MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated May 30, 2006

The financial statements present the results of the Ontario Securities Commission (OSC) for the year ended March 31, 2006 with 2005 comparatives and accompanying notes. Unless otherwise specified, references to years, for example 2005, refer to the fiscal years of the OSC ended March 31. The following comments analyze the factors which affected the OSC's operations during 2006, as well as the factors that reasonably may be expected to affect future operations and financial results.

This document should be read in conjunction with the financial statements. Certain statements included in this annual report are forward looking and are subject to important risks and uncertainties. The results or events forecast in these statements may differ materially from actual results or events. Factors which could cause results or events to differ from current expectations are described in the risks and uncertainties section. Readers should note that some assumptions, although reasonable at the time of publication, are not guarantees of future performance.

Overview

The Ontario Securities Commission is a corporation without share capital. The OSC functions as an independent regulatory agency and administrative tribunal responsible for overseeing the securities industry in Ontario. As a Crown corporation, the OSC is exempt from income taxes. The OSC's operations are funded through fees paid by securities market participants. Employee compensation and occupancy costs account for 81.1% (2005 – 78.4%) of OSC expenses.

The *Securities Act* requires the OSC to complete a Memorandum of Understanding with the responsible Minister to outline the ongoing roles, responsibilities and accountability relationships between the two parties. The OSC and the Minister of Finance signed a Memorandum of Understanding in May 2004. This Memorandum of Understanding was affirmed on November 3, 2005 by the new Minister responsible for the OSC.

The OSC maintains accounting and internal control systems to provide reasonable assurance that its financial information is complete, reliable and accurate and that its assets are adequately protected. The Board of Directors, in conjunction with the Audit and Finance Committee, has an oversight role to ensure the integrity of the reported information.

OSC Fees

The OSC fee schedule is designed to generate fees that reflect the OSC's cost of providing services to market participants. The OSC sets fee levels every three years. The new fee schedule became effective April 1, 2006. Fee levels are adjusted to offset accumulated deficits or surpluses. The fee schedule requires the payment of "activity fees" and "participation fees".

Activity fees are designed to represent the direct cost of OSC staff resources used in undertaking certain activities requested of staff by market participants. Activity fees are charged for a limited number of activities only and are flat rates based on the average cost to the OSC of providing the service.

Participation fee levels are based on the cost of a broad range of regulatory services that cannot be practically or easily attributed to individual activities or entities and are intended to serve as a proxy for the market participant's use of the Ontario capital markets. Participation fee levels are set using a tiered structure. As the market size of a market participant increases, they move through various tiers which have increasingly higher fees. The breadth of the tiers is set sufficiently wide to minimize movement through tiers due to market fluctuations. This tiered design reduces volatility in OSC revenues due to market changes.

The *Securities Act* states that, when ordered to do so by the responsible Minister, the OSC shall pay into the Consolidated Revenue Fund such of its surplus funds as determined by the Minister. The Minister has confirmed that the OSC is not required to remit its surpluses subject to appropriate terms and conditions to be agreed with the Ministry. The OSC has committed to re-evaluate its fee levels every three years and to take into account any accumulated surplus in setting fees for the ensuing period. Any deficits will be funded either through surpluses previously generated or that may be generated in the future, or from the OSC's reserve.

Analysis of Operating Results

2006 Actual versus 2006 Budget

(Thousands)	2006 Actual	2006 Budget
Revenues	$ 83,050	$ 67,062
Expenses	$ 65,823	$ 66,963
Excess of Revenue	$ 17,227	$ 99
Capital Expenditures	$ 2,439	$ 2,989

Excess of Revenue over Expenses

Our budget was for an excess of revenue over expenses of $99K in 2006. Our actual excess was $17.2 million. Revenues were $16 million higher than budget primarily due to higher than expected participation fees ($13.2 million) and the return by CDS. Inc. (CDS) of $964K of the contribution made in 2005 to be used for improving the System for Electronic Disclosure by Insiders (SEDI) as CDS is not leading this phase of the enhancements.

