum listing criteria (Annex C). In order to maintain a listing on the TSX Venture Exchange, an issuer must fulfill a number of requirements on a continuous basis. These include timely disclosure requirements, filing of interim and annual financial statements, and, for its Tier 1 issuers, public disclosure regarding its approach to corporate governance. The combination of newly proposed securities regulation dealing with corporate governance requirements and the ongoing TSX Venture Exchange policy response to corporate governance matters will result in an enhanced disclosure framework for all TSX Venture Exchange issuers. The failure to comply with any of the TSX Venture Exchange policies, or a breach of the Listing Agreement, may, if not cured, lead to the TSX Venture Exchange de-listing the issuer’s securities. The failure to timely file public disclosure documents may, if not cured, result in the applicable provincial securities commissions issuing a “cease-trade” order relating to such securities.

Also, through enforcement of the Listing Agreement, the TSX Venture Exchange evaluates the “suitability” of directors and officers of listed companies on a continuing basis. It can require, in appropriate circumstances, that they resign their positions or that they be prohibited from acting as directors or officers of any exchange-listed company. In addition, as a matter of policy, TSX Venture Exchange approves pricing of shares issued through private placements and reviews the proposed pricing on all transactions.

The TSX Venture Exchange's market regulatory oversight and enforcement was assumed in 2002 by RS, a joint initiative of the TSX, Inc. (of which the Toronto Stock Exchange is a Division) and the Investment Dealers Association of Canada ("IDA"). That assumption of market regulatory oversight and enforcement by RS was done to separate the regulatory functions from the business functions of both the (senior) Toronto Stock Exchange as well as the (junior) TSX Venture Exchange.

RS monitors trading on the TSX Venture Exchange on an ongoing basis using advanced technological means. If unusual trading occurs, RS is empowered to halt trading and RS can require the issuer to make a statement either disclosing information or, if applicable, stating that there are no corporate developments that would explain the unusual trading activity.

III. Sales of TSX Venture Exchange Securities to be made by U.S. Broker-Dealers

The Model Exemption, including any extension to the TSX Venture Exchange, contemplates that any trade by a U.S. person in Canadian securities on either the (senior) Toronto Stock Exchange or the (junior) TSX Venture Exchange would be effectuated by a registered U.S. broker-dealer. Such broker-dealer would be required to be registered under the federal Securities Exchange Act of 1934 as well as under state securities laws. As such, the firm would be subject to the applicable federal and state suitability and "know your customer" rules. Consequently, a U.S. person would be protected by the involvement of a licensed securities professional to the same extent and in the same manner whether he or she was trading in Canadian or U.S. listed securities.

IV. Administrator's Ability to Revoke Designations under the Exemption

The Model Exemption contains a separate provision that accords the securities administrator the authority to revoke any designation under the exemption following a hearing if such becomes necessary for the protection of investors. This revocation provision corresponds to equivalent provisions contained in separate NASAA Model Securities Registration Exemptions adopted by the NASAA Membership in prior years relating to securities traded on the NASDAQ/National Market System, or listed on the Pacific Stock Exchange or the Philadelphia Stock Exchange.

V. The High Standards of the Canadian Regulatory Regime, and Recent Significant Regulatory Developments in Canada

This Section discusses additional regulatory/investor protection aspects present in the Canadian regulatory regime for the Project Group to base its recommendation to extend the applicability of the Model Exemption to the TSX Venture Exchange as follows:

1. The creation of RS, which performs the self-regulatory functions for all securities exchanges involved in equity trading throughout Canada, including the TSX Venture Exchange;
2. The changes in Canadian enforcement resources and increases in regulatory investigations;
3. The development and implementation in Canada of measures to strengthen the detection, investigation and punishment of market misconduct such as insider trading; and
4. Recent Canadian federal Criminal Code changes, and development by the Royal Canadian Mounted Police of integrated securities market enforcement teams across Canada.

