



Shell Energy North America (Canada) Inc.  
400 – 4<sup>th</sup> Avenue S.W.  
Calgary, Alberta T2P 2H5  
phone 403-216-3600

**via email**

January 25, 2012

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

In care of:

Mr. John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West, Suite 1900  
Toronto, Ontario M5H 3S8  
[jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)  
with paper copy via courier

and Me Anne-Marie Beaudoin, Secrétaire de l’Autorité  
Autorité des marchés financiers  
800 square Victoria, 22e étage  
Montéal, Québec H4Z 1G3  
[consultaion-en-cours@lautorite.qc.ca](mailto:consultaion-en-cours@lautorite.qc.ca)

**Re: Canadian Securities Administrators (“CSA”)  
Consultation Paper 91-403 Derivatives: Surveillance and Enforcement (“the Paper”)**

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Shell Energy North America (Canada) Inc. (“Shell Energy”) and Shell Trading Canada (“STC”) (collectively, “Shell Trading”) make this submission to comment on the Paper issued by the CSA considering surveillance and enforcement activities of over-the-counter (“OTC”) derivative markets and participants in Canada. Shell Trading supports the goals of increased transparency of OTC derivatives markets and protecting against improper participant conduct. This support includes the desire to provide constructive and insightful information and responses to the recommendations and proposals of the CSA and provincial regulators. Even though the Paper is predominantly a collection of high-level recommendations and preliminary positions expressing the need for further study and research, Shell Trading provides these comments in hopes of moving this consultation forward to the next step. Ultimately, the CSA and the provincial regulators will need to establish an iterative consultation process with stakeholders for considering the detailed issues of surveillance and enforcement, as well as the other key topics of consultation papers.

### **Description of Shell Trading**

The Shell Trading companies are indirect subsidiaries of Royal Dutch Shell, plc 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. Together, they manage risk and optimize value across physical and financial, exchange-traded and OTC markets.

## **Surveillance and Monitoring**

Shell Trading agrees that the approach adopted must consider the operational and other factors noted, but adds that the costs and benefits also need to be weighed as part of the future recommendation on how to proceed. As proposals emerge that call for new participant responsibilities and institutions, they must be clear as to what objectives or problems are being addressed along with the benefit they bring to the functioning of the markets. Rules that are ill-conceived or simply unnecessarily burdensome can realize unintended consequences of restricting trade and reducing market liquidity. Direct costs of establishing new or different organizations and their oversight roles will be compounded by the costs of market participants needing to interact with them and comply with potentially multiple layers of rules and jurisdictions inside Canada. Efficiency of the entire process and the impacts to participants must be part of the decision making process, along with the technological and resource capabilities and potential jurisdictional preferences of the regulators and other organizations involved.

Precision in terms of the issues being addressed is important at this stage to set the foundation for future work intended to define specific rules that make sense for Canadian markets, products, and participants. This objective must be met while recognizing the importance of supporting Canada's G20 commitments and striving for substantive harmonization of frameworks with other international jurisdictions.

Part (b) related to monitoring participant positions includes some statements that are concerning to Shell Trading due to their vagueness, and the regulatory uncertainty and risk that results. The Paper states, "... the provincial regulators will need to understand the risks resulting from key participants ..." but there is no explanation or definition of who these "key" participants might be and what risks present concerns. Despite this lack of clarity, the section continues on to recommend that regulators should obtain position data from them and that it, "... will include transaction information as well as information provided by the market participants themselves". How and when will these participants be defined or identified? What is the data that might be sought? If not transactional data obtained from trade repositories, under what process or authority is this data to be collected and how will the CSA or provincial regulators be consulting with stakeholders regarding this recommendation? Unfortunately, many of the other recommendations in the Paper are similarly lacking in the details that would enable participants to provide constructive comments, and so they raise more questions than comments.

Shell Trading strongly supports the need to establish provincial legislation that ensures the protection of confidential participant information residing with the regulators and other organizations involved in the monitoring and operation of the OTC derivatives markets. Disclosure of participant information would not only harm the participant but undermine the effectiveness and credibility of

regulatory oversight. Agreements to share information with other regulators must also include the protection of confidential information.

## **Market Conduct Rules**

Shell Trading continues to advocate for the role of the CSA in coordinating the efforts of provincial regulators and submits that the ultimate goal of these consultations should be the issuance of national instruments to address as many areas of OTC regulatory reform as possible. Unfortunately the recommendations of this Paper state that the provincial regulators should individually figure out these extremely significant and complex conduct rules themselves and establish whatever legislation and rules they see fit. This approach is troubling and surprising considering the paper describes how harmonization of market conduct rules has been achieved in the securities industry and includes a governing national instrument. Failing to establish the provincial consistency that results from national instruments could result in regulatory risk for participants, provincial jurisdictional disputes, and undermine efforts to achieve the objectives set out in the G20 agreement.

A coordinated effort leading to consensus is necessary to address the fact that OTC derivatives markets are not the same as securities markets and must be recognized as different in assessing and determining the objectives and outcomes of market surveillance and enforcement. The markets are different, the participants are different and have different objectives and practices, and so their behaviours need to be considered in light of their purposes within the OTC derivative sector and the well established commercial hedging and trading environments that exist. Derivatives rules cannot simply be equated to the rules and practices of the securities industry. These behavioural assessments and rules proposals must then further acknowledge and accommodate within the derivatives context the distinctions that exist between types of participants, types of products, and types of transactions.

