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

via email only

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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:

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1900
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

and

Anne-Marie Beaudoin, Secrétaire de l'Autorité
Autorité des marchés financiers
800 square Victoria, 22e étage
Montréal, Québec H4Z 1G3
consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators ("CSA") Notice 91-303
Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives ("Rule") and Explanatory Guidance ("Guidance")

Shell Energy North America (Canada) Inc. ("Shell Energy") and Shell Trading Canada, a division of Pennzoil-Quaker State Canada Incorporated ("STC") (collectively, "Shell Trading") make this submission to comment on the proposed Rule and Guidance issued by the CSA considering the mandatory clearing of over the counter ("OTC") derivatives transactions.

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.

Definition of "Financial Entity"

The CSA has identified the issue of entity size as an aspect it specifically seeks participant guidance. Shell Trading recommends that a threshold or *de minimis* level be established to permit the exercise of the end-user exemption by entities with lower transaction values. This matter is also integral to the future establishment of registration requirements and caution is warranted in advancing this Rule before the registration rules are finalized.

Subsection 1(f) of the definition makes any party that is "subject to a registration requirement, registered or exempted" a financial entity. Shell Trading has many concerns regarding the intent and outcomes of this inclusion, but unfortunately the Guidance is silent on this aspect of the definition. Shell Trading[1] and other participants have provided the CSA with comments regarding registration, including the need for a *de minimis* threshold. How the registration rules unfold will impact many areas, including the definition of financial entity in the present Rule. For example, a participant exempt from registration requirements would still be a financial entity under the definition as written, and prevented from utilizing this area of the end-user exemption.

Another outcome of this problematic definition is its establishment for the purpose of exclusion of this entity type from the end-user exemption. This exemption should be based solely on the transactional requirement for hedging. Not only should dealers generally be afforded the end-user exemption when they are transacting to hedge commercial risk, but specific registration requirements along with written accommodation within this Rule are needed.

End-User Exemption

Financial Entity: The Rule and the Guidance are clear that the CSA intends to make financial entities ineligible for this exemption under section 7(1). As noted above, this categorical

[1] See Shell Trading submission on CSA Paper 91-407 : http://www.osc.gov.on.ca/en/com_20130617_91-407_shellenrgnorthamerica.pdf

exclusion of an entity type is problematic in many ways, but also unreasonable in the added burden and cost it will bring to the derivatives markets. An energy company that is registered as a dealer or large derivatives participant should be registered only for the types of energy derivatives that are relevant to its dealing activities, and remain an eligible end-user for purposes of hedging its other commercial risks such as foreign exchange and interest rate exposures. Similarly, a bank, even if it is acting like a dealer, and even if it trades in energy commodities and derivatives, should be able to utilize the end-user exemption when it enters into a transaction to hedge the energy price risk it bears with its many business locations. Shell Trading recommends that the end-user exemption be based solely on the transaction level criterion of hedging or mitigating commercial risks related to operating the business. At the very least, the registration rules need to be established first, with any implications reflected in an amended proposed definition of financial entity within this Rule.

Affiliated Entity: Shell Trading appreciates the attempted improvements in the current Rule but remains concerned that the outcome of section 7(2) will be the elimination of a business model that has been successful in reducing costs and systemic risks in Canadian derivatives markets. Shell Trading has commented on this topic repeatedly and in great detail to the CSA, as have other participants. See also above in these comments, the area titled "Description of Shell Trading". The intra-group exemption in section 8 of the Rule provides some limited relief; however, it results in the market-facing transactions of a hedging affiliate being subject to mandatory clearing, even when they are entered into for the purpose of mitigating the risk of the corporate group.

Condition 7(2)(a) requires the hedging affiliate to act "as agent on behalf of" the end-user affiliate. This is not a workable condition, since the purpose of the hedging affiliate is to centralize, consolidate, and manage the overall exposures of the other entities in the corporate group. This is accomplished by entering into contractual transactions with each of the end-user affiliates, and then facing the markets with the net position to hedge. The hedging affiliate enters into market facing/third party transactions as principal, as a contracted counterparty, not as agent. Contracts are entered into as part of a business model and process intended (and successful) at consolidating and mitigating business risks while reducing total risk in the markets. Shell Trading recommends that the CSA make it clear in the Rule or the Guidance that the exemption is available where the hedging affiliate is the contracting party for the purpose of mitigating the commercial risks of an end-user affiliate.