1. Creation of a New Canadian Self-Regulatory Organization--Market Regulation Services, Inc.

Prior to the year 2000, Canadian exchanges were self-regulatory organizations with two duties: the first, operation of quality markets; the second, market surveillance and policing of market conduct and adherence to listing standards. In 2001, TSX purchased the Canadian Venture Exchange and in 2002, created TSX Group Inc. and renamed the Canadian Venture Exchange as TSX Venture Exchange Inc. TSX Venture Exchange's trading system was integrated with that of TSX, which resulted in the junior market having access to trading and surveillance technology that is considered to be at the leading edge in global markets.

To avoid potential conflicts of interest impacting both TSX and TSX Venture Exchange in exercising their dual roles as trading market operators as well as regulators, the IDA and TSX Inc. created the new independent organization, RS, as referenced earlier in this Report. With Canada's creation of RS as an independent trading market regulator that performs the SRO functions for all exchanges involved in equity trading throughout Canada, Canada's approach to surveillance and enforcement of its trading marketplaces is comprehensive, coordinated, and independent.

As a result of the above, RS and IDA regulate nationally broker-dealer conduct on and off Canadian markets. Both TSX and the TSX Venture Exchange now have a limited role in regulating the conduct of listed issuers. Their role is to set high quality standards and monitor performance against them.

The principal role of RS is to identify possible instances of trading that violates the Universal Market Integrity Rules ("UMIR"). UMIR are the market trading rules that the major provincial securities commissions in Canada have accepted as governing trading on all Canadian equity markets. RS identifies trading violations, including possible instances of illegal insider trading, through its real-time surveillance of equity markets. RS enforces compliance with UMIR by participant dealers and refers possible instances of trading abuses by others, including illegal insider trading, to the provincial securities commissions with jurisdiction over the potential respondents. To identify possible trading violations, RS uses a system of electronic alerts that are identical for both exchanges and are based on algorithms that identify abnormal price and volume changes. RS reviews each of these alerts. For insider trading specifically, RS reviews each alert generated by significant price and volume changes for a period of time prior to the general dissemination of a material announcement. In that context, RS also reviews every news release disseminated by the issuers on the exchanges for materiality and compliance with the exchange's policy on timely disclosure. This system of alerts has been favorably benchmarked against systems used by other members and affiliates of the Intermarket Surveillance Group (ISG).

Insiders trading on Canadian equity markets are required to identify their trading by way of a "marker" that is entered with a trade, as was recommended in the Laurier University study referenced below. These markers are visible to RS surveillance staff to help in identifying illegal insider trading.

Unlike the NASDAQ junior market, the OTCBB, Canadian issuers must sign a Listing Agreement with the TSX Venture Exchange. As mentioned in Section II. above, through enforcement of this Agreement, the TSX Venture Exchange, on a continuing basis, evaluates the "suitability" of directors and officers of listed companies. It can require, in appropriate circumstances, that they resign their positions or that they be prohibited from acting as directors or officers of any TSX Venture Exchange-listed company. In addition, as a matter of policy, TSX Venture Exchange approves pricing of shares issued through private placements and reviews the proposed pricing on all transactions. In the

course of these reviews, staff members refer any identified potential manipulative trading issues to RS and will also request that RS perform trading reviews to assess who was in the market prior to material announcements. This is an effective and often-used way of detecting price manipulation.

Through these approaches, the TSX Venture Exchange has been highly effective in addressing director/officer misconduct and manipulative trading. This is important in maintaining the quality of the Canadian junior market. These comprehensive listing and transaction standards, as well as review procedures, are an important risk control mechanism.

2. Changes in Canadian Enforcement Resources and Increases in Regulatory Investigations.

In the last three to four years, Canada has created the basis for a regulatory system that is as robust as that of the United States, and in the case of TSX Venture Exchange, is unique in the world.

There have been two studies, one from Sir Wilfrid Laurier University researchers, another from a Yale University researcher, and a Wall Street Journal article of January 7, 2004, which criticized Canadian regulatory enforcement. However, both of the studies cover the years prior to the year 2000 – the Laurier study deals with trading during stock buyback periods from 1987 to 2000, the Yale study with trading in advance of takeover announcements from 1990 to December 31, 1999.

