Management Discussion and Analysis

(In thousands of dollars)

The Investment Industry Regulatory Organization of Canada ("IIROC") is a not-for-profit Canadian corporation, with locations in Toronto, Calgary, Montreal and Vancouver. IIROC, the "Organization," is the national self-regulatory organization ("SRO") which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. IIROC tracks its operating costs within two main divisions: Dealer Regulation, which provides regulation of investment dealers; and Market Regulation, which regulates debt and equity marketplaces.

IIROC carries out its regulatory responsibilities through setting and enforcing rules regarding the proficiency, business and financial conduct of investment dealers and their registered employees, and through setting and enforcing Universal Market Integrity Rules ("UMIR") regarding trading activity on Canadian equity marketplaces.

The Organization operates on a cost recovery basis and assesses its members' annual fees to recover operating costs. Membership consists of all investment dealers and Alternative Trading Systems. Furthermore, the Toronto Stock Exchange (TSX), TSX Venture Exchange (TSX-V) and Canadian National Stock Exchange (CNSX) exchanges have agreements with IIROC for surveillance of their markets.

Summary financial information

The following is Management's Discussion and Analysis of the financial condition and results of operations of IIROC for the year ended March 31, 2010. IIROC was incorporated on March 17, 2008 as a corporation without share capital under the provisions of Part II under the Canada Corporations Act as a not-for-profit organization. IIROC commenced operations in June, 2008 through the combination of the Investment Dealers Association of Canada ("IDA") and Market Regulation Services Inc. ("RS"). Accordingly, actual results for the 2009 fiscal period are for a 10-month period. Therefore, for comparative purposes, pro-forma financial information for fiscal 2009 has been prepared for the Unrestricted Fund which extrapolates the 10-month period to be a 12-month period.

Unrestricted Fund

(In thousands of dollars)	**FY 2010 Actual**	FY 2009 Actual	FY 2009 Pro forma[1]	Variance $	Variance %
Revenue					
Dealer Regulation					
Membership fees	**$ 38,846**	$ 33,076	$ 39,691	$ (845)	(2%)
Underwriting levies	**8,404**	5,480	6,576	1,828	28%
Registration fees	**2,381**	2,411	2,893	(512)	(18%)
Entrance fee	**160**	170	204	(44)	(22%)
	49,791	41,137	49,364	427	1%
Market Regulation					
UMIR fees	**23,074**	17,138	20,566	2,508	12%
Timely disclosure	**3,260**	2,815	3,378	(118)	(3%)
	26,334	19,953	23,944	2,390	10%
Other revenue					
Interest	**66**	541	649	(583)	(90%)
Miscellaneous	**326**	137	164	162	98%
	392	678	813	(421)	(52%)
Total Unrestricted Fund revenue	**76,517**	61,768	74,121	2,396	3%
Expenses					
Dealer Regulation operating costs	**48,591**	39,941	47,929	662	1%
Market Regulation operating costs	**24,150**	18,668	22,402	1,748	8%
	72,741	58,609	70,331	2,410	3%
Excess of revenue over expenses – Unrestricted Fund	**$ 3,776**	$ 3,159	$ 3,790	$ (14)	0%

(1) Extrapolated based on 10-month period operating statement.

Revenues

Unrestricted Fund revenues for the period were $76,517, a $2,396 (3%) increase from the prior period. The increase is primarily a result of higher than expected Underwriting levies and higher UMIR fees partially offset by smaller declines in revenues in other areas. There are four factors that can affect Membership and UMIR fees, which are the primary sources of IIROC's revenues. The first is budgeted costs required to carry out the Organization's regulatory mandate. As IIROC operates on a cost-recovery basis, changes in costs can result in fee changes. The second is other sources of revenue such as Underwriting levies and Timely Disclosure fees. Budgeted increases in these areas result in a lower recovery of costs via fees. A decrease in these budgets will have the opposite impact. The third is any surpluses or deficits in the Unrestricted Fund at the end of the year which have an impact on fees, subject to Board approval, in the year following their occurrence. Finally, IIROC's requirement to maintain an Unrestricted Fund balance of at least three months operating costs will impact fees.

(In thousands of dollars)

Revenues from Dealer Regulation are made up of Membership fees, Underwriting levies, Registration fees and Entrance fees. Dealer Regulation revenues were $49,791 for the period, compared with $49,364 for a similar period last year.