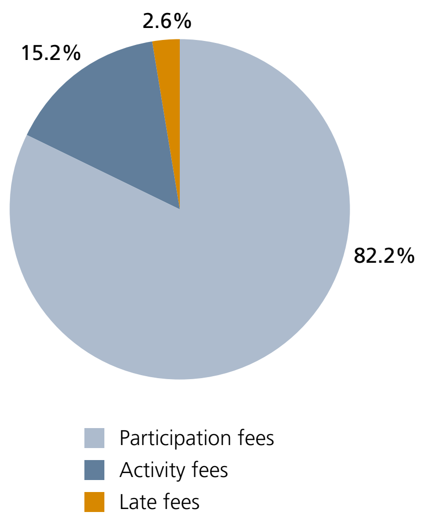
Revenues

(Thousands)	% of Total Fees	2006 Actual	2006 Budget	Change	% Change
Participation fees	82.2	$ 65,759	$ 52,562	$ 13,197	25.1
Activity fees	15.2	12,127	11,566	561	4.9
Late fees	2.6	2,093	1,500	593	39.5
Total fees	100.0	79,978	65,628	14,350	21.9
Investment income		1,872	1,339	533	39.8
Miscellaneous		1,200	95	1,105	1163.2
Total revenues		$ 83,050	$ 67,062	$ 15,988	23.8

Certain columns in this and subsequent tables may not total due to rounding.

Figure 1 shows the sources of OSC fees:

Figure 1 – OSC Fees by Type



Participation fees are the largest revenue source, accounting for 82.2% of fees. Actual fees earned exceeded budget by $13.2 million. Issuer participation fees were $7.9 million above plan. We were expecting fees to decline by about $10.4 million due to the elimination of the one-time timing impact from the introduction of NI 51-102 *Continuous Disclosure Obligations* (NI 51-102). The expected reduction in fees did not occur due to unanticipated revenue increases generated by higher than expected growth in the number and the market capitalization of issuers. Registrant participation fees were $5.2 million above plan. The increase was due to growth in registrant firm revenues which generates higher participation fees.

Activity fees accounted for 15.2% of total fees. Issuer activity fees were $204K over plan due to higher than expected fees from private placements. These were partially offset by a lower than expected volume of filings for relief and filings of preliminary and/or final prospectuses. Registrant activity fees were $355K over plan due to higher than expected registrations of directors, officers and salespersons.

Late fees accounted for 2.6% of fees and were greater than planned by $593K, or 39.5%. The variance occurred because:

- filing of interim and annual statements ($146K) and issuer participation fees ($140K) were greater than plan because NI 51-102 accelerated the filing deadline for issuers and more issuers than expected missed the deadline.
- filing of notices of changes for Registrants were $174K greater than plan due to the volume of activity.

Investment income generated by deposits and other investments was $533K or 40% above plan. The positive variance occurred due to slightly higher interest rates combined with higher than expected cash balances. Interest on cash balances generated $926K (2005 – $715K). These balances earn interest at a rate of 1.75% below the prime rate or 0.25% below bankers' acceptances. Investments in short and mid term instruments with the Ontario Financing Authority generated $946K (2005 – $820K). The average rate of return on these instruments was 2.96% which was 39 basis points higher than in 2005.

Miscellaneous revenues were $1.2 million versus a budget of $95K. The variance was due to the return by CDS of $964K of the contribution made in 2005 to be used for improving SEDI as CDS is not leading this phase of the enhancements.

