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September 21, 2012

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:

Mr. John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1900
Toronto, Ontario M5H 3S8
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and

Me Anne-Marie Beaudoin, Secrétaire de l'Autorité
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Re: Canadian Securities Administrators ("CSA") Consultation Paper 91-406 Derivatives: OTC Central Counterparty Clearing ("the Paper")

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 future central counterparty clearing ("CCP") requirements related to over-the-counter ("OTC") derivative transactions in Canada. Shell Trading supports the majority of the proposals in the Paper, or takes no position at this time, and provides these comments on specific areas of the Paper.

The future treatment of end-user transactions and how this relates to intra-group risk management is a substantial issue for Shell Trading and has been referenced in all its comment submissions to date. Shell Trading urges the CSA and each provincial regulator to review these prior submissions, in particular related to the recent proposals for end-user exemptions[1], which will also be reference in comments below.

[1] Shell Trading submission on CSA paper 91-405 at http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20120615_91-405_kerrp.pdf

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. 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 that has different entities in the corporate group serving 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 activity through hedging affiliates like Shell Trading, this model reduces overall risk to the markets. Inter-affiliate swaps facilitate this process, and because they are fundamentally different than swaps between non-affiliated entities, inter-affiliate swaps should not be regulated in the same manner.

Derivatives Subject to a Mandatory Clearing Requirement

Shell Trading supports the dominant use of the "bottom-up" approach and the aspects of a product and its market that must be considered when evaluating which OTC derivatives might be appropriate for clearing. The "top-down" approach is one that may be enabled for regulators but should be employed rarely, and primarily to support the potential removal of a product from the mandatory clearing obligation. Each method should include the proposed sixty day public comment period coordinated amongst CSA regulators.

The Paper is silent regarding the timeframe between enacting the clearing obligation and the enforcement of the requirement. Further consultation is required in this respect.

Back-loading of Pre-existing Transactions

Shell Trading supports the proposal that mandatory clearing only apply to new transactions, and suggests that new transactions be determined as being executed after the effective date of the obligation.

Clearing Timeframes

Although Shell Trading supports the intent related to "as soon as possible, and in any case no later than the close of business on the day of execution" for submission of trades subject to

mandatory clearing, there may be practical limitations to achieving this goal. Transactions taking place near the end of a day may prove difficult for both the participant to submit, as well as for the CCP to complete the review and communicate acceptance or rejection of the transaction. Differences in geographic locations and time zones will compound this issue. A requirement for submission of no later than twenty-four hours after the transaction is executed may be more practical. For trades that are submitted voluntarily, the timeframe should be extended beyond the current business day, to forty-eight hours after execution.

Exemptions from CCP Clearing

End-users: Shell Trading remains concerned with the approach by the CSA related to end-users presented in CSA paper 91-405. In particular, the proposal to remove from eligibility a participant that is otherwise eligible on the grounds that it is affiliated with a registered participant is not logical or supported. As previously submitted,

> *Shell Trading does not understand, and does not agree with, the recommendation to exclude participants who are affiliates of registrants from being eligible for the end-user exemption. Further, the two brief paragraphs related to this criterion make no reference to this apparent categorical exclusion, let alone any reasoning to support it. This restriction will subject an otherwise eligible end-user to all the new regulatory reforms including mandatory clearing, margin, and capital and collateral requirements. Such an outcome is unnecessary and unreasonable. The financial cost and regulatory burden created will harm the markets through diminished levels of trading and liquidity while providing no regulatory or public interest benefit. Two similar market participants doing the same type of trading and meeting all other eligibility criteria should not be treated differently simply because one of them has an affiliate that is a registrant. This topic is further discussed in part iv) below.*
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> *The uncompromising exclusion of participants trading beyond their own account, as well as registrants, should also be reconsidered by the CSA and Provincial regulators. The Paper makes it clear that it is the type of activity, and the purpose for which the transactions are taking place, that are the primary considerations in determining eligibility. Despite this as a foundation, it is then dictated that the entity may only engage in this type of activity to be eligible for the end-user exemption.*
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> *Participants, including registrants, should be able to qualify for the end-user exemption as it pertains to their hedging activities and the plan or strategy approved internally. Having some non-hedge positions or an additional line of business involving speculation should not disqualify an entity from utilizing the end-user exemption for their hedging transactions. The purpose of the exemption is to avoid undue costs and burden related to entering into transactions under a hedging program, and this objective remains valid where the participant also has a line of business or strategy that goes beyond hedging.*
>
> *Taken together, these proposals would create a dichotomy amongst participants – end-users that are pure hedgers, and end-users that also transact beyond their own account, including registrants. This proposal may make sense in a securities environment but does not recognize the realities of commercial energy markets. In these markets, firms may be*

hedging their physical exposures but also be entering into speculative transactions with other participants as a separate line of business. A regulatory regime that fails to recognize the structure of the markets could be extremely disruptive to energy markets and create unintended or inefficient consequences.[2]

