

Management Discussion and Analysis

(In thousands of dollars)

The financial statements presented are for the year ended March 31, 2011, with comparative numbers for the year ended March 31, 2010, and include accompanying notes.

IIROC is a cost-recovery, not-for-profit organization that recovers its operating costs from several sources. The primary source is through member fees for Dealer Regulation and Market Regulation activities which are collected via application of respective fee models. For Dealer Regulation, secondary sources of revenue are Underwriting Levies which represent a fractional percentage share of the value of most public equity and debt underwritings in Canada and Registration Fees based on fee sharing agreements with provincial securities commissions. The other significant revenue source for Market Regulation is Timely Disclosure fees from the TSX and TSX-V for administering their Timely Disclosure policies.

IIROC developed two new proposed fee models over the past year, one for Dealer Regulation activities and one for Market Regulation activities, and has submitted both for approval to the Canadian Securities Administrators ("CSA"). If they are approved, our intention is to implement the two fee models for the fiscal year beginning April 1, 2012. As IIROC operates on a cost-recovery basis, it is expected that the implementation of the two fee models will have a minimal impact on revenues.

Summary financial information

Unrestricted Fund

(In thousands of dollars)

	FY2011	FY2010	Variance	Variance
			\$	%
Unrestricted Fund Revenue				
Dealer Regulation				
Membership fees	\$ 40,598	\$ 38,846	\$ 1,752	5%
Underwriting levies	8,122	8,404	(282)	(3%)
Registration fees	2,371	2,381	(10)	0%
Entrance fee	270	160	110	69%
	51,361	49,791	1,570	3%
Market Regulation				
UMIR fees	25,435	23,074	2,361	10%
Timely Disclosure	3,378	3,260	118	4%
	28,813	26,334	2,479	10%
Other Revenue				
Interest	294	66	228	345%
Miscellaneous	10	326	(316)	(97%)
	304	392	(88)	(22%)
Total Unrestricted Fund revenue	80,478	76,517	3,961	5%
Unrestricted Fund Expenses				
Dealer Regulation operating costs	51,004	48,591	2,413	5%
Market Regulation operating costs	26,398	24,150	2,248	9%
	77,402	72,741	4,661	6%
Excess of revenue over costs – Unrestricted Fund	\$ 3,076	\$ 3,776	\$ (700)	(19%)

Revenues

Unrestricted Fund revenues for the period amounted to \$80,478, up \$3,961 (5%) from \$76,517 in FY2010. The increase is primarily the result of higher Dealer Regulation Membership Fees and UMIR fees. Membership and UMIR fees represent approximately 82% of the total revenue of IIROC. Since IIROC operates on a cost-recovery basis, these fees have a direct relationship to Dealer Regulation and Market Regulation operating costs which were up 5% and 9%, respectively.

Dealer Regulation Membership Fees are based on approved budgets and are reduced by other sources of revenue that included Underwriting Levies, Registration Fees and Entrance Fees. Furthermore, any surplus or deficit from the preceding year will also affect Membership Fees. Membership Fees were \$40,598, an increase of \$1,752 (5%) from \$38,846 a year ago. The increase was primarily attributable to higher budgeted operating costs, and was offset by the application of a \$3,000 surplus from last year which reduced the impact of increased costs.

Underwriting levies of \$8,122 declined compared to last year, coming in \$282 (3%) lower than \$8,404 as FY2011 did not produce the volume of large offerings that occurred in FY2010.

Registration fees remained essentially flat in FY2011 compared to last year.

Entrance fees for the year amounted to \$270 an increase of 69% from \$160 the year before as new member applications increased year-over-year.