Expenses

(Thousands)	2006 Actual	2006 Budget	Change	% Change
Salaries and benefits	$ 48,871	$ 48,901	$ (30)	– 0.1
Administrative	5,263	4,966	297	6.0
Occupancy	4,570	4,748	(178)	– 3.8
Professional services	3,827	4,329	(502)	– 11.6
Amortization	2,329	2,679	(350)	– 13.1
Other	963	1,340	(377)	– 28.1
Total expenses	$ 65,823	$ 66,963	$ (1,140)	– 1.7

Salaries and benefits spending were on budget. Savings due to vacancies and delays in hiring were offset by higher than expected costs for severance. The OSC conducted a detailed job evaluation and compensation review in 2006. The salary adjustments arising from the results of this process also exceeded the budget. The OSC public salary disclosure (calendar 2005) is available on the Ontario Government website: www.gov.on.ca.

Administrative costs were $297K over budget. Commission expenses were $338K higher than budgeted. This reflected higher than expected governance and policy related activities by commissioners as well as the impact of changes to the per diems for part-time Commissioners. Training was lower by 27% or $207K as planned activities were deferred due to other workload priorities. Actual recruitment costs ($135K) were 50% below budget due to the use of lower cost recruiting alternatives.

Occupancy costs were lower due to reduced maintenance costs and lower than expected security monitoring costs.

Amortization costs were $350K under budget due to unplanned asset disposals and a revision to the budget calculation.

Professional services costs were 11.6% under budget. Spending on enforcement related matters was $924K or 60.6% higher than expected due to higher than expected activity on various high profile cases. A total of $684K in professional services costs related to enforcement were recovered from various matters that were settled during the year. Other professional services spending was $952K or 32% lower than planned because of delays in internal audit activities, deferred information technology initiatives and slower than expected progress on various projects. In other cases such as knowledge management, internal resources were used, reducing the cost of consulting services.

Other expenses were lower by 28.1% or $377K. Certain travel either came in under budget or did not take place. International Organization of Securities Commissions (IOSCO) related travel was lower. As well, costs for compliance staff travel within the province were lower as staff efforts were more focused in the GTA than planned.

2006 Actual versus 2005 Actual

(Thousands)	2006 Actual	2005 Actual
Revenues	$ 83,050	$ 65,755
Expenses	$ 65,823	$ 61,629
Excess of Revenue	$ 17,227	$ 4,126

Excess of Revenue over Expenses

The excess of revenue over expenses for 2006 was $17.2 million (2005 – $4.1 million) up $13.1 million from 2005. This resulted primarily from the $14.9 million fee rebate that was recorded in 2005, partially offset by higher expenses related mostly to higher salaries and benefits. Revenues and expenses are discussed in more detail below.

Revenues

(Thousands)	% of Total Fees	2006 Actual	2005 Actual	Change	% Change
Participation fees	82.2	$ 65,758	$ 64,009	$ 1,749	2.7
Activity fees	15.2	12,127	12,436	(309)	– 2.5
Late fees	2.6	2,093	2,000	93	4.6
Total fees	100.0	79,978	78,445	1,533	2.0
Rebate of fees			(14,935)	14,935	N/A
Investment income		1,872	1,535	337	22.0
Miscellaneous		1,200	711	489	68.8
Total revenues		$ 83,050	$ 65,755	$ 17,295	26.3

Revenues for the year were $83.1 million, up $17.3 million from 2005. The increase primarily reflects the $14.9 million fee rebate that was recorded in 2005. The balance of the variance is related to the following:

Participation fees for registrants were higher due to a 22% growth in registrants' revenues. Issuer participation fees were lower because the implementation of NI 51-102 in April 2004 resulted in higher participation fee revenue in 2005, as some issuers paid fees twice during the year.

Activity fees were lower by $309K reflecting a lower level of prospectuses filed as well as lower volumes for a broad range of fee categories.

Late fees for late SEDI filings generated $944K or 45.1% of total late fees. In 2005, late fees for late SEDI filing generated $1.1 million or 56.3% of total late fees.

