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June 17, 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

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RE: ***CSA Consultation Paper 91-407 - Derivatives-Registration; Comments on the Proposed Definition of Derivatives Dealers and Proposed Implementing Regulations***

Dear Sirs/Mesdames:

I. INTRODUCTION.

Suncor Energy Inc. and its subsidiaries and affiliates (collectively "**Suncor**") hereby respectfully submit comments on the Canadian Securities Administrators ("**CSA**") Staff Consultation Paper 91-4071 – *Derivatives: Registration* ("**Consultation Paper**") published by the CSA over-the-counter (OTC) Derivatives Committee on April 18, 2013. Suncor appreciates the opportunity to submit these comments on the Consultation Paper and looks forward to working with the Committee as it moves forward to implementing Canada's G-20 commitments that relate to the regulation of the trading of derivatives in Canada through its participation in the Alberta Securities Commission Derivatives Advisory Committee.

Suncor is the fifth largest North American energy company and is headquartered in Calgary, Alberta. Suncor's operations include oil sands development and upgrading, conventional and offshore oil and gas production, petroleum refining, and product marketing (under the Petro-Canada brand). Suncor's common shares are listed on the Toronto Stock Exchange and the New York Stock Exchange under the symbol "SU." Suncor's Energy Trading business is organized around four main commodity

groups – crude oil, natural gas, sulphur, and petroleum coke. Suncor's customers include mid- to large-sized commercial and industrial consumers, utility companies, and energy producers. The Energy Trading business is used as a mechanism to support the marketing of Suncor's oil sands production by optimizing price realizations, managing inventory levels during unplanned outages at Suncor's facilities, and managing the impacts of external market factors, including pipeline disruptions or outages at refining customers. The Energy Trading business has entered into arrangements for other midstream infrastructure, such as pipeline and storage capacity in order to optimize delivery of existing and future growth production, while generating trading earnings on select strategies and opportunities.

In addition to this submission, Suncor generally supports the positions set out in the comment letter submitted by Dentons Canada LLP, on behalf of the Canadian Energy Derivatives Working Group.

II. COMMENTS OF SUNCOR.

A. General Comments.

1. Consistency with G-20 Commitment

The CSA, in the Consultation Paper, indicates that, at some level, the proposals in the Consultation Paper are in response to Canada's G-20 commitments. The Consultation Paper states, "in September 2009, Canada and other members of the G20 called for the improvement of the global financial market and committed themselves to reforming OTC derivatives markets and improving oversight of those markets. These reforms included specific commitments to improve transparency, mitigate systemic risk, and protect against market abuse." In short, as part of the G-20, Canada committed to achieve the following:

- All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest.
- OTC derivative contracts should be reported to trade repositories.
- Non-centrally cleared contracts should be subject to higher capital requirements.

Suncor submits the CSA should focus on finalizing and implementing the above noted key reforms before tackling issues outside of the scope of its G-20 commitment. The regulation and registration of Derivatives Dealers should be undertaken only once Canada's G-20 commitments have been satisfied and markets have had time to adjust. To impose the registration requirements in the Consultation Paper on a market in flux may lead to a regulatory design that is not fully functional in derivatives markets that have completed their G-20 reforms.

2. Energy Derivatives Markets Operate Differently Than Other Domestic Derivatives Markets

The CSA's regulatory reform initiative will result in significant changes to Canadian derivatives markets. Any changes to market regulation of this magnitude have the potential to cause significant unintended consequences that could adversely impact Canadian energy markets. These unintended consequences may include, but are not limited to: (a) a loss of liquidity and corresponding increase in volatility; and (b) uncertainty regarding the regulatory status of certain market participants.