Condition 7(2)(c) will also lessen the usefulness of this exemption provision, while at the same time introducing a potentially discriminatory outcome. The Rule requires the hedging affiliate to not be subject to a registration requirement, and the Guidance makes it clear that the entity cannot be a registered entity but it may be a financial entity. Again, this is an issue that requires more discussion and conclusions with respect to the registration regime and the definition of financial entity, but given the market-facing role of the hedging affiliate, there would seem to be a potential for the entity to be viewed as a dealer. Registration as a dealer, or even a large derivatives participant, would eliminate the ability to utilize this exemption. However, the CSA has also indicated that certain types of participants, such as banks, may not be subject to the registration regime because of their existing prudential and other regulatory constructs. If this is the case, the Rule will allow the clearing exemption for entities that avoid registration while preventing its use by other entities, despite the performance of similar activities in the derivatives markets.

Intra-Group Exemption

Shell Trading generally supports the intra-group exemption as presented in the Rule, however, there are some areas in need of clarification or change regarding implementation.

Conditions: Shell Trading seeks confirmation from the CSA that exemption from clearing is available where one or more of the entities involved are subject to registration requirements. This confirmation could be put in the Guidance along with potentially clarifying what is intended in Rule subsection 8(2)(c) or changing the Rule language. As written, this part seems to indicate that a written agreement is required where the transaction is between two non-registrant affiliates, and by silence might imply that no agreement is required where one or both of the counterparties are registrants. As the requirement for a contract seems reasonable irrespective of the registration status of the affiliates, Shell Trading recommends that the subsection could be shortened to simply stipulate the requirement for a written agreement setting out the terms of the transaction between the counterparties.

Form F1: The purpose, value, and consequences of this form have not been provided which puts the need for the form into question. Much of the information requested will be available to regulators through the reporting of transactions to trade repositories. Shell Trading recommends the CSA provide further guidance as to the need for, and consequences of, this form.

If the form is to remain, there are practical issues that should be addressed. Is submission of the form an application for exemption? If yes, a great deal more discussion is required between the CSA and participants. Assuming it is not an application; the word "application" should be removed from section 3 of the form. Additionally, there is no value or justification for requiring the form be re-submitted annually so section 8(4) should be eliminated, such that participants and regulators may reasonably rely on section 8(5) requiring the submission of an amended form when or if any changes are made.

Also, although the Rule and the Guidance discuss the need to identify transactional information, there does not appear to be any place in the form to list or otherwise report the types of transactions between the affiliates. Shell Trading recommends that despite the filing of the form being prompted by an initial single transaction, the parties should be permitted to provide a listing of all types of transactions expected between them, and that "types" of transactions be indicated at the sub-asset class level used for trade reporting.

Non-Application

Shell Trading is opposed to the proposal in section 11 of the Rule to stipulate that the mandatory clearing requirement does not apply generally to federal and provincial governments and government entities. No rationale or Guidance is provided, however, the proposal related to wholly owned government entities is conditioned on the obligations being guaranteed by the federal or provincial government. This implies that such governments and entities are excluded due to their creditworthiness. If the CSA believes that creditworthiness is a legitimate measure or

screen for the purposes of not mandating a clearing requirement, the correct and only defendable approach would be to establish an exemption available to all market participants based on an explicitly set credit rating.

If these parties are entering derivatives transactions for the purpose of hedging the risks of the government or of their businesses, the end-user exemption is available to avoid the mandatory clearing requirement. As such, the substantial consequence of the proposed non-application is to provide an avoidance of clearing for transactions when these parties are acting as dealers. Avoiding the clearing requirement will provide an unacceptable direct financial advantage to government entities and negatively influence the competitiveness of the markets. 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. This issue is particularly important in the energy sector, where government enterprises actively compete directly with non-public participants.

Notice Regarding Determination

Section 13 of the Rule proposes that each local regulator "may" invite participant comments during a comment period before making a determination that a derivative is subject to mandatory clearing. Shell Trading recommends that these types of determinations should be made by all regulators jointly so as to ensure consistency across the provinces. Additionally, the posting for comments needs to be mandatory such that the word "may" should be replaced with the word "will" or "shall".

Conclusion

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

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