Investment income was higher related to the higher cash balances and interest rates. Interest on cash balances generated $926K (2005 – $715K). Investments in short and mid term instruments with the Ontario Financing Authority generated $946K (2005 – $820K). The average rate of return on these instruments was 2.96% which was 39 basis points higher than in 2005.

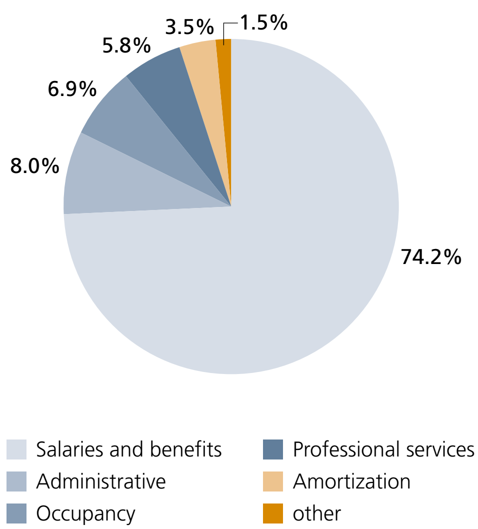
Miscellaneous revenue was greater related to the net effect of the $964K returned to the OSC by CDS (representing the return of the contribution the OSC made to CDS for SEDI improvements) less $456K recovered last year from the Autorité des marchés financiers for their portion of the National Registration Database (NRD), recorded last year.

Expenses

(Thousands)	% of Total Expenses	2006	2005	Change	% Change
Salaries and benefits	74.2	$ 48,871	$ 44,287	$ 4,584	10.4
Administrative	8.0	5,263	5,648	(385)	– 6.8
Occupancy	6.9	4,570	4,037	533	13.2
Professional services	5.8	3,827	3,232	595	18.4
Amortization	3.5	2,329	3,267	(938)	– 28.7
Other	1.5	963	1,158	(195)	– 16.8
Total expenses	100.0	$ 65,823	$ 61,629	$ 4,194	6.8

Total expenses for 2006 (Figure 2) increased 6.8% to $65.8 million (2005 – $61.6 million).

Figure 2 – OSC Expenses by Type



The key contributors to the expenditure increase were as follows:

Salaries and Benefits costs increased by 10.4% to $48.9 million (2005 – $44.3 million) and accounted for 74.2% (2005 – 71.9%) of total OSC expenses. Key contributors to this increase were the impact of job evaluation and other annual salary adjustments ($1.9 million), higher costs for bonuses ($362K) and severance costs ($1.1 million). The full year cost impact of staff hired during the year in 2005 also contributed to the increase. Because we operate in a competitive environment for professional talent, our compensation system includes performance-based incentives. These incentives represented 8.8% of our total salaries and benefits costs.

Administrative costs accounted for 8.0% (2005 – 9.2%) of the OSC's total expenses. Expenditures on administrative costs decreased by 6.8% to $5.3 million (2005 – $5.6 million). Spending for training declined by 16.9% to $550K (2005 – $662K). Commission related expenses rose 43.5% to $1.1 million (2005 – $758K). The increase is due to a greater volume of governance and policy related activities by commissioners and an increase in per diems for part-time commissioners. The number of matters before the Commission increased by 9.7% to 34 (2005 – 31). The number of hearing days decreased 18.3% to 67 (2005 – 82). Communications costs were 11.4% higher at $1.4 million (2005 – $1.2 million). Key contributors to this increase were higher costs for Investor Communication initiatives and Enforcement related printing.

Occupancy costs accounted for 6.9% (2005 – 6.6%) of the OSC's total expenses. Expenditures on occupancy increased $533K or 13.2% to $4.6 million. The increase reflected the impact of higher lease costs and the acquisition of additional space late in 2005 to accommodate staff growth.

Professional Services costs increased 18.4% from $3.2 million to $3.8 million and accounted for 5.8% (2005 – 5.2%) of the OSC's total expenses.

