February 4, 2013

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Ontario Securities Commission
Saskatchewan Financial Services Commission

VIA ELECTRONIC MAIL

Re: CSA Staff Consultation Paper: Model Provincial Rules - *Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting*.

Dear Members of the Canadian Securities Administrators:

Direct Energy Marketing Limited ("Direct") hereby submits comments to the Canadian Securities Administrators (the "Administrators") with respect to CSA Staff Consultation Paper: Model Provincial Rules - *Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting*, published on December 6, 2012 (the "Proposed Model Rules").[1] Direct offers these comments on the present proceeding and looks forward to working with the Administrators as you move forward with the regulatory reform process.

I. Direct Energy.

Direct is one of North America's largest energy and energy-related services providers with over 6 million residential and commercial customer relationships. A subsidiary of Centrica plc (LSE: CNA), one of the world's leading integrated energy companies, Direct operates in 10 provinces in Canada and 46 states, plus the District of Columbia in the United States. In addition to owning and operating over 4,600 wells in Alberta with total natural gas production of 172 mmcfe per day, Direct's Midstream and Trading group performs a variety of physical and financial energy management activities, including production marketing and hedging, wholesale energy supply, transportation and storage.

II. Proposed Definition of "Derivative".

A. Treatment of Forward Contracts for Physical Commodities

As proposed, the definition of "derivative" contains an exclusion for forward contracts for physical commodities ("Forward Contracts"), but the language of the exclusion creates certain interpretational issues. Specifically, the exclusion for Forward Contracts is only available

[1] Canadian Securities Administrators, CSA Staff Consultation Paper 91-301, *Model Provincial Rules – Derivatives: Products Determination and Trade Repositories and Derivatives Data Reporting*, December 6, 2012.

for contracts that (i) "require counterparties to make or take physical delivery," (ii) do not "allow for cash settlement in place of physical delivery," and (iii) "that [are] intended by the counterparties to be physically settled."[2] Although, in the proposed model explanatory guidance to the definition of "derivative," the Administrators state that in certain situations cash settlement in lieu of physical delivery would not render a Forward Contract a derivative.[3]

Direct appreciates the Administrators recognition that certain commercial realities, such as a *force majeure* event or counterparty default, do not render "an otherwise firm obligation for physical delivery merely an option for physical delivery."[4] However, there are other common commercial practices where Forward Contracts that would otherwise meet the criteria of the exclusion from the definition of "derivative," but nevertheless, such contracts fully or partially settle in cash. For example, in certain markets it is common for intermediate counterparties in a delivery chain to book-out their delivery obligations and cash settle. The result is that only the first and last parties in the delivery chain actually take and make physical delivery of the underlying commodity, though each counterparty in the delivery chain retains the legal right (and the legal obligation) to require delivery of that commodity. In other markets, it is common practice for counterparties with offsetting delivery obligations to deliver just the net amount of commodity obligated to be transferred between the counterparties. That netting process can be conducted bilaterally between the counterparties or by a market administrator.

In both of these examples, counterparties to the Forward Contracts intended to take and make physical delivery when they executed the contracts, the counterparties retained the right to require physical delivery and, ultimately, some degree of physical delivery occurred. The book-outs and delivery netting were a commercially efficient way of satisfying the counterparties' obligations and do not change the underlying character of the transactions from physical to financial. As such, Direct respectfully requests that the Administrators clarify that common commercial practices designed to make the trading of physical commodities efficient and practical, such as book-outs and net settlement, do not convert Forward Contracts into derivatives as long as, at execution, the counterparties intended to take and make physical delivery.

B. Treatment of Certain Foreign Exchange Derivatives

For purposes of the Proposed Model Rules, spot foreign exchange contracts that call for the delivery of the underlying currencies are excluded from the definition of "derivative." The scope of that exclusion is appropriate for the context of reporting, but may be too narrow for other facets of derivatives regulation. The Administrators have an interest in having a complete view into the Canadian derivatives markets, and so the inclusion of all non-spot foreign exchange derivatives in the definition of "derivative" for the Proposed Model Rules is warranted. However, for future rulemakings on additional regulatory requirements for derivatives, such as mandatory central clearing, Direct suggests that the Administrators consider

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[2] *Proposed Model Rules* at Model Provincial Rule, *Derivatives: Product Determination*.

[3] *Proposed Model Rules* at Model Explanatory Guidance to *Model Provincial Rule – Derivatives: Product Determination.*

[4] *Id.*

a broader exclusion for foreign exchange products.[5] An alternative approach is to exclude foreign exchange transactions from the definition of "derivative" and establish a related, but separate, regulatory paradigm for such transactions.

III. Proposed Reporting and Trade Repository Rules.

A. Coordination with International Standards

Direct appreciates the Administrators permitting trade repositories located outside Canada to serve as designated trade repositories. Allowing them to do so will significantly reduce the burden on multi-national companies that trade in multiple markets. For example, such companies might minimize the number of data repositories with which they become enabled. Direct requests that as the Administrators finalize these model rules they continue to provide enough flexibility for Canadian market participants to satisfy their reporting obligations by reporting transactions to non-Canadian trade repositories.

In addition, Direct requests that the Administrators make every effort possible to coordinate the required data fields and data format in the Proposed Model Rules with those promulgated by the United States' Commodity Futures Trading Commission (the "CFTC") in implementing the reporting requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Many Canadian companies, including Direct's Canadian entities, have already undertaken, and in some cases completed, efforts to build the reporting infrastructure necessary to comply with the CFTC's rules. Accordingly, any significant deviation between the final version of the Proposed Model Rules and the CFTC's final reporting regulations could result in Canadian market participants needing to build out duplicative and costly reporting and recordkeeping systems.