Shell Trading recognizes that this is a complex and difficult exercise and urges the CSA and member provincial regulators to tackle it together, with stakeholders, rather than have each province attempt to address it individually. This approach will be more productive and less disruptive to participants and markets than the recommendations within the Paper that summarily state the provinces should “extend” the securities related conduct prohibitions to OTC derivative markets “as appropriate”. The judgement as to what is appropriate should be assessed and debated and decided through a collective industry engagement with the CSA rather than with each provincial regulator separately.

Part (a) Market Manipulation and Fraud: The extension of securities types of prohibitions to OTC derivatives such as commodities will be difficult, and the extension to “... any interest underlying a derivative” will present jurisdictional problems for regulators. Provinces have diverse approaches to the regulation of energy commodities. Authority over these physical markets may already lie with other regulatory bodies, surveillance administrations, or market operators having their own processes for market surveillance and enforcement.

Part (d) Abusive Trading Practices: The statement is made that the CSA considers, “... trading based on the use of material non-public information to be an abusive trading practice in certain circumstances”. Participants need to understand what is meant by “material” and what the “certain circumstances” are so they can ensure their practices and training programs address the issues correctly. Any such rules should not include OTC trading of physical commodities or their

derivatives, for example. Without defining such issues consistently and clearly across the provinces the outcome could reduce economic and efficient practices and transactions and impair market liquidity.

Part (f) Insider Trading: Shell Trading is confused and concerned by the contents of this section. Most of the consideration is clearly specific to derivatives of securities, however, it begins with the proposal that, "... these prohibitions be extended to include all derivatives". It could be, and is assumed by Shell Trading, that this was intended to state or infer the extension to all derivatives of securities rather than more broadly to all derivatives. This uncertainty must be clarified by the CSA. Similar to trading on non-public information, it would not be reasonable or appropriate to extend securities-based insider trading rules to all OTC derivative activity. These rules have not been applied to commodities or derivatives of commodities in the United States, for example, and should not be applied in Canada. In adopting rule 180, the Commodity Futures Trading Commission determined as follows;

"The Commission believes that Congress addressed these concerns, however, by enacting CEA section 6(c)(1), which provides that "no rule or regulation promulgated by the Commission shall require any person to disclose to another person non-public information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect." To be clear, the Commission is not, by this rulemaking, imposing any new affirmative duties of inquiry, diligence, or disclosure."

and,

"The Commission received comments regarding hedging or speculating (i.e., trading) on the basis of material nonpublic information. These comments use the label "insider trading," which can mean different things in different contexts. The Commission recognizes that unlike securities markets, derivatives markets have long operated in a way that allows for market participants to trade on the basis of lawfully obtained material nonpublic information. This final Rule does not prohibit trading on the basis of material nonpublic information except as provided in the following paragraph or otherwise prohibited by law."<sup>1</sup>

The CSA should reconsider the recommendations in the paper, and explore each of the conduct rules in much greater detail with respect to the types of products and transactions taking place.

Given the extensive research and consultation still to take place on these topics, Shell Trading supports the CSA proposal that position limits and rules around monitoring and enforcing them do not need to be established at this time.

## **Process and Conclusion**

The conclusion of the Paper states, "Once public comments have been received and considered the Committee will finalize rule making guidelines and each province will begin the rule making process." As noted previously, Shell Trading encourages the CSA to reconsider this approach and strive for the issuance of a national instrument for all the key components of OTC regulatory reform.

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<sup>1</sup> Federal Register / Vol. 76, No. 135 / Thursday, July 14, 2011 / Rules and Regulations: pages 41402 and 41403

Regarding surveillance and enforcement specifically, this Paper provides very little insight for participants and very little guidance to the provincial regulators, and so it is difficult to envision what the CSA will consider in moving towards issuing some sort of guidelines. There should be at least one more consultation paper issued to convey the results of the many areas noted in need of further study and research. Stakeholders would also benefit from much more detail and discussion related to the assessments and judgements to be used in proposing exactly what market conduct rules are to be applied to OTC derivatives and how this considers the complex differences in the types of products and the various markets, especially as related to commodities.

The CSA should also develop a process to report back to participants how comments have been assessed and incorporated, or not, into current thinking and future proposals. This iterative process would also be able to capture the final positions and rules adopted in other jurisdictions, especially where these rules differ from prior recommendations of the CSA. For example, the Commodity Futures Trading Commission recently determined that swaps between affiliates should not be subject to real time reporting requirements;

“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.”<sup>2</sup>

Shell Trading appreciates the opportunity to provide these comments, and would similarly welcome the opportunity to work more closely with the CSA on the future regulation of energy commodity derivatives and the critically important treatment of affiliates and 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,

*original signed*

Paul Kerr  
General Manager – Market Affairs  
Shell Energy North America (Canada) Inc.

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<sup>2</sup> Federal Register / Vol. 77, No. 5 / Monday, January 9, 2012 / Rules and Regulations, page 1187