- Membership fees are assessed to investment dealers to provide sufficient funding for Dealer Regulation operating costs, less other revenue components described below. For the year, Membership fees were $38,846 and were lower by $845 (2%) from a similar period last year. The decrease was caused primarily by reduced budgeted costs and the application of a surplus arising in FY 2009 to FY 2010 fees.
- Underwriting levies of $8,404 increased year-over-year by $1,828 (28%). The increase is attributable to improved market conditions which caused an increase in underwriting activity.
- Registration fees reached $2,381, a decline of $512 (18%) compared to the prior year as a result of Registration Reform and lower activity. Registration Reform has resulted in fewer positions that attract fees. Additionally, lower registration activity in some provinces decreased compared to the prior year.
- Entrance fees are assessed on new investment dealer members to cover costs related to the review of applications. For the year these fees were $160, a decrease of $44 (22%) from the prior year.

Market Regulation revenues consist of UMIR fees and Timely Disclosure fees.

Market Regulation revenues were $26,334, up $2,390 (10%) from the prior year.

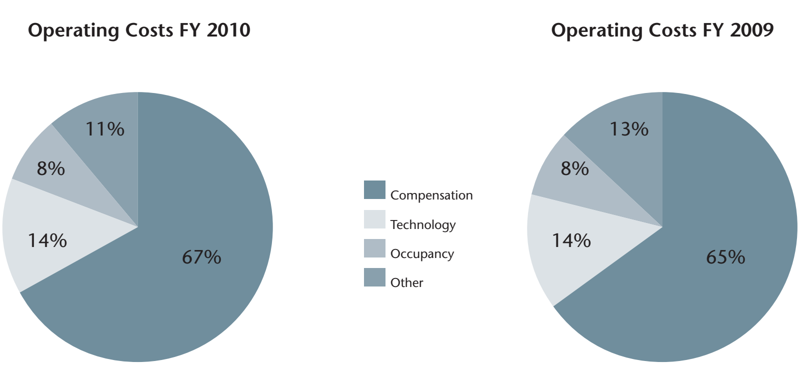
- UMIR fees are assessed to investment dealers that carry out trading activity on Canadian equity marketplaces, in order to provide sufficient funding for Market Regulation operating costs, less Timely Disclosure fees. For the year UMIR fees were $23,074, an increase of $2,508 (12%) from the prior year. The increase arose from higher budgeted costs connected with market surveillance technology.
- Timely Disclosure fees are for administering the Timely Disclosure policies of the TSX and TSX-V. Fees for the period were $3,260, a decrease of $118 (3%) due to one-time adjustments received in FY 2009 related to fees for a prior year in one of IIROC's predecessor organizations.

Other revenue

- Interest revenue for the year amounted to $66, substantially below the prior year by $583 (90%). The major reason for lower interest revenue was lower interest rates on short-term investments.
- Miscellaneous revenue was $326 for the year, up by $162 (98%) from the prior year.

Operating costs

Operating costs for IIROC are made up of five main categories.



The major categories of Compensation, Technology and Occupancy make up approximately 90% of IIROC's Operating costs. In order to ensure that costs, upon which fees are based, are segregated between Dealer Regulation and Market Regulation, IIROC uses a cost allocation model.

(In thousands of dollars)	**FY 2010**	FY 2009	FY 2009	Variance	Variance
	Actual	Actual	Pro forma[1]	$	%
Unrestricted Fund expenses					
Dealer Regulation operating costs	**$ 48,591**	$ 39,941	$ 47,929	$ 662	1%
Market Regulation operating costs	**24,150**	18,668	22,402	1,748	8%
	$ 72,741	$ 58,609	$ 70,331	$ 2,410	3%

(1) Extrapolated based on 10-month period operating statement.

Dealer Regulation costs of $48,591 increased $662 (1%) mainly as a result of an increase in Compensation costs arising from the introduction of a new compensation framework for employees, and some Technology costs. This was partially offset by a decrease in Other costs, primarily arising from hearing cost recoveries connected with the Asset-Backed Commercial Paper enforcement action, and lower discretionary expenses in administration and travel.