Energy derivatives markets are unique. In energy markets, derivatives transactions are routinely executed *without* the involvement of dealers. This is because producers and users of a commodity

generally have opposite risk profiles and often make natural hedging counterparties. In these transactions, neither counterparty is engaged in dealing activity. Unlike certain large financial institutions, energy firms primarily trade derivatives as principles to, among other things, hedge the risk associated with their core business of providing electricity, crude oil, natural gas, propane, gasoline, and other energy commodities to customers. The CSA should recognize that certain energy firms, while primarily engaged in hedging activities, may also engage in speculative trading or limited dealing activity. However, that activity is ancillary and incidental to their core physical business. An overly broad definition of "Derivatives Dealer" could require such energy companies to register as Derivatives Dealers. Those companies would face the unfortunate choice between: (i) registering as a Derivatives Dealer; or (ii) reducing their activity in financial derivatives markets to avoid registration. As discussed below, either choice will increase costs for energy market participants, and consequently, Canadian energy consumers.

3. <u>The Scope of the Consultation Paper Should Be Limited to Identifying the Factors that Would Require Registration</u>

The Consultation Paper should limit its scope to identifying the factors that would trigger an obligation for a market participant to register as a Derivatives Dealer or Derivatives Advisor. The identification of activities that would cause an entity to register and determination of which entities should register are important, complex threshold issues and should be answered before considering the regulatory structure that would apply to registrants. Undertaking to address those issues simultaneously may well result in a regulatory infrastructure that is properly designed for the markets and entities to which it is applied.

The CSA's definition of "Derivatives Dealer" should only capture entities that the market traditionally has viewed as "dealers". The CSA should focus its initial efforts on providing clear guidance to market participants through enumerated factors that market participants can use to determine whether they must register as a Derivatives Dealer.

In addition, the Consultation Paper's business triggers and regulatory requirements are significantly similar to those set forth in the securities context by National Instrument 31-103[1] ("NI 31-103"). While certain parts of the securities markets' registration framework may be appropriate for the regulation of derivatives markets, that framework should not be adopted whole-cloth. The majority of those rules were designed to operate in a retail market. The over-the counter derivatives markets in Canada are not retail markets.

B. Definition of "Derivatives Dealer."

1. <u>The Proposed Definition of "Derivatives Dealer" Should be Narrowly Construed</u>

The CSA's use of the word "trading" in the phrase "persons carrying on the business of **<u>trading</u>** in derivatives"[2] when describing the business trigger for registration as a Derivatives Dealers could be interpreted to capture <u>all</u> active participants in derivatives markets. The definition of "Derivatives Dealer" should focus only on activities that are routinely understood in derivatives markets to be "dealing activity." While similar language is used in NI 31-103 to determine if an entity is a securities dealer,[3] Derivatives Dealers operate in different markets. The use of the word "trading" could be read

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[1] Canadian Securities Administrators, National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (July 17, 2009).

to create an unintentionally broad definition by including non-dealing trading activities in the Derivatives Dealer determination.

Market participants trading for their own account and profit are commonly understood to be engaged in "trading activity," while entities entering into derivatives transactions for the express purpose of making markets, providing liquidity, or functioning as an intermediary on behalf of a customer are engaged in "dealing activity." As such, the proposed definition of "Derivatives Dealer" should be amended to refer to "persons carrying on the business of **dealing** in derivatives."

The determination of whether an entity must register as a Derivatives Dealer should focus on dealing activity. As discussed further in Sections II.2. and II.4., below, Suncor requests that the CSA: (a) exclude any non-dealing activity from the definition of "Derivatives Dealer"; and (b) promulgate a *de minimis* threshold up to which an entity may engage in limited dealing activity without having to register as a Derivatives Dealer.

2. The Definition of "Derivatives Dealer" Should Expressly Exempt "Non-Dealing Activity"

The definition of "Derivatives Dealer" should be drafted to recognize that a large portion of activity engaged in by commodity derivative market participants is trading activity that is not derivatives dealing. While the CSA may in fact believe that the activity discussed below is not derivatives dealing activity, to provide regulatory certainty that such activity is not derivatives dealing, the CSA should explicitly recognize the following:

- Hedging is not dealing activity;
- Speculation is not dealing activity; and
- Anonymous on-facility transactions are generally not dealing activity.

a. Hedging.