($ Millions)	2006	2005
Actual costs	4.5	3.5
Less recoveries of costs	0.7	0.3
Net Professional Services	3.8	3.2

The increase in actual costs related to increased enforcement work. Approximately $1.8 million in net professional services was for enforcement-related matters including the use of external legal and forensic accounting resources and other specialized expertise.

The OSC is a member of the Canadian Securities Administrators (CSA), which is a forum of provincial securities regulators. Total CSA spending on shared projects was $1.9 million in 2006 (2005 – $1.9 million), of which the OSC contributed $787K (2005 – $755K). Professional services include costs to operate CSA offices (allocated on a formula basis) as well as our portion of costs for all professional services costs incurred on joint CSA projects.

A central secretariat co-ordinates all CSA projects, including the development of harmonized securities policies and rules. A CSA systems office manages the CSA's business relationships with third party technology providers. In 2006, the OSC contributed $193K (2005 – $175K) to the cost of the CSA Secretariat and $211K (2005 – $208K) to the cost of the systems office.

Key initiatives funded through this process included:

Investor education initiatives	$ 230K
Uniform securities transfer legislation	$ 144K
National Registration System	$ 122K
National cease trade order system	$ 106K
Joint Forum initiatives	$ 100K

Amortization costs accounted for about 3.5% (2005 – 5.3%) of the OSC's total expenses. Amortization expenses decreased to $2.3 million (2005 – $3.3 million) due to the fact that the leasehold improvements related to the major renovations completed before 2003 are completely amortized.

Other expenses, which reflect travel and related expenses, declined by $195K or 16.8% to $963K million (2005 – $1.2 million) and accounted for 1.5% (2005 – 1.9%) of the OSC's total expenses. Less travel to support our international work with IOSCO, reduced compliance staff travel within the province and other planned travel that did not take place due to other priorities were the key sources of this decrease.

Liquidity and Financial Position

Liquidity

The OSC has sufficient liquidity to finance its operations and capital purchases. Our cash position improved by $19.3 million or 52.8% in 2006. Cash flows from operations were $21.6 million. Purchases of capital assets used $2.4 million.

As at March 31, 2006, the OSC held $55.9 million (2005 – $36.6 million) in cash, had current assets of $57.7 million (2005 – $38.4 million) and current liabilities of $10.1 million (2005 – $8.4 million) for a current ratio of 5.7:1 (2005 – 4.6:1). Our general surplus increased by $17.2 million, reflecting our excess of revenues over expenses. The fee schedule for the next three years was designed to generate deficits over the period in order to draw down this surplus. This will reduce liquidity.

Reserve

Our fee structure has reduced the potential for significant fluctuations in revenues arising from market volatility. Revenue generation remains a source of risk for the OSC as all revenues are still correlated to market activity to some extent. To manage this uncertainty, the OSC has a $20 million reserve as an operating contingency for revenue shortfalls or unexpected expenses. The OSC has an additional $12.0 million reserve that may only be used to offset costs incurred related to the proposed merger of the OSC with the Financial Services Commission of Ontario.

The rate of return on investments is low as the funds are invested in treasury bills. The prime investment consideration for the reserve is the protection of capital and the appropriate liquidity to meet unanticipated cash flow needs. The OSC records income generated by the reserve into general operations.

Accounts receivable

Accounts receivable were essentially unchanged at $1.5 million. Outstanding late fees, which accounted for 13% of accounts receivable, decreased 44% to $521K (2005 – $936K) due to more active collection efforts and an increase in our allowance for doubtful accounts. Other key receivables are interest receivable $554K (2005 – $377K) and $128K from the Investor Education Fund (IEF) (2005 – $120K).

