

ALBERTA SECURITIES COMMISSION

RECOGNITION ORDER CLEARING AGENCY

Natural Gas Exchange Inc.

Background

1. Natural Gas Exchange Inc. (**NGX**) has applied to the Alberta Securities Commission (the **Commission**) for recognition under the *Securities Act* (Alberta), R.S.A. 2000, c. S-4 (the **Act**) as a clearing agency.
2. NGX has concurrently applied to the Commission for recognition under the Act as an exchange because it also operates an electronic trading system.
3. The definition of “clearing agency” in the Act does not contemplate an entity that is also an exchange (the **Definition Limitation**).

Interpretation

4. Unless otherwise defined, terms used in this order have the same meaning as in the Act or in National Instrument 14-101 *Definitions*.

Representations

5. NGX represents as follows:
 - (a) NGX operates an electronic clearing system (the **Clearing System**) based in Calgary, Alberta, for clearing and settlement of natural gas and electricity commodity contracts, certain of which constitute exchange contracts, futures contracts or options under the Act (the **Contracts**).
 - (b) NGX has operated an electronic trading system (the **Trading System**) since 1993 in accordance with the terms and conditions of exemptive relief granted by the Commission and other Canadian securities regulatory authorities.
 - (c) NGX provides clearing and settlement services for Contracts traded through the Trading System and on third party marketplaces.
 - (d) NGX also provides clearing services for certain over-the-counter transactions that are entered into the Clearing System.
 - (e) Access to the Clearing System is restricted to entities (**Contracting Parties**) each of which:
 - (i) has entered into a contractual agreement (the **Contracting Party's Agreement**) with NGX; and

(ii) has, or is a wholly-owned subsidiary of a business entity that has, a net worth exceeding \$5 000 000 or total assets exceeding \$25 000 000 (the **NGX Sophistication Thresholds**).

(f) The Contracting Parties use the Clearing System only as principals.

Undertakings

6. NGX undertakes:

- (a) to comply with applicable securities legislation;
- (b) to operate the Clearing System in accordance with the clearing principles set out in Appendix A to this order (the **Clearing Principles**);
- (c) to report to the Commission in accordance with the reporting requirements set out in Appendix B to this order (the **Reporting Requirements**);
- (d) not to enter into any contract, agreement or arrangement that may limit its ability to comply with applicable securities legislation or this order;
- (e) to take reasonable steps to ensure that each officer or director of NGX is a fit and proper person for that role and that the past conduct of each officer or director affords reasonable grounds for belief that the officer or director will perform his or her duties with integrity;
- (f) to notify the Commission at least 10 business days in advance of entering into any agreement to outsource key Clearing System functions;
- (g) to notify the Commission at least 10 business days in advance of any significant change in the operation of the Clearing System;
- (h) to notify the Commission at least 10 business days in advance of any change in the beneficial ownership of NGX;
- (i) to use its best efforts to provide the information required in paragraphs 6(f) to (h) above earlier than specified, when possible;
- (j) to seek the Commission's prior approval of any significant changes to the NGX Sophistication Thresholds;
- (k) to notify the Commission immediately upon NGX becoming aware that any of its representations in this order are no longer true and accurate or that it becomes unable to fulfil any of its undertakings set out in this order; and
- (l) to comply with any request from the Executive Director of the Commission for electronic or any other form of access to the NGX Clearing System to assist the Commission in its oversight of NGX as a clearing agency.

Decision

7. Based on the above representations and undertakings and notwithstanding the Definition Limitation, the Commission, being satisfied that it would not be prejudicial to the public interest, recognizes NGX as a clearing agency pursuant to sections 67 and 213 of the Act, provided that:
- (a) subject to paragraph 6(k) above, the representations made by NGX remain true and accurate; and
 - (b) NGX fulfils the undertakings given above.

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APPENDIX A

Clearing Principles

1. **Core Principle 1: Financial Resources** - The clearing agency shall demonstrate on an ongoing basis that it has adequate financial, operational, and managerial resources to discharge the responsibilities of a clearing agency.
2. **Core Principle 2: Participant and Product Eligibility** - The clearing agency shall maintain: (i) appropriate admission and continuing eligibility standards (including appropriate minimum financial requirements) for its members or participants; and (ii) appropriate standards for determining eligibility of products, agreements, contracts or transactions submitted to the clearing agency.
3. **Core Principle 3: Risk Management** - The clearing agency shall maintain the ability to manage the risks associated with discharging the responsibilities of a clearing agency through the use of appropriate tools and procedures.
4. **Core Principle 4: Settlement Procedures** - The clearing agency shall maintain the ability to: (i) complete settlements on a timely basis under varying circumstances; (ii) maintain an adequate record of the flow of funds associated with each transaction cleared; and (iii) comply with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations.
5. **Core Principle 5: Treatment of Funds** - The clearing agency shall maintain standards and procedures designed to protect and ensure the safety of member or participant funds.
6. **Core Principle 6: Default Rules and Procedures** - The clearing agency shall maintain rules and procedures designed to allow for the efficient, fair, and safe management of events of member or participant insolvency or default by the member or participant with respect to its obligations to the clearing agency.
7. **Core Principle 7: Rule Enforcement** - The clearing agency shall: (i) maintain adequate arrangements and resources for the effective monitoring and enforcement of compliance with the rules of the clearing agency and for resolution of disputes; and (ii) maintain the authority and ability to discipline, limit, suspend, or terminate a member's or participant's activities for violations of rules of the clearing agency.
8. **Core Principle 8: System Safeguards** - The clearing agency shall: (i) maintain a program of oversight and risk analysis to ensure that the automated systems of the clearing agency function properly and have adequate capacity and security; (ii) maintain emergency procedures and a plan for disaster recovery; and (iii) ensure that its systems, including back-up facilities, are annually tested by a qualified professional, sufficient to ensure timely processing, clearing and settlement of transactions.