Many market participants, including energy firms, use derivatives to hedge the commercial risk that arises from their primary physical business. Hedging is risk reducing. When hedging, an entity acts for its own account and does not act as an intermediary for a customer. As such, it should be explicitly excluded from the types of activities that would require an entity to register as a Derivatives Dealer.

b. Speculative Trading.

Speculation is also a legitimate non-dealing activity. Market participants engaged in speculative trading are not neutral to price movements in derivatives markets and underlying commodity markets, where entities engaged in dealing activity typically are neutral to price movements. Speculative trading activity is entered into for purposes of benefiting from changes in the price of the instrument.

Speculative trading is a key strategy many energy commodity market participants use in order to ensure optimal value of their underlying commodity assets. Developing a speculative trading capability enables an energy commodity market participant to achieve active market intelligence and logistical

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[2] *Consultation Paper* at 4,125.

[3] *Companion Policy to NI 31-103* (July 17, 2009) at Section 1.3.

flexibility which are key to maximizing asset values over the long term. In that regard, speculative trading: (a) provides price information that can allow an entity to hedge more effectively; and (b) prevents counterparties from anticipating the trading needs of entities that also use commodity derivatives to hedge. In short, entities engaged in speculative trading act for their own account and not as an intermediary for third-parties, and such activity should not be deemed dealing. If the CSA is concerned that speculative trading may introduce systemic risk into the derivatives markets, then the Large Derivatives Participant ("LDP") regime is the proper framework to address this, not within the definition of "Derivatives Dealer. "

c. Exchange Trading "On-Facility."

Finally, when crafting the definition of "Derivatives Dealer," the CSA should acknowledge the differences among the various types of derivatives. Uncleared OTC derivatives have a risk profile vastly different from on-facility cleared derivatives. Registration criteria should take these differences into account in order to properly align regulation to proportional risks. In addition, derivatives trading on an exchange generally is not considered dealing activity and the CSA should explicitly state this. Derivatives transactions in which counterparties are anonymously matched should be explicitly classified as "non-dealing" activity, unless such market participants are explicitly engaged in market-making activity.

3. <u>The CSA Should Provide Comprehensive Guidance on the Factors to Be Considered When Determining if a Person Must Register as a Derivatives Dealer</u>

While the Consultation Paper appears to correctly identify general types of behavior that are routinely characterized as "dealing activity," further clarification is necessary. Certain of the general factors set forth for identifying dealing activity in derivatives markets broadly align with Suncor's view of what constitutes such activity.[4] The relevant factors are whether an entity is: (a) acting as an intermediary; (b) acting as market maker; and (c) providing clearing services. When engaging in each of those activities, derivatives dealers typically remain neutral to price movements in the relevant instrument as they are compensated through fees and the difference in the bid/ask spread.

The definition of "Derivatives Dealer" should generally be qualitative in nature. Said another way, it should be based on the functional role an entity plays in the market. As such, it should only cover a limited set of market participants. Suncor is concerned that the proposed definition of "Derivatives Dealer," will capture a set of derivatives market participants much larger than those entities engaged in dealing derivatives as their primary business purpose.

a. Market-Making.

The use of the term "market-making" without further definition could lead to overly broad and potentially conflicting interpretations of the concept. As such, the CSA should develop interpretive guidance, including enumerated criteria, that clarifies the types of activities that constitute market making.

Although an energy company may, on occasion, take either side (*i.e.,* short or long) of a particular type of derivatives transaction, this is not market-making activity. It is driven by the

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[4] *Consultation Paper* at 4,126.

commercial energy firm's primary physical business.[5] Such activity is generally undertaken to address changes in the risk associated with underlying physical positions or to engage in price discovery.

b. Remuneration and Compensation.