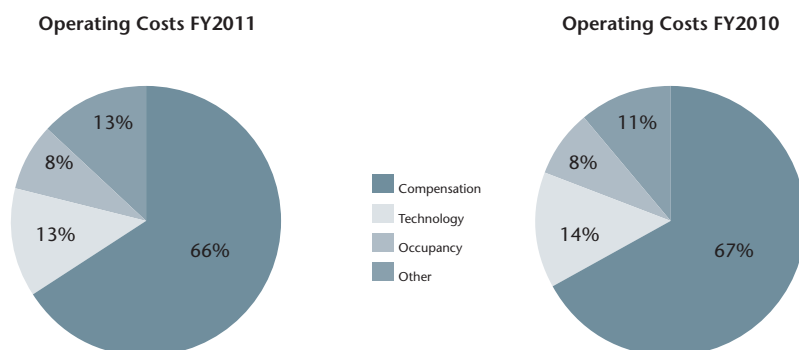
Market Regulation UMIR fees are also based on approved budgets and are reduced by Timely Disclosure revenue. As with Dealer Regulation, any surplus or deficit from the preceding year will also affect fees. UMIR Fees for the year came in at \$25,435, up \$2,361 (10%) from the \$23,074 in the prior year. The increase was the result of operating cost increases which were reduced by the use of \$1,200 of the previous year's surplus.

Timely Disclosure revenue for the year was \$3,378, which is an increase of \$118 (4%) from last year due to the receipt of prior-year credits in FY2011.

Interest revenue of \$294 ended the year 345% ahead of last year due to the increase in interest rates. IIROC's investment policy is focused on capital preservation and narrows its investments to short-term Canadian and provincial government debt and single A grade Canadian chartered bank paper.

Operating costs

IIROC operating costs consist of four main categories.



The major categories of Compensation, Technology and Occupancy make up approximately 90% of IIROC's operating costs. To facilitate proper fee allocation, direct costs are segregated between Dealer Regulation and Market Regulation activities and indirect costs are apportioned using a cost allocation model based on direct cost or headcount.

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(In thousands of dollars)

(In thousands of dollars)	FY2011	FY2010	Variance	Variance
	Actual	Actual	\$	%
Unrestricted Fund expenses				
Dealer Regulation operating costs	\$ 51,004	\$ 48,591	\$ 2,413	5%
Market Regulation operating costs	26,398	24,150	2,248	9%
	\$ 77,402	\$ 72,741	\$ 4,661	6%

Dealer Regulation costs of \$51,004 were up \$2,413 (5%) over the prior year primarily as a result of increased staffing, salary increases and the impact of the Harmonized Sales Tax ("HST"), which added an additional 8% to the non-compensatory costs of Dealer Regulation for the last nine months of the year when compared to the prior year. Furthermore, since Membership Fees are exempt from HST, the corresponding input tax credit to help reduce HST on costs was not realized, which compounded the impact of HST.

Costs of the Market Regulation activities increased up to \$26,398, a \$2,248 (9%) increase over the previous year. IIROC introduced a second surveillance system, the Surveillance Technology Enhancement Program ("STEP") in May 2010 for cross-market surveillance and to handle increased volumes. Higher technology costs were incurred as a result. This increase, however, was partially offset by the reduced costs of the first surveillance system, SMARS, as hardware and data feeds previously used by SMARS were either made redundant or were transferred to STEP. Compensation was higher for Market Regulation due to salary increases and increased staffing for the launch of STEP. The impact of HST for Market Regulation costs was lower compared to Dealer Regulation as UMIR Fees are taxable, resulting in the use of input tax credits to reduce HST-eligible costs below what they were prior to implementation of HST.

Excess of Unrestricted Fund revenues over expenses

Revenues exceeded expenses in FY2011 by \$3,076, increasing the Unrestricted Fund balance to \$34,871 compared to the opening balance of \$29,107. This compared with \$3,776 from the year prior, a \$700 (19%) decrease. Internal policy requires IIROC to retain three months' operating costs as a minimum balance in the Fund. Potential uses of any excess surplus are future capital projects, pension funding and the consolidation of the Toronto office facilities.

Externally Restricted Fund

Revenues for the Fund are made up of the collection of fines, penalties and disgorgement of profits determined by IIROC Hearing Panels on existing members, plus new member contributions as part of their entrance fees and interest.

The Fund is restricted by the Recognition Orders of IIROC from provincial securities commissions to qualifying expenditures. Those expenditures include:

- Non-recurring capital expenditures to address emerging regulatory issues arising from changing market conditions, and are directly related to investor protection and capital markets integrity,
- Education of market participants and the public about or research into investing, financial matters or the operation or regulation of securities markets,
- Donations to non-profit, tax-exempt organizations for investor protection and education, and
- Costs associated with the administration of IIROC's Hearing Panels.

