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

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**Re: Canadian Securities Administrators (“CSA”)
Consultation Paper 91-407 Derivatives: Registration (“the Paper”)**

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 Paper issued by the CSA considering the proposed registration regime and compliance requirements for participants in the Canadian over the counter (“OTC”) derivatives markets.

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 an important, practical, and efficient component of this process.

Registration Requirement and Categories of Registration

Exchange-based Transactions - The Paper does not distinguish OTC transactions from exchange traded contracts and the consequences with respect to the business triggers for registration. The CSA has proposed to exclude commodity-based derivative contracts traded on exchanges from the definition of derivatives under the requirements for trade repository reporting. However, the CSA has also previously stated that the definition of derivative may be different for other aspects of new regulatory requirements. This has created uncertainty regarding the intentions of the CSA and the types of activity that trigger registration requirements. Shell Trading recommends that the CSA specifically exclude exchange traded contracts from the definition of derivative for registration purposes. If not excluded from the definition of derivative, the CSA should ensure that such activity is addressed and excluded from the triggers for registration, as referenced below.

Qualified Parties - Shell Trading strongly supports the delineation of participant types for the purpose of establishing compliance requirements designed to provide further protections for less sophisticated parties. While the Paper is silent as to the process involved for determining qualified party status, it is important that any proposed definition specify that status may be established at the time parties enter into a contract, and that each party may rely on the representations made by the other. Additionally, where a transaction is completed on an exchange, there should be an exemption from the need to determine qualified party status and the onus placed on the exchange to ensure that each party is a qualified party. Shell Trading does not take a position in recommending the adoption of any of the existing definition examples listed in the Paper, but notes that the breadth of scope of participant types and criteria contained in each of the examples are important factors in establishing the definition of a qualified party for derivatives regulation.

Derivatives Dealer - The Paper incorrectly makes the activities of “trading” and “dealing” synonymous, and the enumerated business triggers present the outcome that any entity that is determined to be trading in derivatives should be registered as a dealer. This results in an unacceptable risk that many more participants will be required to be registered, and regulated, than is necessary which is inconsistent with the CSA approach to date. The CSA has repeatedly

acknowledged the need to avoid placing undue burden on participants or negatively impacting markets, but in this instance concludes that, “*The proposed trigger may result in a variety of persons that do not carry out derivatives dealing activities as their primary business becoming subject to an obligation to register as a derivatives dealer.*”¹ There are many types of participants, including ones that would otherwise be considered “end-users” that are active in trading and may be captured by the proposed triggers and forced to register as dealers.

For example, a company that is in the business of speculative trading should not be required to register as a dealer if all of the trading activity is done on an exchange, even where the identity of the counterparty is known. Similarly, a participant who transacts predominantly for hedging purposes but also for speculative purposes on an exchange should not be required to register as a dealer, which would result in the participant losing end-user status and the accompanying exemptions. Producers and consumers of energy commodities will generally be considered as end-users under the evolving OTC derivatives regulatory regime, however, some may take a more active and dynamic approach to trading for the purpose of hedging. It is important to avoid imposing a dealer registration requirement on these participants on the basis of subjective triggers such as “*acting as a market maker*” or “*directly or indirectly soliciting*”.

In line with the comments above, the frequency of trading activity, whether for speculative or other purposes, should not be used as a trigger that requires any form of registration.

Registration for Categories of Derivatives - The Paper is silent on whether registration is specific to the derivatives, or category of derivatives, in which the participant is dealing. For example, a participant dealing in certain OTC energy commodity derivatives might be considered a dealer for those derivatives and thus be subject to registration under that category. The participant might, however, also be actively engaged in trading foreign exchange derivatives for the purpose of hedging this risk arising from trading energy commodity derivatives. It is important that registration as a dealer does not encompass these other transactions and impose dealer-type requirements or prevent the participant from being treated as an end-user for this separate and distinguishable activity.

De Minimis Exemption - Shell Trading disagrees with the proposal to not implement a *de minimis* threshold for exemption from the requirement to register as a dealer. Compared to international markets, the Canadian derivatives markets are small in size. The lack of a *de minimis* exemption will likely drive many current participants out of the Canadian OTC markets resulting in reduced competition and liquidity, with increased costs to those remaining who rely on such instruments to hedge their commercial exposures. Fewer parties willing to enter derivatives transactions could also result in greater concentration of risks among those remaining.

The CSA has placed a great deal of importance on the transparency objective of OTC derivatives regulation, resulting in the trade reporting rules being the first category of changes to be put in place. Implementing a *de minimis* exemption at the start will not diminish the transparency available to regulators. It will allow for further analysis of the markets to determine whether to reduce the threshold in the future if warranted. Any value in starting without a threshold and then assessing whether one could be enacted in the future would be outweighed by the burden and costs unnecessarily imposed on participants and the damage caused to the markets. In

¹ The Paper at page (2013) 36 OSCB 4127

implementing a *de minimis* level the CSA might consider establishing different thresholds based on whether the transactions are conducted with qualified parties or non-qualified parties. This would allow the threshold for participants whose transactions include non-qualified parties to be set lower than the threshold for those transacting with qualified parties only.

Large Derivatives Participant - The Paper notes that additional work will be undertaken, “*in consultation with other Canadian authorities to establish the thresholds for registration as a LDP.*”² Shell Trading recommends that consultation related to registration thresholds as well as any resulting compliance obligations should include public consultation seeking participant comments on proposals.