B. Reporting of Pre-Existing Derivatives

Direct understands the Administrators' rationale for requiring market participants to report their unexpired derivatives entered into prior to the effective date of Part 3 of the Proposed Model Rules. Reporting of such trades provides the Administrators with a picture of the current risk in the Canadian derivatives markets. The Proposed Model Rules reduce the potential burden associated with reporting of pre-existing transactions in two ways. *First*, the exemption in Proposed Model Rule 41.4 for transactions that expire within 365 days of the effective date of Part 3 of the Model Rules will likely exclude the majority of pre-existing derivatives from the reporting requirement. *Second*, allowing both counterparties to serve as reporting party for a transaction will eliminate the need for many market participants to negotiate reporting obligations with respect to pre-existing trades.

However, the Proposed Model Rule 26 has reporting requirements for pre-existing derivatives that would impose a significant burden on market participants. As drafted, Proposed Model Rule 26 requires market participants to report the same creation data as required for

[5] The United States Department of Treasury recently excluded certain foreign exchange products from the definition of "swap" (the U.S. term for regulated derivative) for certain purposes because of those products' unique characteristics and risks. *See Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act.* Final Determination. 77 Fed. Reg. 69,694, Nov. 20, 2012.

transactions entered into after the effective date of Part 3 of the Proposed Model Rules. With respect to pre-existing derivatives, at execution, market participants captured the data they deemed necessary in the normal course of their business. Those data capture systems were most likely developed prior to the contemplation of the Proposed Model Rules. As such, many market participants likely do not have the required data formatted in a manner to allow it to be easily reported and, in certain circumstances, may not have the required data at all. Even if it were possible to report such information, requiring market participants to reformat or even recreate creation data for pre-existing derivatives could prove to be quite costly. Therefore, Direct respectfully requests that the Administrators amend Proposed Model Rule 26 to require market participants to report only the creation data currently in their possession.

C. Definition of Local Counterparty

The proposed definition of "local counterparty" could impose a significant burden on Canadian companies and serve as a competitive disadvantage to those companies' foreign operations. Specifically, the definition of "local counterparty" (*i.e.*, those entities subject to the reporting requirements set forth in the Proposed Model Rules) would capture the direct and indirect subsidiaries of entities domiciled in Canada. This definition would subject derivatives transactions between foreign subsidiaries of Canadian enterprises and such subsidiaries' foreign counterparties to Canadian law.

Subjecting such transactions to a reporting obligation under Canadian law places an unnecessary burden on subsidiaries of Canadian entities and may also serve as a disincentive for foreign counterparties to enter into derivatives transactions with such subsidiaries. Direct, in light of the potentially significant costs and indirect benefits associated with the current definition of "local counterparty," suggests that the Administrators strike subsection (f) of that definition.

D. Reporting of Centrally Cleared Trades

Under Part 3 of the Proposed Model Rules, a reporting party retains its reporting obligations even for a centrally cleared derivative.[6] Requiring market participants to report cleared derivatives ignores the fact that clearing agencies, given the nature of their business, are in a better position to provide the necessary data on a cleared derivative directly to a designated trade repository. As such, Direct suggests the Administrators amend the definition of "reporting counterparty" to designate a clearing agency as the reporting party for all bilaterally executed and centrally cleared derivatives. In the event that a local counterparty clears a trade with a clearing agency that is unable to report to a designated trade repository, only then should the Administrators place the reporting burden on that local counterparty.

E. Phase-in of Reporting Deadlines

[6] Conceptually, both counterparties to a derivative that is executed bilaterally, but then centrally cleared, could be a reporting counterparty for life-cycle and valuation data as the original transaction between the counterparties is replaced by two transactions, each between one of the counterparties and the clearing agency once the original derivative is cleared by the clearing agency.

The Proposed Model Rules require market participants report a derivatives transaction as soon as technologically practicable and no later than the business day following execution of the derivative.[7] *First,* Direct requests that the Administrators clarify, to the extent possible, what criteria denote "as soon as technologically practicable." *Second,* given that reporting of derivatives transactions will initially be a significant undertaking for many market participants, Direct requests that the Administrators allow market participants to gradually phase-in their compliance with the above timeframes in order to avoid market disruption.

F. Public Comment on Forms

Finally, the Model Prosed Rules would require a reporting counterparty to report a swap that cannot be reported to a designated trade repository to be reported to the appropriate securities regulator.[8] That report would be made via a yet-to-be promulgated form. Given Direct's experience with derivatives regulatory reform in other jurisdictions, Direct requests that the Administrators release any form required to be filed by market participants in connection with derivatives regulation for public comment prior to using it to ensure that such form is functional and not overly burdensome.

IV. Conclusion.

Direct thanks the Administrators for the opportunity to provide comments on the Proposed Model Rules. Direct is looking forward to working with the Administrators in crafting the new regulatory environment for derivatives in Canada. If Direct can offer any assistance to the Administrators as regulatory reform efforts move forward, please contact me at 403-776-2246.

Sincerely,

/s/ Bill Rutherford

Bill Rutherford
Credit Risk Officer
Direct Energy Marketing Limited

[7] *Proposed Model Rules* at Part 3, Data Reporting.

[8] *Id.*