The CSA should clarify that "trading with the intention of being remunerated or compensated" refers explicitly to fees for acting, or providing services, on behalf of customers and money made from or compensation for market making. The language as written, even when read in conjunction with the Companion Policy to NI 31-103, opens up the possibility that trading profits generated by beneficial market movements could be indicia of dealing activity.

c. Solicitation of Interest.

The CSA should make clear that "directly or indirectly soliciting" includes scenarios in which an entity seeks out a counterparty to facilitate the goals of that counterparty and not to trade for its own account. It should not cover scenarios in which a party knows that a potential counterparty likely has a business reason to take the other side of a trade it would like to enter into. For example, a refinery is natural counterparty for a producer of crude oil.

d. Frequent Dealing Activity.

Finally, Suncor strongly encourages the CSA to include "frequent derivatives ***dealing*** activity" and not "frequent derivatives ***trading*** activity" as a factor to consider in determining whether an entity triggers the registration requirement. Suncor requests that the CSA provide guidance as to the frequency of dealing activity that would require an entity to register as a Derivatives Dealer. Without such guidance, market participants will grapple with the concept of being "in the business" of dealing derivatives. At a minimum, the CSA should clarify that nominal or irregular dealing activity, or dealing activity that is ancillary to an entity's primary physical business, has a business purpose of supporting such primary business and will not lead to the entity's categorization as a Derivatives Dealer.

4. The CSA Should Provide a *De Minimis* Exemption

The CSA should provide an exception from the definition for market participants that engage in a *de minimis* amount of derivatives dealing activity. A *de minimis* exception is necessary for two major reasons:

First, requiring market participants that enter into a small amount of derivatives dealing activity that is incidental and ancillary to their core business to register as a Derivatives Dealer will likely result in such entities discontinuing that activity. Causing these entities to stop that behavior will likely concentrate risk and market-share within large financial institutions and will reduce market liquidity. This will limit options for non-dealer market participants, and the potential drop in liquidity could lead to increased volatility. Both of which likely will increase the cost of hedging, potentially increasing energy costs for Canadian consumers.

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[5] In certain derivatives markets, particularly those tied to physical locations, only a few firms trade. This applies in Canada with respect to certain energy-related derivatives (notably swaps). Any interpretive guidance developed or proposed by the CSA should recognize that providing or eliciting two-way pricing in non-liquid or episodically liquid markets does not, by itself, constitute dealing activity as such activity is necessary to efficiently hedge the risks unique to that specific location.

Second, without a *de minimis* exception, a single dealing transaction could trigger a registration obligation. A *de minimis* exception would limit that possibility and provide market participants with certainty as to their non-dealer status. To the extent that the CSA adopts the precedent-based, facts and circumstances approach set forth in NI 31-103,[6] then a *de minimis* exception may only be necessary temporarily as the adequate precedent as to what kind of activity constitutes "carrying on the business of dealing in derivatives" is developed as entities that are clearly derivatives dealers register as such.

Any *de minimis* threshold level proposed should be set carefully and should be based on actual market data. To do so, Canadian regulators should finalize and implement their proposed reporting rules in order to collect at least six months of data prior to setting a *de minimis* level. For energy markets, special consideration should be taken, as the notional value of commodity derivatives are sensitive to changes in commodity prices. For example, natural gas prices are depressed from historic norms. If a proposed *de minimis* threshold is set at an unduly restrictive level, market participants transacting in natural gas derivatives that currently meet such a threshold could easily violate it in the future simply due to rising energy prices, not an increase in actual dealing activity.

If the CSA decides to provide a *de minimis* exception prior to the advent of transaction reporting, Suncor would prefer a *de minimis* determination method similar to what has been crafted under the Dodd-Frank Wall Street Reform and Consumer Protection Act, whereby the notional value of all dealing activity would be aggregated and evaluated against a minimum threshold level to determine whether there is a requirement for registration. Initially, $3B is an appropriate level for this threshold. This approach to the determination of which entities must register as Derivatives Dealers satisfies the G20 mandate of systemic risk mitigation in a practical way, and can allow companies some certainty in evaluating their business models appropriately.