Registration of Individual Representatives - Shell Trading supports the proposal to require the registration of individuals where they are the ultimate designated person, chief compliance officer, and chief risk officer of the registrant but has some concerns as discussed below. Shell Trading also supports the proposal that individual representatives of a derivatives dealer need not register where they do not trade on behalf of non-qualified parties.

Registration Requirements

Proficiency Requirements - Shell Trading supports the recommendation that individual proficiency requirements be principle based and only for the class or category of OTC derivative being traded. Initially allowing work experience as a means to develop proficiency should be established as an enduring method to achieve this goal.

Financial Records and Reporting - The CSA proposes that registrants be required to file quarterly financial statements and audited financial statements annually. Many potential registrants are subsidiaries within a larger corporate group and may not have their own audited financial statements. If such a requirement is implemented as worded, it could cost each of these participants tens of thousands of dollars in audit fees. Shell Trading recommends that registrants be permitted to file the consolidated statements of their parent.

Compliance and Risk Management Systems - Shell Trading supports the need for such systems, policies, and procedures, but again notes that a registrant entity might be part of a larger corporate group. The CSA should make it clear that where the registrant functions within or under the systems, policies, and procedures of a corporate parent or group, the registrant is permitted to rely on these as control mechanisms in their operations as well as to demonstrate compliance, rather than be required to implement duplicative controls for the registrant entity solely.

Appointment of an Ultimate Designated Person, Chief Compliance Officer, and Chief Risk Officer - The CSA recommends that, “*no individual may simultaneously act as UDP, CCO and CRO however in certain situations, such as where the entity is very small in size, one individual may be allowed to fill more than one role.*”³ Shell Trading appreciates the intent to be flexible in this regard, but is concerned about the uncertainty that remains. For some participants this

² Id. at 4129

³ Id. at 4135

concern may be lessened if the CSA confirms in future rules that the individuals acting in these roles are not required to be employees of the registered entity. Irrespective of entity size, a registrant should be able to have these roles performed by an employee of their parent company or other affiliate. This arrangement may be necessary due to size, but also may be the most practical approach where the trading, compliance, or risk management functions and policies of the registrant are governed by or part of those of another entity. Difficulties for smaller participants brought on by such new requirements are another reason why the CSA should implement a *de minimis* threshold for registration.

Complaint Handling - It is not reasonable to require that all responses to complaints be approved by the registrant's UDP or CCO. In particular, complaints related to account or billing issues do not warrant the involvement of these individuals. Such a requirement should be limited to situations involving potential breaches of specific conduct requirements or involve an accusation of impropriety.

Honest Dealing - Shell Trading strongly supports the CSA's recognition that imposing the full gamut of fair dealing and other conduct requirements in circumstances where sophisticated parties enter into an OTC derivative trade is unnecessary to protect the interests of the registrant's counterparty and would disadvantage the registered entity. The recommendation to impose only the obligations to act honestly and in good faith when dealing with qualified parties, and then supplementing this with additional requirements when transacting with non-qualified parties, is reasonable. Similarly, it is also appropriate to limit the requirements for pre-trade reports, post-trade reports, and account statements to relationships with non-qualified parties, as recommended in the Paper.

Exemptions from Registration or Registration Requirements

Domestic Governments - Regulators must avoid providing an advantage to any type of participant in competitive markets when establishing rules and requirements related to participating in the markets. In the energy sector, government enterprises actively compete directly with non-public participants. As such, Shell Trading opposes the recommendation to exempt domestic governments and their corporations from registration and registration requirements where they are transacting only with qualified parties. The CSA justification based on financial resources and presenting little risk to the markets is not valid, as there are privately owned participants that are more financially sound than some of these governments.

Avoiding requirements related to capital and margining will provide an unacceptable direct financial advantage to government entities and negatively influence the competitiveness of the markets. Additionally, in considering the other requirements that come with registration as a dealer, it could be argued that with public funds at risk it is even more important that government entities have in place appropriate record keeping along with robust compliance and risk management policies, practices, and systems.

Affiliated Entities - Shell Trading supports the exemption from registration related to affiliate transactions and suggests there are other considerations that stem from this conclusion. For example, if the CSA adopts a *de minimis* exemption, inter-affiliate transactions should be excluded from the calculation of notional value within the threshold. Similarly, the value of

these transactions should be excluded from any calculation related to registrant capital and collateral requirements that may be proposed in the future.

Foreign Parties - The recommendation to exempt foreign derivatives dealers and advisors from certain regulatory requirements is reasonable, however, further clarification and caution is necessary regarding comparing the rules of other jurisdictions. Having an “equivalent” regulatory regime or even “equivalent” requirements may be too narrow a test for the purposes of this exemption. The CSA should review these foreign requirements for similarity rather than equivalency, which is in line with the approach taken in the United States. More broadly, when crafting rules and requirements applicable to Canadian participants, the CSA should continue to be mindful of the different structure and needs of Canadian markets and avoid attempting to make the domestic rules “equivalent” to those of other jurisdictions.

Conclusion

In establishing regulations related to OTC derivatives dealer registration the CSA must also consider the views of participants previously filed related the end-user exemption. The comments of Shell Trading can be found at: http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20120615_91-405_kerrp.pdf

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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and Shell Trading Canada