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VIA ELECTRONIC SUBMISSION

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
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Re: Submission on Real-Time Public Reporting And Inter-Affiliate Swaps

Dear Mr. Stawick:

Shell Trading (US) Company (“**STUSCO**”) and Shell Energy North America (US), L.P. (“**Shell Energy**”) (collectively, “**Shell Trading**”) respectfully submit the following comments to address the proposed rulemakings regarding the real-time public reporting requirements applicable to certain swap transactions under Section 727 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank Act**”)¹ (“**Real-Time Reporting Release**”)² and the end-user exception to mandatory clearing under Section 723 of the Dodd-Frank Act (“**End-User Release**”).³ These comments focus on the potential impact of the proposed rules on swaps entered into between affiliated entities within a corporate group. Shell Trading submits these comments consistent with the Notice of Acceptance of Public Submissions issued by the Commodity Futures Trading Commission (“**Commission**”) on August 26, 2010.⁴

Shell Trading understands that Commission staff is considering the extent to which certain transactions among affiliated entities should be subject to the real-time public reporting requirements applicable to swap transactions under Section 727 of the Dodd-Frank Act.⁵ As the

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

² *Real-Time Public Reporting of Swap Transaction Data*, 75 Fed. Reg. 76140 (proposed Dec. 7, 2010).

³ *End-User Exception to Mandatory Clearing of Swaps*, 75 Fed. Reg. 80747 (proposed Dec. 23, 2010).

⁴ *Acceptance of Public Submissions on the Wall Street Reform and Consumer Protection Act and the Rulemakings that Will be Proposed by the Commission*, 75 Fed. Reg. 52512 (Aug. 26, 2010).

⁵ See Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 75 Fed. Reg. 80174, 80183 (proposed Dec. 21, 2010).

companies noted in prior submissions to the Commission,⁶ Shell Trading is concerned that the Commission's treatment of swaps between affiliated entities under the Dodd-Frank Act, if overly aggressive in its application, may well undermine the efficiencies that certain market participants currently realize from the use of centralized hedging affiliates.

Congress established the requirement for real-time public reporting of swap transaction data under Section 727 of the Dodd-Frank Act to increase market liquidity and enhance price discovery in the derivatives markets.⁷ However, real time public reporting of transaction data regarding swaps between affiliated entities within a corporate group does not contribute to either goal, and may in fact distort pricing in the public swaps markets. Accordingly, consistent with the express purpose of Section 727 of the Dodd-Frank Act, and for the reasons set forth below, Shell Trading encourages the Commission to clarify that the reporting requirements as applied to inter-affiliate transactions used to hedge or mitigate commercial risk are limited to reporting of specified data elements regarding the "primary economic terms" of such transactions to a swap data repository, as described in detail in Section V below.

I. Description of Shell Trading

STUSCO and Shell Energy are indirect subsidiaries of Royal Dutch Shell, plc ("**Shell**"). STUSCO trades various grades of crude oil, refinery feedstocks, bio-components and finished oil-related products, including such commodities that are produced, manufactured or imported by its affiliates. Shell Energy markets and trades natural gas, electricity and environmental products, including the natural gas produced by its affiliates. Both entities actively participate in the U.S. energy derivatives markets. Together they manage risk and optimize value across physical and financial, exchange-traded and over-the-counter markets.

As an adjunct to its physical marketing and trading activities and the hedging of certain of Shell's physical exposures, Shell Trading takes proprietary positions in response to internal forecasts of supply and demand to position itself ahead of foreseeable physical movements. It also executes swaps related to energy commodities with various counterparties, including other Shell affiliates, to offset its risks, including credit risks, and to facilitate physical transactions.

⁶ Shell has separately commented on the treatment of certain transactions among affiliated entities as "swaps" under the Dodd-Frank Act and the rules proposed thereunder. See Letter to David A. Stawick, Secretary, from Robert Reilly, Vice President, Shell Energy, *Submission on Treatment of Affiliates under Dodd-Frank Act and CFTC Proposed Rulemakings [End-User Clearing Exception]*, (Jan. 21, 2011). Shell Trading incorporates those comments herein by reference.