C. The Consultation Paper Should Address How the Proposed End-User Exemption Would Operate in Conjunction with the Derivatives Dealer Registration Regime.

In order to ensure market certainty, Suncor also urges the CSA to provide more guidance on how this Consultation Paper operates in conjunction with *Consultation Paper 91-405 – Derivatives: End-User Exemption*,[7] and how entities falling outside the registration regime and End-User Exemption will be regulated under this framework. Suncor generally believes that the Consultation Paper should work in tandem with the End-User Exemption such that all Canadian derivatives market participants know their regulatory classification with respect to their derivatives activities.

The intersection between the Consultation Paper and the End-User Exemption creates a regulatory purgatory. Entities that are "in the business of trading derivatives" will be required to register as Derivatives Dealers, while entities that only use derivatives to hedge will be eligible for the End-User Exemption. However, market participants that engage in some dealing or speculative activity will be neither Derivatives Dealers nor be permitted to use the End-User Exemption.

Market participants that are not required to register with a Canadian regulator in any derivatives-related capacity should be eligible for the End-User Exemption. Said another way, the CSA

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[6] One of the primary factors relied upon in determining if an entity has engaged in "securities trading for a business purpose" is whether that entity is engaged in activities similar to those of a registered securities dealer. *Companion Policy to NI 31-103* at Section 1.3(a). The Consultation Paper includes a similar factor in the Derivatives Dealer context. *Consultation Paper* at 4,127.

[7] *See* Canadian Securities Administrators, CSA Consultation Paper 91-405 – Derivatives: End-User Exemption (April 13, 2012).

should allow for non-registered entities to qualify for the End-User Exemption even if they engage in speculative activity or *de minimis* dealing activity.

D. The CSA Should Minimize Duplicative Registration and Regulatory Requirements.

As discussed above, the CSA must take care not to adopt a regulatory framework for derivatives regulation that inadvertently impacts market liquidity. The Canadian derivatives market is 1% of the global market. Suncor is concerned that market participants could choose to leave or scale back their participation in Canadian markets if the Derivatives Dealer registration rules and related regulatory obligations are seen as too invasive and onerous. In short, it would be an easy decision for multi-national entities to leave Canada if the regulatory costs of trading in Canadian markets are too high. Any reduction in Canadian market liquidity would be damaging to domestic market participants.

To avoid that outcome, Suncor requests that CSA structure its framework for the regulation of Derivatives Dealers as follows. *First,* if an entity is registered as a Derivatives Dealer in its principal Canadian jurisdiction, then it should be subject to the transaction and entity-level regulatory obligations imposed upon it by that jurisdiction and should only have to provide a notice filing to the other Canadian jurisdictions in which it operates. *Second*, if an entity is a non-Canadian entity and is registered in its home jurisdiction as the equivalent of a Derivatives Dealer, then the CSA should allow for substituted compliance with regard to entity-level regulatory obligations.

E. The LDP Regulatory Paradigm Should be Addressed Once the CSA has Adequate Data.

The concept of "Large Derivatives Participant" ("LDP") as addressed in the Consultation Paper is vague and incomplete. It is difficult for Suncor to foresee, on a practical basis, that any Canadian entity, other than those likely to register as Derivatives Dealers, would pose enough risk to make it an LDP. Hence, Suncor recommends that the CSA re-visit the LDP issue and related thresholds once it has enough data under the new reporting requirements to address the issue properly.

III. CONCLUSION.

Suncor thanks the Committee and the CSA for the opportunity to comment on the Consultation Paper and hopes that the Committee takes these comments into consideration as it finalizes these rules. Suncor respects the efforts of the CSA to regulate the Canadian OTC derivatives market and will continue to provide support and feedback to the CSA as it publishes further consultation papers to regulate the Canadian OTC derivatives market.

Should the Committee have any questions, or if Suncor may be of further assistance, please contact the undersigned.

Yours truly,
Suncor Energy Inc.

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