Designated settlements

In 2006, the OSC approved $2.2 million in designated settlements arising from enforcement proceedings. Funds that are received as a result of settlements may, under the terms of the settlement, be designated to or for the benefit of third parties such as the IEF which the Commission established five years ago. Funds that are not designated at the time of the settlement are paid to the Consolidated Revenue Fund of the Government of Ontario. The IEF's objectives are to increase knowledge and awareness among investors and potential investors and to support research and develop programs and partnerships which promote investor education. A Board of Directors governs the IEF and is responsible for developing criteria for, and approving, the disbursement of funds.

The OSC currently holds $4.7 million in designated settlements. Amendments to the *Securities Act* in December 2004 removed the requirement for Ministerial approval of allocations of designated settlement funds. The Minister retained the right to impose guidelines for the allocation process. The OSC will continue to seek Ministerial approval for designated settlements exceeding $1 million approved prior to the amendment. The OSC is currently seeking Ministerial approval to transfer $1.9 million of these designated settlement balances to third parties.

Funds in trust, CSA

Since 2005, the Commission has received $8.6 million from the operator of the System for Electronic Document Analysis and Retrieval (SEDAR), representing the accumulated surplus from the operations of SEDAR from its inception. Interest earned on these funds in 2006 was $204K. These funds are held by the Commission in accordance with agreements amongst the Commission, the Alberta Securities Commission, the British Columbia Securities Commission and L'Autorité des marchés financiers, and shall be used towards one or more of the following actions:

- development or enhancement of SEDAR;
- development or enhancement of the System of Electronic Disclosure by Insiders (SEDI);
- to permit a reduction in the SEDAR fee schedule;
- for application towards a previous year's shortfall.

Capital expenditures

Capital expenditures during 2006 included:

(Thousands)	2006	2005	% Change
Furniture and Equipment	$ 372	$ 191	94.8
PC's, Laptops and other IT equipment	1,148	1,388	– 17.3
Leaseholds and other capital items	919	473	94.3
Total	$ 2,439	$ 2,052	18.9

Capital assets were essentially unchanged at $ 4.0 million. Capital expenditures of $2.4 million (2005 – $2.1 million) were made during 2006. About 47.1% of the purchases were technology related ($1.1 million), including equipment purchased for increased staff complement and replacement of computer equipment to ensure the currency of our technology base. Leasehold improvements for additions to and consolidation of our leased space accounted for 37.7% of capital spending and furniture and equipment accounted for the remainder.

Liabilities

Accounts payable and accrued liabilities increased 17.6% to $9.9 million (2005 – $8.4 million). Key accrual increases included bonuses and severance ($1.3 million), vacations ($151K) and a $220K increase in our payroll accrual. General payables declined by $207K.

Other long term liabilities of $1.2 million (2005 – $1.1 million) represents future obligations relating to supplementary pension plans. The unfunded supplemental pension plans had an accrued benefit obligation of $1.2 million (2005 – $967K) at March 31, 2006. The OSC's related expense for the year was $170K (2005 – $187K) and is included in salaries and benefits.

Risks and Uncertainties

Operational Risk

The OSC has policies and processes to identify, manage and control operational risk. Key components of our operational risk approach include:

- a Board of Directors responsible for sound corporate governance.
- independent third party internal auditors who, through periodic, risk-based audits, are responsible for verifying that significant risks are identified, assessing the appropriateness of our controls and recommending changes as required.
- a strong internal control environment which includes separation of duties between key functions and defined authorization controls.
- our Chief Economist group works with our program areas to develop risk-based solutions for their operations.
- we mitigate risk to our assets through insurance where practical and appropriate.
- regular reviews of our systems security measures to monitor our controls and identify potential vulnerabilities against external parties accessing our data.

We also monitor and manage operational risk through activities such as business continuity planning and risk-based approaches to compliance.

Business continuity

The OSC has a Business Continuity Plan to ensure the continuation of critical regulatory services should the OSC face a significant disruption to its operations. Detailed business continuity plans are in place for each priority business function. Each plan includes documented recovery procedures including manual workarounds and mitigation strategies. Offsite recovery services and facilities are in place and were successfully tested during 2006. We are currently finalizing our plan to include strategies to recover and resume our operations for various disruption scenarios (such as a pandemic) that could limit our access to our staff or render our offices unusable for an extended period.