The Wall Street Journal article selectively compares “15 insider trading convictions” in Canada with “hundreds of trading prosecutions” undertaken in the U.S. from 1980 to 2002.” However, such comparison mixes the “apples” of convictions with the “oranges” of prosecutions and thus does not provide a true “comparison.” Moreover, although the comparison of raw numbers might appear to represent a significant difference, such is not the case when you take into account the difference in the size of the two markets -- the U.S. market is more than 25 times the size of Canada’s as measured by market capitalization. Viewed in that way, there is little if any statistical difference in enforcement/regulation of the two markets in the insider trading context.

In addition, many changes have been incorporated into the Canadian regulatory enforcement scheme, including the enforcement of insider trading rules, after the time periods covered in the two studies. The Laurier study, for example, recommends that announcements of insider trading should take place much faster than under then-prevailing rules. Also, the study recommends that insider trades be flagged at the time of each trade. Both of those improvements now have been incorporated into the Canadian system, as further discussed below, and additional enhancements are about to be introduced.

The Yale study concludes that “the only way of reducing the potential benefits of breaking the law is to improve a firm’s disclosure requirements, increase penalties and improve the detection technology.” All these measures have been taken in Canada since the end of the study period for the Yale paper.

The extent of the changes is, in fact, displayed in the recent Wise Persons Committee’s (WPC) study of the effect of multiple regulators. For example, the WPC states that “the change in Ontario’s enforcement resources is remarkable, increasing 77% between 1998 and 2002.” In terms of TSX Venture, the same study notes that on average between 1998 and 2002, 35.8 regulatory investigations closed per year on the TSX and 118 investigations closed per year on TSX Venture Exchange. This is a reflection of the large number of companies on the junior exchange as well as the extra vigilance that is considered necessary on an exchange that, by its very nature, specializes in trading smaller and therefore riskier companies than one finds on senior markets. Significantly, these numbers reflect investigations closed by the exchanges prior

to the creation in 2002 of RS as discussed in V.1 above. With RS having assumed many of the regulatory functions previously performed by the two exchanges, each exchange has been able to focus solely on enforcing its respective market quality standards. The benefits of this specialization are reflected in the substantial overall increase in closed investigations since the period described by the WPC. In 2002 and 2003, TSX Venture Exchange closed an average of 188 investigations per year, while RS closed an average of 186 investigations per year during 2002 and 2003. The total investigations that RS closed are exclusive of certain broker conduct investigations that they had conducted during the period covered by the WPC study, but which now fall under the jurisdiction of the IDA. In the aggregate, therefore, the annual number of investigations being closed by TSX Venture Exchange and RS, on behalf of the TSX Venture Exchange only, has increased to an average of 374 per year.

The WPC study notes that the administrative fines and penalties imposed by state and provincial regulators are comparable, on average, in the U.S. and Canada. Where significant differences arise between the two countries, they stem from SEC civil penalties and disgorgements of illegal profits, as well as U.S. state restitution. One reason for these differences has been that provincial securities commissions have not had as ready access as U.S. state securities administrators to the criminal justice system. This is another regulatory/enforcement aspect that is in the process of changing in Canada.

3. Development and Implementation in Canada of New Regulatory Measures Strengthening the Detection, Investigation and Punishment of Canadian Market Misconduct.

Canadian regulators themselves have introduced parallel actions to tighten their own requirements regarding insider trading. For example, until the year 2000 -- the end of the research period for the Laurier and Yale academic studies -- insider reports in Canada were required to be filed within 10 days of the end of the month during which a trade took place. As a result of recent changes, insider reports now have to be reported within 10 days of the trade, and the requirement is augmented with more efficient disclosure by the regulatory commissions themselves.

Also, prior to May 5, 2003, Canadian securities commissions provided information on insider trading to the public in weekly bulletins. Since then, however, information has been available online to the public on SEDI (www.sedi.ca), the System of Electronic Disclosure by Insiders developed by the Canadian Securities Administrators, the umbrella organization for provincial and territorial regulators. As a result of the change, insider trading information now becomes publicly available nationwide within moments of its filing, which constitutes another significant advancement in disclosure benefiting investors in the Canadian trading markets.

All of these changes have produced a much tighter regulatory environment than before. For example, compared to 23 prosecutions for insider trading reported in the 13 years before the year 2000, RS referred to regulators in the year ended February 29, 2004, 23 alleged cases of insider trading involving TSX Venture Exchange.