The Market Regulation division's Operating costs were $24,150, an increase of $1,748 (8%) over the prior year. The primary driver of the increase was higher technology costs for market surveillance systems. The introduction of the new compensation framework also contributed to higher costs. Helping to reduce the impact of these increases was reduced discretionary expenses in travel and administration.

Excess of Unrestricted Fund revenues over expenses

Revenues exceeded expenses for the period by $3,776, which increased the Unrestricted Fund balance to $29,107. The balance at the end of the prior year was $26,199. IIROC retains three months operating costs in the Unrestricted Fund. Any of this year's excess revenues may be used to reduce fees or provide funding for pensions for Dealer and Market Regulation or to finance market surveillance upgrades for the TSX-owned SMARS system in the upcoming year. The surplus allocated to Dealer Regulation amounts to $1,568, while $2,208 of it goes to Market Regulation.

The use of funds in the three Restricted Funds of IIROC is restricted to specific expenses under IIROC's recognition order. As such, they do not lend themselves to extrapolation for comparative purposes. Therefore the comparative figures below are actual revenues and costs for the FY 2010 (12-month) and FY 2009 (10-month) periods.

Externally Restricted Fund

Total revenues for the period amounted to $1,130 compared to $3,893 last year, a decrease of $2,763 (71%). The major reason for the decline was a reduction in fine revenue in FY 2010 of $2,238 (74%). The cause of the decrease is a $2,000 fine collected from one firm in FY 2009. Based on the value of fines assessed for FY 2010, approximately 100% of fines against firms were collected, while for individuals it was approximately 20%. In FY 2009 it was 100% and 45%, respectively. Interest revenue declined $481 (90%) to $55 due to the decline in interest rates.

The main expenses were hearing panel-related costs of $1,798, compared to a cost last year of $1,254, an increase of $544 (43%). The reason for the increase was a higher number of hearings in FY 2010 of 45 compared to 31 in FY 2009. Other major costs were contributions of $282 to the Canadian Foundation for the Advancement of Investor Rights ("FAIR"), and $201 to the Funny Money project, which introduces the markets to students. Last year the major project was the Rule Book project, which is an initiative to rewrite the Dealer Regulation rules in plain language, with expenditures of $224. This year expenditures declined by $133 (59%) as the rewrite of the Dealer Regulation rules are coming to an end.

(In thousands of dollars)

The fund ended the period with a deficiency of revenue over expenses of $1,686. After the deduction of $3,712 in capital expenditures for the STEP market surveillance system and the transfer of $4,061 from the Merger Fund, the fund balance decreased from $28,682 to $27,352 at the end of the year.

Externally Restricted ABCP Fund

A subset of the Externally Restricted Fund, this fund was set up as a custodian fund for the fines specific to the ABCP enforcement action. Revenue for the year amounted to $32,262 and consisted of fines and interest. It is anticipated that the disposition of the fund will be settled in FY 2011. Until that time, funds are being held in segregated funds in accordance with IIROC's investment policy.

Merger Fund

Set up for the IDA/RS combination, the fund has wound down in activity. The fund ended the year with an excess of revenue over expenses of $313 compared to a deficiency of $3,984 last year. The cause of the variance is due to the wind down of merger activity expenses. After transfers to the Unrestricted Fund and Externally Restricted Fund of $4,072, the fund ended the year at $(386).

Liquidity and capital resources

At the end of the year IIROC was in a surplus position of $100,553 consisting of the Capital Asset Fund, Unrestricted Fund, the Externally Restricted Fund, Externally Restricted ABCP Fund and the Merger Fund.

The Unrestricted Fund surplus of $29,107 must be maintained at a level equal to three months' operating costs. Based on the FY 2011 budget of $85,975, the surplus must be $21,494, leaving an excepted excess surplus at the end of FY 2011 with Dealer Regulation of $4,122 and Market Regulation of $3,491. As noted above, the excess surplus may be used to reduce fees or fund pensions in FY 2011 in both divisions and to finance technology upgrades for Market Regulation.

During the year, IIROC assessed and received $32,250 in ABCP fines, which it is holding in an Externally Restricted Fund pending the outcome of discussion between the CSA and IIROC as to the eventual distribution of these funds. It is expected a decision will be made sometime in FY 2011.

On a consolidated fund basis, during the year, investments were made with the purchase of capital assets in the amount of $7,187. The primary components are development of the new market Surveillance Technology Enhancement Program ("STEP"), $3,707; $2,462 for upgrades to the SMARS surveillance system; and computer hardware and software, $951.