Risk-based compliance

Risk-based approaches are being used for disclosure review and compliance. Our Corporate Finance group continue to enhance their risk-based screening procedures so that a substantial proportion of their review population receives some form of meaningful assessment each year, while ensuring that they only invest our resources into a full review when it is merited. The group completed 477 reviews or 35% of Ontario-based reporting issuers this year.

Our Investment Funds group recently initiated reviews of continuous disclosure filings made under NI 81-106, *Investment Funds Continuous Disclosure*. As part of this process, staff is compiling a list of compliance issues, which vary depending on the nature of the fund reviewed, with a view to developing a risk-based process for these reviews.

Enforcement also uses a risk-based approach to ensure cases that are brought forward are subject to consistent scrutiny, involve significant breaches of Ontario securities law, and give appropriate consideration to Commission priorities.

Reputational Risk

The OSC actively manages its reputational risk through its governance practices, various policies and procedures and by its code of conduct (Bylaw 2). The activities of our Communications branch and our offices of the General Counsel, Corporate Secretary and Policies and Projects are key participants in managing our reputational risk.

People risk

As a knowledge-based entity our ability to attract and retain people is critical to our success. We track a range of measures (e.g., turnover, compensation surveys) to manage this risk. Turnover increased to 44 staff or 11.6% from 34 staff or 8.9% in 2005. Knowledge management is a key focus and we continue to pursue initiatives to improve our ability to retain corporate memory and to ensure effective knowledge transfer.

National approaches to securities regulation

The implications of the ongoing national discussions on approaches to securities regulation in Canada are a source of uncertainty and could have a material impact on OSC operations.

Reliance on CDS

CDS operates a number of major systems on behalf of the CSA and the OSC. The NRD system was launched on March 31, 2003. The current operating agreement for the NRD expires March 2009. SEDI became fully operational in May 2003. The current operating agreement for SEDI runs until May 2010.

CDS recovers its costs to operate these systems by charging user fees to filers. In 2006, 89.8% (2005 – 90%) of our fee revenue was collected through national systems: SEDAR (49.5%) and the NRD (40.3%). No material change is expected in the volume of fees collected through these systems.

If CDS becomes unwilling or unable to operate one or all of these systems, the OSC and the CSA will need to ensure the continued operation of these systems as disruptions in processing our fees through these systems would materially affect our cash flows.

2007 Outlook

Our 2006/2007 Statement of Priorities sets out our priorities and proposed initiatives for the upcoming year. The document is available at www.osc.gov.on.ca. The proposed 2006/2007 budget will allow us to move toward achievement of the following goals:

- Provide fair, vigorous and timely enforcement
- Take actions to better understand and address the needs of the retail investor
- Promote a harmonized, simplified and strengthened securities regulatory framework for Canada
- Work to achieve appropriate regulatory integration of North American and global capital markets
- Support and promote a more flexible, efficient and accountable organization

Our 2006/2007 budget reflects our plan to return surplus funds earned during the past three years to our stakeholders by way of reduced fees. As a result, we are projecting a deficit of $12.2 million in 2007.

2007 Budget versus 2006 Actual

(Thousands)	2006 Actual	2007 Budget	Change	% Change
Revenues	$ 83,050	$ 60,016	$ (23,034)	– 27.7%
Expenses				
OSC Operations	65,752	70,275	4,523	6.9%
SEDI Modernization	71	1,893	1,822	2566.2%
Excess of Revenue	$ 17,227	$ (12,152)	$ (29,379)	
Capital Expenditures	$ 2,439	$ 1,284	$ (1,155)	– 47.4%

Revenues

In 2006, $83.0 million was earned in revenue. The OSC remains committed to ensuring that fees paid by issuers and registrants reflect the projected costs to regulate each group. Our new fee schedule became effective April 1, 2006. In setting the new activity fees we reviewed each service activity and its related cost. Participation fees were set at levels to generate a cumulative deficit equal to the forecast surplus collected from market participants as at March 31, 2006.