⁷ See Dodd-Frank Act § 727 (adding CEA Section 2(a)(13)(B)).

II. The Dodd-Frank Act's Real-Time Public Reporting Requirement

Section 727 of the Dodd-Frank Act adds new Section 2(a)(13) of the Commodity Exchange Act (“CEA”), which requires the Commission to provide by rule for the “real-time public reporting”⁸ of certain swap transactions, including swaps subject to the mandatory clearing requirement of CEA Section 2(h)⁹ and those excepted from the mandatory clearing requirement under CEA Section 2(h)(7).¹⁰ Generally, the mandatory clearing requirement applies to swaps that the Commission has determined are required to be cleared and which are accepted for clearing by a derivatives clearing organization (“DCO”).¹¹ CEA Section 2(h)(7) excepts from the mandatory clearing requirement swaps as to which one of the counterparties (i) is not a “financial entity,” (ii) is using the swap to “hedge or mitigate commercial risk,” and (iii) notifies the Commission how it generally meets its financial obligations with respect to non-cleared swaps (“End-User Swaps”).¹² Read in isolation, the language of CEA Section 2(a)(13)(C)(i) would thus appear to subject End-User Swaps generally to the real-time reporting requirement, regardless of whether such swaps are facing a neutral third party on the open market or merely risk allocating devices as between affiliated entities within a corporate group.¹³

A. The Purpose of the Dodd-Frank Act's Real-Time Public Reporting Requirement is to Enhance Price Discovery in the Swaps Market

In contrast to the Commission's broad interpretation of the scope of the real-time public reporting requirement, the explicitly stated purpose of Section 2(a)(13)(B) “is to authorize the Commission to make swap transaction and pricing data available to the public *in such form and at such times* as the Commission determines appropriate *to enhance price discovery*.”¹⁴ Thus, the purpose of the requirement is not singularly to promote transparency of swap transaction data in the swaps market, but rather to improve the efficiency of the public swaps market by informing market participants as to the prices and volumes at which swaps are executed.¹⁵ Notably, the Commission's rulemaking mandate under Section 727 specifically requires the

⁸ CEA Section 2(a)(13)(A) defines “real-time public reporting” as the reporting of “data relating to a swap transaction, including price and volume, as soon as technologically practicable after the time at which the swap transaction has been executed.”

⁹ CEA Section 2(a)(13)(C)(i) requires real-time public reporting of swaps subject to mandatory clearing of CEA Section 2(h).

¹⁰ See 75 Fed. Reg. at 76141.

¹¹ CEA Section 2(h)(1)(A).

¹² CEA Section 2(h)(7)(A).

¹³ In the Real-Time Reporting Release, the Commission states that the Dodd-Frank Act's real-time reporting requirement applies to all swaps, irrespective of the identity of the counterparties to the swap or the terms of the swap transaction. See 75 Fed. Reg. at 76141, fn. 9.

¹⁴ CEA Section 2(a)(13)(B) (emphasis supplied).

¹⁵ See 75 Fed. Reg. at 76150, fns. 46-47 and accompanying text.

Commission to “ensure such information does not identify the participants,” to provide delayed reporting for large trades, and “to take into account whether the public disclosure will materially reduce market liquidity.”¹⁶ Shell Trading respectfully submits that imposing real-time public reporting requirements on inter-affiliate swaps will not enhance price discovery and may impair the anonymity of swap market participants that are end-users.¹⁷

B. Price Discovery in the Swaps Market In General

Although transaction data regarding swaps may provide transparency with respect to perceived future values of commodities underlying a swap, the swap itself does not drive the value of that commodity because a swap is merely a credit instrument through which counterparties take and give economic exposure to the value of the asset underlying the swap. Real-time public reporting of swap transaction data does not improve price discovery with respect to swap *underlyers*, because the swap underlyer is not priced by the swap, but *vice versa* – the swap’s value is driven by the price of the underlying commodity in external markets.¹⁸

