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

In care of:

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Re: Canadian Securities Administrators ("CSA")
Consultation Paper 91-301 Model Provincial Rules – Derivatives: Product Determination, and Trade Repositories and Derivatives Data Reporting

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Shell Energy North America (Canada) Inc. ("Shell Energy") and Shell Trading Canada, a division of Penzoil-Quaker State Canada Incorporated ("STC") (collectively, "Shell Trading") make this submission to comment on the model rules issued by the CSA considering the determination of derivatives and related data reporting obligations.

Description of Shell Trading

The Shell Trading companies are indirect subsidiaries of Royal Dutch Shell, plc ("Shell") which is impacted by, and participating in, the global efforts to reform financial markets regulation. Shell Energy markets and trades natural gas, electricity, and environmental products, including the natural gas produced by its affiliates in Canada. STC trades various grades of crude oil, refinery feed stocks, bio-components, and finished oil-related products, including such

commodities that are produced, manufactured, or imported by affiliates. Both entities also participate in the Canadian energy derivatives markets and together they manage risk and optimize value across physical and financial, exchange-traded and OTC markets.

Energy companies such as Shell often use an integrated approach to physical trading, supply management, and financial hedging in which different entities in the corporate group participate as a producer, trader, and marketer in the relevant commodity markets. Separate legal entities within the group are designated to enter into physical and financial transactions to help manage risk and optimize the physical portfolio of commodity assets owned and controlled by the corporate group. Such an approach achieves economies of scale, reduces and consolidates risk, and lowers administrative and transactional costs. By consolidating such physical and financial trading activity through hedging affiliates like Shell Trading, this model reduces overall risk to the company and the markets. Inter-affiliate swaps are a practical and efficient means to facilitate this process.

Model Provincial Rule, Derivatives: Product Determination ("Scope Rule") and Related Model Explanatory Guidance ("Scope EG")

Physical optionality – Shell Trading appreciates the clarity offered by the Scope EG as it relates to physical optionality within physical commodity contracts and supports the following statement:

> *"A contract or instrument that has an option relating to some aspect of physical delivery such as the volume of physical commodity to be delivered or the location of delivery would not, as a result of such an option, be a derivative."*

Environmental attributes / biofuel components – Another positive aspect of the proposed Scope EG is the enumeration of some categories of products viewed by the CSA to be physical commodities. Shell Trading understands that the intent is to provide some examples and not be all-encompassing. However, there are two categories of products that have been recognized by other jurisdictions as being physical commodities, which should be included in the Scope EG to avoid uncertainty. These categories of products for inclusion are environmental attributes and biofuel components.

Excluded derivatives – One of Shell Trading's biggest concerns regarding the Product Rule is the potential for physical transactions to be inappropriately treated as derivatives. This concern is especially relevant in the context of the exclusion provided for in section 2(d) of the Scope Rule. Generally, the wording should be consistent with that adopted by the Alberta Securities Commission in Blanket Order 91-505[1] to define a physical commodity contract.

Subsection 2(d)(i) of the Scope Rule uses the word "requires" related to the counterparties making and taking physical delivery. Contracts are negotiated to include many elements of a transaction, including the rights and obligations of each of the parties. The Scope Rule language

[1] Effective December 31, 2012.
http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/Proposed%20ASC%20Rule%2091-505/170-4321674-v8-Blanket_Order__-_91-505_OTC_Derivatives.pdf

should be changed to reflect this and be consistent with Blanket Order 91-505, such that subsection 2(d)(i) would read, "contains an obligation to make or take physical delivery".

Subsection 2(d)(ii) of the Scope Rule should be removed entirely. During the ASC Blanket Order 91-505 consultative process, the uncertainty for market participants created by an expansive interpretation of this cash settlement element was identified and accordingly the element was deleted from the definition of physical commodity contract. While the Scope EG attempts to provide some clarity, it fails to address the potential unintended consequences of not excluding transactions known in the industry as "bookouts" and "netting" from being considered derivatives. Trade in physical commodities regularly involves counterparties buying and selling between them over an extended period of time. This results in offsetting obligations for physical delivery of the commodity, and has been addressed through the operational and contracting practices of the industry.

Shell Trading suggests that the Scope EG be amended to include bookouts and netting arrangements as being acceptable aspects of physical commodity contracts that do not result in contracts or transactions being considered a derivative. This approach is consistent with the Provincial regulators who hosted the Derivatives Roundtable held in Calgary and other cities on January 16, 2013. The regulators noted that they are familiar with bookouts and netting transactions, and did not consider them as "cash settlements in place of physical delivery" for the purposes of the Scope Rule.