These activities led to the end of period cash and cash equivalents position of $103,839. This was comprised of cash in banks of $13,341 as well as Treasury Bills and Promissory Notes of $90,498 guaranteed by the Canadian or a Provincial government.

Commitments

As at March 31, 2010, the basic minimum aggregate annual rental payments were $13,743, excluding GST and occupancy costs, net of expected recoveries from other parties under long-term leases with varying expiry dates to February 18, 2018, for the Organization's premises.

The Organization has also entered into a services agreement in the aggregate amount of $22,523, under which information technology and other administrative services are provided for the next three years until May 2013.

The Organization has also provided a $100,000 guarantee on the Canadian Investor Protection Fund ("CIPF") bank lines of credit. At March 31, 2010, the CIPF has not drawn on these lines of credit. Any amount drawn on the guarantee would be assessed to dealer member firms.

The Organization has agreed to establish the Canadian Foundation for the Advancement of Investor Rights ("FAIR"). The Organization is committed to funding the Foundation over a three-year period to a maximum of $3,750. As of March 31, 2010 the remaining commitment is $1,640 (2009 – $1,922). Additionally, the Organization has committed to fund the Investor Education Foundation for the "Funny Money" program to a maximum of $558. As of March 31, 2010 the remaining commitment is $357. IIROC has also committed to fund the Capital Markets CRC for research work to a maximum of $450. As at March 31, 2010 the remaining commitment is $300.

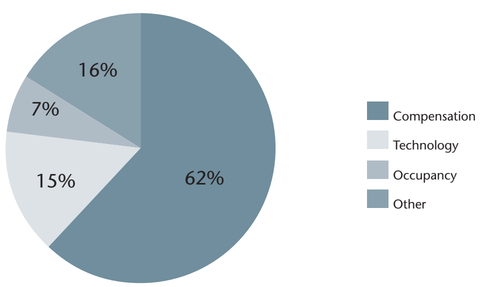
Future changes in accounting policies

In March, 2010, the Canadian Institute of Chartered Accountants ("CICA") issued an Exposure Draft on "Accounting Standards for Not-for-Profit Organizations." The Accounting Standards Board of the CICA expects the final standards will be issued in late 2010 with application for annual financial statements beginning on or after January 1, 2012. It is proposed that early adoption will be permitted. IIROC will assess the impact of the new standards when the final standards are issued.

Outlook

IIROC's budget for the coming year was prepared to maintain its current level of operational capability with respect to Dealer Regulation and increase its capability for Market Regulation by launching STEP and strengthening market knowledge in IIROC's Montreal office. Operating costs for FY 2011 are expected to be $85,975 with the following distribution.

FY 2011 Budgeted Operating Costs



For the Dealer Regulation division, in FY 2009, there was a surplus of which $2,900 was applied to reduce the FY 2010 fees. Without considering any subsidies, Membership fees for the upcoming year are expected to increase by 4.5% due to an increase in Compensation arising from market adjustments for eligible staff, promotions and new staff. Other increases are for regional bandwidth upgrades and the implementation of the HST in British Columbia and Ontario. Subsequent to the approval of the budget, the Board approved the use of $3,000 of the FY 2010 surplus to reduce FY 2011 fees, resulting in a 4.5%-increase when compared to FY 2010 subsidized fees.

In the Market Regulation division, UMIR fees are expected to increase by 10.2%. The primary driver of the increase is market surveillance technology costs. The new system, STEP, is scheduled for launch in Q1 of the upcoming year. At that time it will be used to perform cross-market surveillance of all equity marketplaces regulated by IIROC and single-market surveillance of each marketplace, except for the TSX and TSX-V. SMARS will be used for surveillance of the TSX and TSX-V. The FY 2011 budget reflects the costs of operating both STEP and SMARS. Discussions are underway with the TSX and TSX-V to use STEP to monitor those markets; however, the decision to use STEP does not rest with IIROC alone. Similar to Dealer Regulation, Compensation increases and the impact of the HST also contributed to higher costs. Subsequent to the approval of the budget, the Board approved the use of $1,200 of the FY 2010 surplus to reduce FY 2011 fees. If the surplus was not applied, FY 2011 fees would have increased by 15.4%.