More changes and improvements are planned. In 2002, Canadian securities administrators established the Insider Trading Task Force, to evaluate current practices and recommend how to better address illegal insider trading in Canadian capital markets. The Task Force submitted its Report in November 2003 containing recommendations in three areas: (i) prevention, (ii) detection, and (iii) deterrence. Among other things, the Task Force recommended measures to integrate client and trade data and to restrict the use of offshore accounts -- the two most significant measures to improve the ability of market regulators to identify illegal trading.

Implementation of these measures will result in Canadian practices and capabilities that far exceed those currently in place for North American markets. A CSA project team involving the

four major provincial securities commissions, TSX and TSX Venture Exchange, the IDA, RS and the Montreal Exchange are now directing implementation, which is anticipated to take place over the next 12 months.

3. Recent Canadian Criminal Code Changes and Development by the Royal Canadian Mounted Police of Integrated Securities Market Enforcement Teams.

There are pending changes in the Criminal Code of Canada that were recently announced by the Canadian federal government. Proposed legislation would create a new offense of illegal insider trading, including the potential for a 10-year prison sentence. This change to the Criminal Code is especially important, because under the Canadian Constitution, the federal government has sole jurisdiction for criminal law.

In addition, the Royal Canadian Mounted Police, the Canadian national police force, has set up integrated market enforcement teams across the country, working closely with Canadian provincial regulators as well as self-regulatory organizations like the IDA and RS.

Conclusion

The Project Group recommends the extension of the Model Secondary Trading Exemption to the TSX Venture Exchange on the basis that not only are the same regulatory and investor protection considerations that underlay the original Model Exemption for the Toronto Stock Exchange present with respect to the TSX Venture Exchange, but also that the significant regulatory developments that have taken place in Canada over the last several years, together with other initiatives being implemented, make the TSX Venture Exchange regulatory system as robust as, and in many cases superior, to that of the United States regarding its junior exchanges (such as the OTCBB). Canada has a long history of regulating junior stock exchanges, which has led Canada to develop a junior market model with listing standards that are different from and more comprehensively regulated than any other junior market in the world.

Expanded Model Exemption Language As Recommended

Following is the text of the NASAA Model Exemption as adopted in April 2002 (but renumbered to correspond with the 2002 Uniform Act's numbering of the Exemption), with supplemental underscored language that, for purposes of the Project Group's recommendation for consideration by the NASAA membership at the NASAA 2004 Fall Conference, expands the scope of the exemption to include securities of Toronto Venture Exchange-listed issuers meeting the requirements of the Exemption.

Section 202(b) Exempt Transactions.

(23)(a) A nonissuer transaction in an outstanding security by a registered agent of a registered broker-dealer, provided that:

1. The issuer is a reporting issuer in a foreign country or jurisdiction designated in paragraph (b), or by rule [or order] of the Administrator, and has been subject to continuous reporting requirements in such foreign country for not less than 180 days before the transaction; and
2. The security is listed on such foreign country's securities exchange which has been designated in paragraph (b), or by rule [or order] of the Administrator, or is a security of the same issuer which is of senior or substantially equal rank to such listed security or is a warrant or right to purchase or subscribe to any of the foregoing.

(b) For purposes of paragraph (a), Canada together with its provinces and territories is a designated foreign jurisdiction and The Toronto Stock Exchange, Inc. ~~is a~~ , as well as the Toronto Venture Exchange Inc., are designated securities ~~exchange~~ exchanges .

(c) After an administrative hearing in compliance with applicable state law, the Administrator may by rule [or order] revoke the designation of a securities exchange under this section if the Administrator finds that such revocation is necessary or appropriate in the public interest or for the protection of investors.

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[Drafting Note: Because NASAA U.S. jurisdictions either already have been, or shortly will be, considering in their legislatures the Uniform Securities Act 2002 which contains the 2002 language of the Model Exemption in Exempt Transactions section 202(23), NASAA U.S. jurisdictions are reminded that upon adoption by the NASAA membership of the recommendation to expand the Model Exemption to include the Toronto Venture Exchange, they will need to add the underscored language noted above in order to include the Toronto Venture Exchange for purposes of the Exemption.]

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