

Annual Assessment Report
Natural Gas Exchange Inc.

**2009
Report**

Alberta
Securities
Commission

July 2010

Contents

Executive Summary3

The Assessment Report.....3

 Purpose and Scope3

About NGX.....4

 Regulation of NGX in other jurisdictions4

ASC Market Regulation’s Oversight of NGX in 20094

 Oversight Review.....5

Summary of NGX’s 2009 Business Activities.....5

Conclusion.....5

Executive Summary

The Alberta Securities Commission's (ASC) Market Regulation division annual assessment report (the **Assessment Report**) summarizes the ASC's oversight activities pertaining to the regulation of Natural Gas Exchange Inc. (NGX) in 2009. Specific initiatives undertaken by ASC staff (**Staff**) are addressed in the Assessment Report and include: a focused on-site review (**Oversight Review**); review and analysis of NGX's required reporting to the ASC; regular meetings and discussions with NGX's management; and continued monitoring of the results of the integration of certain operations of NetThruPut Inc. (NTP) into NGX.

The ASC's view is that NGX is in compliance with the core principles and reporting obligations under Alberta securities laws.

The Assessment Report

Purpose and Scope

The ASC has issued orders (the **Recognition Orders**¹) granting NGX recognition as both an exchange and a clearing agency under Alberta securities laws. The ASC is mandated to assess NGX's compliance with its obligations under those laws. As an exchange, NGX is required to regulate the operations and standards of practice of its participants in accordance with its rules and practices.²

The ASC's oversight of NGX is guided by the clearing and operating principles (the **Core Principles**) and reporting requirements (included as an appendix to the Recognition Orders). Under a memorandum of understanding (**MOU**) among some Canadian Securities Administrators respecting the oversight of exchanges, the ASC is the lead exchange regulator of NGX, with its exchange and clearing systems based in Alberta. The ASC has also entered into an MOU with the United States (**US**) Commodity Futures Trading Commission (**CFTC**) regarding sharing of cross-border clearing information, which will apply to the ASC's oversight of NGX's clearing activity.

This Assessment Report summarizes the ASC Market Regulation division's oversight of NGX and its evaluation of NGX's compliance with the Recognition Orders, for the 2009 calendar year.

- Section III outlines NGX's operations and history, as well as regulation of NGX in other jurisdictions.
- Section IV describes ASC's oversight activities for 2009, including key initiatives undertaken in the year.
- Section V discusses NGX's business activities and significant changes thereto during 2009.

¹ Copies of NGX's recognition orders are available on the ASC's website at www.albertasecurities.com.

² Section 63(2) of the Securities Act (*Alberta*).

About NGX

NGX – a wholly-owned subsidiary of TMX Group Inc. – operates an electronic trading and clearing system based in Calgary for the trading, clearing and settlement of natural gas, power, and crude oil physical and financial contracts.

In March 2007, NGX entered into a technology and clearing alliance with IntercontinentalExchange Inc. (ICE) for the North American natural gas and Canadian power markets. In March 2008, NGX's natural gas and Canadian power contracts were outsourced to the ICE trading platform, while NGX retained the clearing function. In May 2009, TMX Group Inc. exercised its option to purchase NTP from Enbridge Inc. and Circuit Technology Ltd. NTP is an electronic crude oil trading and clearing platform, and certain aspects of its operations were integrated into NGX.

The ASC recognized NGX as an exchange and as a clearing agency in October 2008; prior to that, NGX had been exempted by the ASC from some recognition criteria, but was required to abide by certain operating principles. In April 2009 the ASC varied the Recognition Orders to include the trading and clearing of crude oil contracts.

Regulation of NGX in other jurisdictions

NGX is exempted from the exchange recognition requirements by the Ontario Securities Commission, the Autorité des Marchés Financiers, and the Manitoba Securities Commission. The British Columbia Securities Commission has exempted NGX from certain provisions of their securities laws regarding trades in exchange contracts and the prohibition of trading of exchange contracts in unrecognized exchanges outside British Columbia.

NGX was granted registration in the US by the CFTC as a derivatives clearing organization in December 2008. NGX also operates in the US as an exempt commercial market (ECM) for exempt commodities that are traded on a principal-to-principal basis between eligible entities.

The CFTC in April 2009 published final rules applicable to ECMs trading significant price discovery contracts (SPDC). In October 2009, the CFTC gave notice of this intent to determine whether certain NGX contracts perform significant price discovery functions. On April 27, 2010 the CFTC determined that they currently do not.

ASC Market Regulation's Oversight of NGX in 2009

The ASC's oversight goals, pertaining to NGX as a recognized exchange and clearing agency during this period, primarily include:

- determining the adequacy of NGX's policies, procedures and reporting, for compliance with Alberta securities laws including the Recognition Orders during 2009; and
- identifying issues in NGX's operations, which may need to be addressed to ensure NGX's ongoing compliance.

In September 2009, Staff conducted a focused review of NGX's policies and operating procedures, as well as NGX's compliance with its internal controls, reporting requirements and safeguards. Staff also reviewed NGX's trading and clearing activities to evaluate the adequacy of NGX's resources to operate

as an exchange and clearing agency. The review focused on certain events that occurred during the assessment period – in particular, TMX Group Inc.’s acquisition of NTP.

Throughout 2009, Staff undertook extensive discussions with senior NGX personnel on focused and topical subject areas, including NGX’s application to vary its Recognition Orders to add crude oil contracts, and the effects of NGX’s market strategies on the adequacy of its trading and clearing systems to provide an appropriate market. These discussions addressed changes to NGX’s business, with a view to ensuring that the ASC keeps abreast of these changes, and that NGX, as it evolves, remains in compliance with its obligations under the Recognition Orders.

Staff also reviewed information provided by NGX either as part of its regular reporting under the Recognition Orders, or in response to specific Staff requests. Staff followed their analysis of this information with further information gathering and meetings with NGX staff, to ensure that Staff have an appropriate understanding of NGX’s operations and results.

Staff also engaged in various discussions with CFTC staff about NGX, in the context of each commission’s respective orders relating to NGX.

Oversight Review

The structure of the Oversight Review was guided by certain themes relating to NGX’s operations, and reflecting changes in its business, as well as the Core Principles of the Recognition Orders. These themes also incorporated recent changes to NGX’s business.

After conducting the Oversight Review in September 2009, Staff presented their findings to NGX. Among these were certain issues that NGX needed to address, relating either to NGX’s operational procedures or its adherence to them. NGX responded to the ASC’s findings within the requisite time, with proposed solutions for each item of concern. None of the findings poses an immediate risk to NGX’s ability to function as an exchange or a clearing agency.

Summary of NGX’s 2009 Business Activities

NGX’s parent company, TMX Group Inc., acquired NTP on May 1, 2009. NTP’s electronic crude oil trading platform was acquired by NGX, which now provides exchange services for crude oil contracts through this platform. NGX began trading and clearing US oil contracts in May 2009. The ASC had granted a variation order on April 9, 2009, adding crude oil contracts to NGX’s product list in advance of the acquisition and transition.

NGX added 10 new US and two new Canadian natural gas “cleared points” (i.e. contract locations) in 2009.

Conclusion

Based on the 2009 oversight activities outlined above, we conclude that NGX was in compliance with its obligations under Alberta securities laws. Staff will continue to adapt our oversight activities to changes in NGX’s business and developments in the broader marketplace.