The chart below sets out the 3-year projections that were used in developing the new fees, as projected at January 2006. The forecast reflected management's best estimates at the time and is subject to material change.

(Thousands)	2006/2007	2007/2008	2008/2009
Opening Surplus	$ 39,500	$ 27,500	$ 14,100
SEDI Modernization Commitment	1,900	–	–
	$ 41,400	$ 27,500	$ 14,100
Projected Revenues	58,300	60,000	63,000
Projected Expenses	(70,300)	(73,400)	(77,000)
Projected SEDI Modernization Costs	(1,900)	–	–
Projected Surplus	$ 27,500	$ 14,100	$ 100

The budget does not anticipate a material change in the level of market activity. Although our fee structure is designed to reduce the potential for significant fluctuations in revenues arising from market volatility, the potential for material market fluctuations due to world events is an ongoing source of risk that could have a negative impact on OSC revenues. OSC revenues are expected to be $60.0 million or 27.7% lower in 2007. The revised fee schedule will affect stakeholders differently in order to better reflect the services they receive and the benefits they derive from participating in Ontario's capital markets.

Total participation fees paid by issuers are forecast to decline by 39.3%. Total participation fees paid by registrants are forecast to rise by 5.1%. Total activity fees are projected to decline by 10.9%. Late fees are forecast to fall by 32.8%. Investment income is forecast to fall by $200K due to expected lower cash balances.

Expenses

Salaries and benefits costs are projected to rise 5.5% to $51.6 million (2006 – $48.8 million) accounting for 44% of the total budget increase. This increase reflects a decision to increase approved staffing by 3% from 412 to 424. The areas with the largest increases are compliance and enforcement. The rest of the increase is generated by annual performance related changes to salaries of current staff, additional bonus requirements arising from staff growth and the annualized impacts of various in-year staff changes and vacancies.

Administrative costs are expected to rise by 18.9% or $994K. Staff training is projected to increase by $480K primarily due to plans to increase management training and the cost of the bi-annual Mutual Reliance Review System training with other CSA staff. This training enhances the consistency of review approaches used by staff across all CSA jurisdictions. Training was also underspent against budget as planned activities were deferred due to other workload priorities. Other planned cost increases are Commissioners' costs ($157K), recruitment expenses ($105K) and IT maintenance ($247K).

Occupancy costs are projected to rise 14.4% to $5.2 million (2006 – $4.6 million) due to higher lease-related operating costs.

Amortization costs are expected to decline 24.6% to $1.8 million for 2007 (2006 – $2.3 million) reflecting a reduced capital base.

Professional services costs are projected to rise 18.6% to $4.5 million for 2007 (2006 – $3.8 million). Our share of the costs for CSA shared projects is expected to rise by $385K. The budget includes a stakeholder survey ($100K) and $519K primarily for CSA contingency costs and potential freedom of information policy work. These increases will be partially offset by an expected decline in external consultant costs for enforcement litigation activity.

Other expenses are forecast to increase 33.5% to $1.3 million (2006 – $1.0 million). Increased travel costs for various CSA initiatives (e.g., Highly Harmonized Securities Legislation) and IOSCO related travel are the key sources of the increase. Higher costs are also expected due to a return to traditional compliance field work in Capital Markets involving travel throughout Ontario.

Capital expenditures are budgeted at $1.3 million, 47.4% lower than the $2.4 million spent in 2006. Minor renovations for new staff will require spending for leasehold improvements ($50K) and related furniture ($50K). Information technology-related capital expenditures in 2007 will remain virtually unchanged at $1.2 million.