9. **Core Principle 9: Reporting** - The clearing agency shall provide to the Commission all information necessary for the Commission to conduct its oversight function of the clearing agency with respect to the activities of the clearing agency.
10. **Core Principle 10: Recordkeeping** - The clearing agency shall maintain records of all activities related to its business as a clearing agency, in a form and manner acceptable to the Commission, for a period of 5 years. The clearing agency shall also maintain a record of allegations or complaints it receives concerning instances of suspected fraud or manipulation in clearing activity.
11. **Core Principle 11: Public Information** - The clearing agency shall make information concerning the rules and operating procedures governing the clearing and settlement systems (including default procedures) available to its market participants.
12. **Core Principle 12: Information Sharing** - The clearing agency shall: (i) enter into and abide by the terms of all appropriate and applicable domestic and international information-sharing agreements; and (ii) use relevant information obtained from the agreements in carrying out the clearing agency's risk management program.
13. **Core Principle 13: Restraint of Trade** - The clearing agency shall avoid: (i) adopting any rule or taking any action that results in any unreasonable restraint of trade; or (ii) imposing any material anticompetitive burden on trading in the regulated markets.

APPENDIX B

Reporting Requirements

In addition to fulfilling any reporting requirements in applicable securities legislation, the clearing agency will report as follows to the Commission:

Immediate Reporting

1. NGX will report immediately upon occurrence or upon becoming aware of the existence of:
 - (a) any event or circumstance or situation that renders, or is likely to render, NGX unable to comply with applicable securities legislation or this order;
 - (b) any default by NGX that affects its financial resources or its ability to meet its obligations as a clearing agency, including the particulars of the default and the resolution proposed. NGX shall also provide the Commission with information regarding the impact of the default on the adequacy of NGX's financial resources;
 - (c) any order, sanction or directive received from, or imposed by, a regulatory or government body;
 - (d) any investigations of NGX by a regulatory or government body;
 - (e) any criminal or quasi-criminal charges brought against NGX, any of its subsidiaries, or any of the officers or directors of NGX or its subsidiaries; and
 - (f) any civil suits brought against NGX, any of its subsidiaries, or any of the officers or directors of NGX or its subsidiaries, that would likely have a significant impact on NGX's business.

Key Event Reporting

2. NGX will report no later than 2 business days of the date of occurrence:
 - (a) the appointment or resignation of one or more directors of NGX's board of directors;
 - (b) a change to the senior management team;
 - (c) any significant changes to the Contracting Party's Agreement.

In the event that a default by a Contracting Party under the Contracting Party's Agreement is not resolved within 2 business days, NGX will report:

- (a) such default including particulars of the default, the parties involved in the default, and the method of resolution proposed.

Quarterly Reporting

- 3. NGX will provide, within 60 days of the end of each fiscal quarter:
 - (a) a description of any significant margin requirement exceptions that NGX allowed during that quarter;
 - (b) an up-to-date list of Contracting Parties; and
 - (c) interim financial statements.

Annual Reporting

- 4. NGX will provide, within 90 days of the end of each fiscal year:
 - (a) audited financial statements; and
 - (b) a self-assessment of the accomplishments and the challenges faced during the year, which will include, but is not limited to:
 - (i) a summary of NGX's business activity for the year;
 - (ii) a summary of new products introduced and expansion plans that were implemented during the year;
 - (iii) a report detailing the testing undertaken to ensure the adequacy of system safeguards including, but not limited to, risk management methodologies, emergency procedures and disaster recovery plans, business continuity and proper functionality of backup facilities;
 - (iv) a summary of staffing changes at NGX during the year; and
 - (v) any additional information that NGX considers important.

Triennial Reporting

- 5. Every three years NGX will provide a report of a review conducted by an independent party, assessing NGX's clearing operations risk and controls.

Other

- 6. The Executive Director may direct the form of the reporting required and may, pursuant to applicable securities legislation, require further information from NGX.