Total revenues for the year amounted to \$1,975, compared to \$1,130 for FY2010, an increase of \$845 (75%). The increase mainly arose from higher fines which increased by \$706 (89%) from \$790 to \$1,496. Fine revenue is up this year as a result of an increased number of completed disciplinary hearings from which fines were assessed and collected. IIROC endeavors to collect all fines imposed by Hearing Panels; however, its ability to recover fine money from former registrants is extremely limited in most provinces. IIROC continues to work towards enhanced ability to collect its fines.

Hearing Panel related costs amounted to \$1,715, down \$83 (5%) from \$1,798 due to the complexity of the Hearings that took place last year. Other major qualifying expenditures during the year were for contributions to the Canadian Foundation for Investors Rights ("FAIR") of \$743, bringing the total contributed to the program to \$2,855, including contributions from the predecessor organizations; a contribution of \$281 for the Social and Enterprise Development Innovations; costs of \$265 for the IIROC Rule Book Rewrite project; and Member Education initiatives of \$261. Spending on other projects was \$407. As a result, total expenditures for the year amounted to \$3,672, up by 30% from the \$2,816 spent last year.

The resulting deficiency for the year was \$1,697, \$11 (0.7%) higher than the \$1,686 deficit last year. Capital projects expended from the fund for the year amounted to \$2,147, primarily for the STEP market surveillance system. The deficit and capital expenses reduced the Fund from \$27,532 to \$23,516 by the end of the year. An IIROC policy is in place to ensure adequate Hearing Panel related costs are maintained.

Externally Restricted ABCP Fund

Activity in this fund was limited to interest of \$226, an increase of \$214, up from \$12 the prior year. Investments are governed by IIROC's investment policy. This brought the Fund balance up to \$32,488 from its beginning-year balance of \$32,262. IIROC is waiting for the release of an OSC panel decision before proceeding to distribute these funds according to a previous agreement with the OSC.

Merger Fund

This Fund was set up to support the Investment Dealers Association/Market Regulation Services Inc. combination and the only activity in the current year was for legal costs for the Consolidated Enforcement Rules and the development of the proposed integrated fee model; the latter in accordance with IIROC's Recognition Orders. The balance at the end of FY2011 was \$16.

Liquidity and capital resources

At the end of FY2011, IIROC held consolidated surpluses of \$102,572, up \$2,019 from the \$100,553 last year, including the Capital Asset Fund, Unrestricted Fund, Externally Restricted Fund, Externally Restricted ABCP Fund and the Merger Fund.

During the year, IIROC invested \$3,282 in capital assets consisting of the completion of phase one of the STEP market surveillance system, website enhancements and rebuild, annual PC and laptop refresh and an HR system.

IIROC maintains the Unrestricted Fund balance at approximately three months' operating cost level in accordance with an internal guideline. At \$34,871, up \$5,764 from the beginning balance, it holds excess funds of \$12,387 after taking account of FY2012 budgeted expenses; \$4,379 for the Dealer Regulation and \$8,008 for the Market Regulation. Potential uses for this surplus include fee reductions, pension funding, future capital expenditures and construction costs for the consolidation of the Toronto office facilities.

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Commitments

At the end of the year IIROC had total minimum rental commitments of \$29,801 excluding Goods and Services Tax/HST and occupancy costs, net of expected recoveries from other parties, under long-term leases with varying expiry dates to February 18, 2024. This is an increase from last year's amount of \$13,743, as IIROC entered into a lease for additional premises to consolidate Toronto offices and to extend the lease term by eight years.

Subsequent to the end of the year, the organization has entered into a credit facility with a Canadian financial institution for financing connected to the Toronto office consolidation.

The Organization has commitment obligations under a services agreement for information technology and other administrative services with TMX Group Inc. which expires in May 2014 amounting to \$13,520, compared to \$22,523 the year before.

Subsequent to the year end, IIROC entered into discussions with the TMX Group in respect of IIROC using the STEP market surveillance platform to monitor the TSX and TSX-V marketplaces. In conjunction with these discussions, IIROC and the TMX Group are also discussing an early termination of the services agreement, including a potential early termination fee payable by IIROC.