Model Provincial Rule, Trade Repositories and Derivatives Data Reporting ("TR Rule") and Model Explanatory Guidance ("TR EG")

Part 1: Definitions and Interpretation

Shell Trading disagrees with element (f) of the definition of "local counterparty", which states,

> *(f) the party is a subsidiary of a person or company, or group of persons and companies, described in any of paragraphs (a) to (d),*

This inclusion within the definition is unreasonable and should be removed or qualified further to limit its application. Under the proposed definition, the subsidiary of an entity meeting one or more of the other elements would become subject to the data reporting obligations in Part 3 of the TR Rule. No context or intent is provided in the TR EG, so this element must be taken at face value and interpreted to apply to the full universe of potential circumstance that might fit the wording.

Canadian companies operate globally and in many cases utilize foreign subsidiaries to achieve these operations. The proposed definition would make each of these subsidiaries subject to oversight by Canadian regulators irrespective of the circumstances of the company, the country in which they operate, or the regulatory regime in place in that country. This extraterritorial reach will create duplicative regulatory oversight and risk along with obligations and burden on market participants that are costly and provide no regulatory or public interest benefit.

Part 2: Trade Repository Designation and Ongoing Requirements

Section 23 specifies the requirements for the trade repository to confirm "with each counterparty to a transaction, or agent acting on behalf of such counterparty" that the data reported by the reporting counterparty is correct. This requirement will place an unnecessary burden on the non-reporting counterparty. This party may transact with several different reporting counterparties that report to multiple trade repositories. The technical and communications capabilities necessary to interact with each of these trade repositories creates a financial and labour burden that is too great considering the marginal benefit that it might achieve.

Part 3: Data Reporting

Reporting, local counterparty – Section 25 obligates a local counterparty to report each transaction to which it is a counterparty, and so two local counterparties to a transaction each would be obligated to report. Section 27 provides for the limitation of reporting obligations to only one counterparty. Together these sections raise some confusion about which counterparty is obligated to report. The TR Rule should be amended to address this potential confusion, possibly by making section 25 subject to section 27.

Pre-existing derivatives – Section 26 requires clarification regarding data that may be unavailable or not practically obtainable by participants. The requirements related to the reporting of pre-existing transactions are generally reasonable, however, the requirement to "include the same creation data as a transaction entered into after the coming into force" of the TR Rule will be difficult or impossible. Many elements of the proposed creation data (the time-stamp, for example) do not, or may not, exist or be available to the reporting counterparty because there was no business need to capture the data in the past. The TR Rule or TR EG should recognize the practical limitations of strict compliance and permit compliance on a reasonable efforts basis.

Valuation data – Section 35(1) regarding valuation data needs to be re-considered. Where a transaction has been cleared through a recognized central counterparty, or CCP, it is the CCP that should have the obligation to report valuation data to the trade repository. The CCP has to do a daily valuation in order to manage margin requirements for each party with cleared transactions. Those parties have no need to maintain separate valuation data.

Section 35(2)(a) requires valuation data reporting by "each local counterparty if that counterparty is a derivatives dealer". Where both parties are dealers, this paragraph would seem to unnecessarily obligate both of them to do the reporting, despite an arrangement between them that one would be the reporting counterparty. Shell Trading recommends that the wording be changed such that the reporting is done by the reporting counterparty where at least one of the counterparties is a derivatives dealer.

Data available to public –Under section 39(3) public access is available to transaction level reports "not later than" one day where one of the counterparties is a dealer and "not later than" two days in all other circumstances. The TR EG explains that the purpose of the delay is to ensure that participants have adequate time to enter into other transactions to offset or hedge their

positions. Section 39(3) does not, however, necessarily create a delay because the phrase "not later than" does not codify a required delay, but rather puts a time limit on the trade repository to complete the public reporting. The transaction level detail could end up being published by the trade repository within hours, or even minutes, of receiving the data. Shell Trading recommends the wording specify the earliest time that the data should be published, along with the latest. For example, it could be required "no sooner than" one day (or two, depending on the type of counterparties) and "not later than" two days (or 3 days).

Furthermore, the TR EG for this section provides that the time delays apply to all transactions, regardless of transaction size. Block trades were the subject of comments previously filed by stakeholders to the CSA so it is not clear why there is no accommodation within the TR Rules for the treatment of block trades. Shell Trading recommends that block trades be addressed in the TR Rule and TR EG and that their time delay be extended beyond those provided for other transactions. This will help ensure that counterparties have sufficient time to enter into further related transactions as desired.