Intra-group transactions: The CSA makes note of the regulatory evolution taking place in Europe and the United States related to intra-group transactions (also sometimes referred to as inter-affiliate transactions). Since the Paper was issued, the Commodities Futures Trading Commission has issued a notice of proposed rulemaking, "Clearing Exemption for Swaps between Certain Affiliated Entities".[3]

Although the CSA appears inclined to adopt a more restrictive approach than other jurisdictions, Shell Trading supports the willingness of the CSA to consider situations for exemptions where they do not present undue risk to the market or third parties. Shell Trading cannot speak to the specifics of other sectors or their products, but has made prior submissions to the CSA based on its role as a centralized risk management entity within a broader family of energy companies. Such prior submissions include the following relevant discussion;

The topic of centralized risk management entities within a corporate group ("hedging affiliate") is of significant importance to Shell Trading. In addition to trading derivatives to hedge commercial risk for themselves and for their affiliates, Shell Trading and many other energy market participants engage in some speculative trading in energy derivatives. Exemption eligibility for end-user entities should be determined on their own merits and not be impacted by the status of affiliated entities that may be non-eligible, or considered a large derivatives participant, or even registered as dealers. At a transactional level, the exemption from requirements such as centralized clearing should be the same whether the end-user is contracting with an affiliate or a third party.

For those end-users that manage their commercial risk through one or more hedging affiliates, the hedging affiliate's trading acumen, dynamic market knowledge, and efficient, enterprise-wide risk management affords the end-users with access to expertise that they might not be able to achieve on their own. This is particularly true for global energy companies that manage a variety of separate, but related, commodities across multiple continents and countries, and at various points along the commodities' production and marketing chain (i.e., upstream, midstream and downstream). In addition, the availability of a centralized hedging affiliate allows the end-user to minimize or avoid much of the internal infrastructure that is necessary to support a trading function (e.g., credit facilities, trading agreements). Another source of savings is the fact that large trading companies often pay lower fees to exchanges and clearinghouses than end-users who do not regularly trade on the exchanges.

A clearing requirement for swaps entered into between affiliates (as just one example of the consequences of an end-user losing exemption eligibility) will require the use of large amounts of capital to margin deposits for both sides of the transaction for what would be

[2] Id, at 3
[3] 77 Fed. Reg. 50425 (August 21, 2012)

basically a riskless position at the clearinghouse. Draining already constrained working capital from a company of any size will reduce its ability to invest in its sector, slowing economic growth.

Use of a designated entity within a corporate family for this purpose can also allow some of the exposures of the end-user affiliates to be offset internally, reducing the number of swaps that have to be executed with third parties. For example, the price risk associated with the production of crude oil by one affiliate could be offset by the price risk faced by an affiliated refiner that desires to hedge the cost of the crude oil that it purchases. This offset is only possible if hedging is handled on a centralized basis.

Consequently, the use of one or more hedging affiliates to manage an end-user's commercial risk reduces transaction costs, increases operating efficiency, conserves working capital, and minimizes the net exposure that affiliated companies need to hedge, whether on or off-exchange, resulting in reduced systemic risk to the market. Given these benefits both to end-users and the markets generally, the end-user exemption criteria must not create barriers to the use of a hedging affiliate for the purposes of risk management based on the eligibility status or registration status of the hedging affiliate.[4]

Exemption from clearing requirements (as well as any margin or collateral requirements) is also critical where the two related companies may both be a type of registered participant. The same arguments exist, where the transaction between two affiliates does not contribute to systemic risk to the financial system or create undue exposure to third parties. These transactions are risk reducing and provide operational and efficiency benefits within the corporate group.

Conclusion

Shell Trading appreciates the opportunity to provide these comments, and would welcome the opportunity to work more closely with the CSA on the future regulation of energy 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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[4] See Shell Trading submission on CSA paper 91-405, page 5