The Organization is a sponsor of the Canadian Investor Protection Fund ("CIPF"), which was established to protect customers who have suffered financial loss due to the insolvency of a Dealer Member of IIROC. IIROC has provided a \$100 million guarantee on bank lines of credit of the CIPF. At March 31, 2011, the CIPF has not drawn on these lines of credit. Any amount drawn on the guarantee would be assessed to Dealer Member firms. In order to meet potential financial obligations, the CIPF has the following resources in place: i) a contingency fund balance of \$381 million on hand as at December 31, 2010 (2009 – \$359 million); and ii) lines of credit provided by two Canadian chartered banks totaling \$100 million (2009 – \$100 million) as noted above.

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 at March 31, 2011, the remaining commitment is \$897. Additionally, the Organization has committed to fund the Investor Education Foundation for the "Funny Money" program to a maximum of \$558. As at March 31, 2011, the remaining commitment is \$216. The Organization has also committed to fund the Capital Markets CRC for research work to a maximum of \$450. As at March 31, 2011, the remaining commitment is \$150.

Future changes in accounting policies

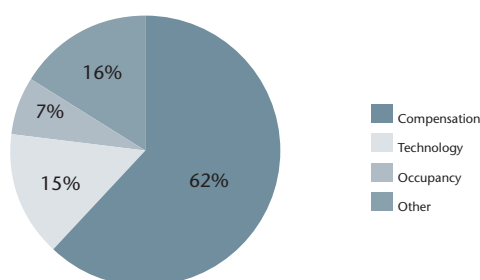
On December 31, 2010, the Accounting Standards Board (AcSB) issued Part III of the Accounting Handbook: Accounting Standards for Not-for-Profit Organizations ("ASNFPPO"). The standards are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2012. The standards are applicable to all not-for-profit organizations. Additionally, not-for-profit organizations maintain the option to adopt International Financial Reporting Standards. IIROC has decided to adopt Part III ASNFPPO.

Outlook

Operating expenses for the coming year are budgeted to be \$89,935, which is driven by additional human resource requirements in response to increasing demands of IIROC's regulatory mandate. These demands include the expansion of the complaint resolution process and increased branch reviews in the compliance areas. Additional IT staff will be added in order to provide greater operational capability, infrastructure and marketplace testing.

The budget for IIROC's 2012 fiscal year was prepared on the assumption that IIROC increases capability for Dealer Regulation in the areas of Business Conduct Compliance and complaints handling, and Market Regulation by enhancing STEP.

FY2012 Budgeted Operating Costs



New projects and programs being introduced in the upcoming year include regulatory reviews for specific firm compliance and updated compliance programs to address new practices and products at the member firms. IIROC plans to partake in special studies for new regulatory issues. From an efficiency perspective, IIROC intends to automate single-issue compliance reviews. IIROC plans to enhance the complaint handling process by adding new staff in that area. We will also place an emphasis on investor issues for seniors. IIROC will be implementing an organization-wide staff training program designed to ensure standardized training is delivered to our managers and will also focus on relevant functional specific training.

IIROC has extended its current lease and added additional space for the consolidation in the coming year of the Toronto staff. IIROC will also migrate next year to a VoIP telephony technology, easing communication between all its facilities. During the upcoming year, IIROC has planned an enhancement to STEP's architecture to increase its processing and storage capacity up to a billion messages per day. Additionally, IT infrastructure and data centres will be updated and streamlined to provide better support.

As a result of these upcoming objectives, FY2012 member fees were to increase by 12% for Dealer Regulation activities and 8% for Market Regulation activities when compared to FY2011 fees that were subsidized with a surplus of \$3,000 for Dealer Regulation and \$1,200 for Market Regulation from the prior year. If compared to FY2011 fees without the subsidy, the increase would have been 6% for Dealer Regulation and 3% for Market Regulation. Subsequent to the approval of the budget, the Board approved the use of \$780 of the FY2011 surplus of the Dealer Regulation division to reduce fee increases to 4% on a post subsidy basis. The Board also approved the use of \$2.092 million of the FY2011 Market Regulation surplus to reduce fees so they decrease by 4.5% on a post subsidy basis. The return of the FY2011 surplus brings the total surplus returned to IIROC members in the form of fee reductions up to almost \$10 million since IIROC was launched in 2008.

In FY2011, IIROC ended the year with a surplus in the Market Regulation division. Potential uses of the surplus include pension funding, future capital projects and construction of the Toronto facilities.