Part 5: Exemptions

In response to the CSA's request for specific feedback on subsection 40(2), Shell Trading provides the following comments:

De minimis threshold – Shell Trading supports the inclusion of a de minimis threshold for reporting obligations under the TR Rule, but suggests it should apply to all transactions, including ones in which a dealer is a counterparty.

Notional value – The term "notional value" must be clearly defined because it is not a term that has been used in the energy industry in this context in Canada or the United States. The United States Commodity Futures Trading Commission (CFTC) has not provided definitive guidance on this topic, which has resulted in significant uncertainty for market participants seeking to comply with the new rules. That experience demonstrates the importance of establishing commonly understood calculations for the notional value of each type of derivative instrument. Therefore, it is important for the CSA to initiate consultation with stakeholders to discuss the meaning, details, and calculation of "aggregate notional value". Further discussion is also required around the application of the de minimis standard in different situations. For example, if a party has five transactions with an aggregate value of $450,000 that range from three to one year old, and then the party enters into a sixth transaction valued at $100,000, what obligations are triggered with the sixth transaction? Is it the sixth and subsequent transactions that must be reported, or is it all transactions including the ones that may have been entered into several years ago, or is it something else?

In respect of the level of value to be exempt from the TR Rule, the proposed $500,000 threshold is far too low and should be at least $2 million to accomplish the desire of avoiding the burden of reporting small transactions that are not material to risk in the markets.

Part 6: Effective Date

Shell Trading supports the proposed effective dates.

Inter-affiliate Transactions

Shell Trading strongly advocates against reporting of inter-affiliate transactions. Please see earlier comments filed on this issue, including those on CSA consultation paper 91-402.[2] Inter-affiliate transactions do not pose systemic risk and thus have no cause to be required to be reported under the TR Rule. If reporting is required, the data must not be included in either the aggregate or transactions specific data that is publicly reported by the trade repository. At best, the data is non-informative and, at worst, public disclosure can potentially cause great harm as recognized by the United States CFTC,

> *"The Commission agrees with the comments regarding the public dissemination of certain swaps between affiliates and portfolio compression exercises. The Commission concurs that publicly disseminating swap transaction and pricing data related to certain swaps between affiliates would not enhance price discovery, as such swap transaction and pricing data would already have been publicly disseminated in the form of the related market-facing swap. This information may create an inaccurate appearance of market depth. Notably, there is a very high volume of swaps between affiliates in certain asset classes (e.g., foreign exchange). To require public dissemination of all such transactions could be very costly for market participants. Where there are no price discovery benefits to publicly disseminating such transactions, the Commission has determined not to require the public dissemination of these transactions at this time."*[3]

The CSA should specifically exclude inter-affiliate transactions from the data reporting requirements in Part 3 of the TR Rule and specify in Part 4 that the trade repository must not publicly disseminate inter-affiliate transaction data.

Conclusion

Shell Trading also makes these two general comments about the CSA rules process.

First, parties that comment on the consultation papers have no means to determine the CSA's thinking about recommendations made by parties. In particular, when a recommendation is not adopted by the CSA, there is no means for the party making the recommendation to understand the CSA's assessment and decision. The process used by the CFTC is more transparent and informative. When the CFTC adopts a final rule it publishes an extensive preamble in which it discusses (at a high level) the recommendations made by various parties and explains why or why not the recommendations were adopted. This is helpful to parties as they formulate comments on other proposed rules and demonstrates the diligence of the regulator. In releasing future model rules, the CSA should adopt a similar approach that responds to stakeholder comments received and explains the reasoning for positions taken in the proposals.

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[2] See full filing at http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20110912_91-402_kerrp.pdf

[3] Federal Register / Vol. 77, No. 5 / Monday, January 9, 2012 / Rules and Regulations, page 1187

Second, the CSA should consider the future evolution of regulations and the ability to adapt to changes in markets and regulatory needs in a coordinated way among the Provinces. Given the scope of the model rules, this is particularly important where aspects of them might be in strong contrast to the views of industry, or inconsistent with the approaches of other jurisdictions. This could be achieved through the use of sunset clauses in the rules themselves or a firm commitment by the regulators and the CSA to engage in a review of the rules within two or three years after adoption.

Shell Trading appreciates the opportunity to provide these comments, and welcomes the opportunity to work with the CSA on the future regulation of commodity derivatives, including the critically important treatment of commercial energy firms within the reforms.

Please contact me at (416) 227-7312 if you have any questions regarding these comments or would like to explore any of the issues further.

Respectfully submitted,

Submitted electronically

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for Shell Energy North America (Canada) Inc.
and Shell Trading Canada