In an efficient, public swaps market, the “price” or value of a swap reflects the costs associated with transacting in that financial instrument, including credit costs, hedging costs and various administrative costs.¹⁹ The credit cost of a swap relates to the risk of counterparty default (e.g., failure to pay under the terms of the swap), while hedging costs generally relate to the cost of offsetting market risks incurred in connection with giving the counterparty the relevant exposure under the terms of the swap. Accordingly, real-time public reporting will only “enhance price discovery” in the swaps market if such reporting provides swap market participants with better information regarding credit costs, administrative costs, and hedging costs than might otherwise be available to market participants.

¹⁶ CEA Section 2(a)(13)(E).

¹⁷ There is increased risk that swap market participants will be able to “reverse engineer” the identity of counterparties to publicly reported inter-affiliate swaps. Particularly with respect to illiquid markets and specialized trades, a requirement to publicly report inter-affiliate trades may enable market participants to identify the exposures of individual commercial end-users. The Commission has noted the difficult balance that must be struck in protecting the anonymity of counterparties to publicly reported swaps. *See* 75 Fed. Reg. at 76150. With respect to inter-affiliate trades, Shell Trading believes the balance weighs heavily against requiring public reporting.

¹⁸ The Commission has acknowledged that swap valuation depends on externally-sourced underlyer pricing data: “parties often dispute valuations of thinly traded swaps where there is not widespread agreement on valuation methodologies or the *source for formula inputs*. . . . The inability to agree on the value of a swap became especially acute during the 2007–2009 financial crisis when there was widespread *failure of the market inputs needed to value many swaps*.” *See Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 6715, 6718 (proposed Feb. 8, 2011).

¹⁹ *See* David Mengle, *The Value of a New Swap*, Issue 3, 2010 (ISDA Research Note), *available at* <http://www.isda.org/researchnotes/pdf/NewSwapRN.pdf>.

III. Real-Time Public Reporting of Data Regarding Inter-Affiliate Swaps Will Not Enhance Price Discovery

Affiliates within a corporate group typically enter into swaps with one another to efficiently allocate risk within the corporate group. Such transactions are often little more than accounting entries and do not express an individual economic view as to potential movements in asset prices. Consequently, public reporting of data regarding such swaps will not give any meaningful indication of the overall exposure the corporate group has in the market with respect to any particular asset underlying an inter-affiliate swap transaction. Further, because the value of such swaps does not reflect the credit, hedging, and administrative costs that prevail for swaps entered into with a neutral third party on the public swaps market, real-time public reporting of such trades will not enhance price discovery with respect to swaps generally.

In fact, public reporting of inter-affiliate swap transaction data may cause distortions in public swaps market pricing. Such a concern prompted the Federal Energy Regulatory Commission (“FERC”) to exclude the reporting of data on physical gas and power transactions between affiliates in FERC rules governing price reporting to index developers.²⁰ In addition, FERC has explicitly stated that the exclusion of inter-affiliate transactions from mandatory reporting on Form No. 552²¹ is specifically intended to enhance price discovery with respect to natural gas transactions.²² FERC recognizes the important role of indices in providing a benchmark for pricing of physical gas transactions, but acknowledges that data regarding transactions among affiliates does not contribute to price discovery because such transactions do not reflect the interaction of market forces.²³ Consistent with the Dodd-Frank Act and with the approach of other federal regulatory authorities that have imposed transaction reporting requirements with a view to enhancing price discovery in the commodity markets, Shell Trading believes the Commission should exclude inter-affiliate transactions from the real-time public reporting requirement of Section 727 of the Dodd-Frank Act.

Consider a transaction intended to transfer between affiliates certain risks with respect to a commodity. An entity within a corporate group may enter into a transaction facing a centralized hedging affiliate within the corporate group, effectively transferring risks within the corporate group.²⁴ Thereafter, the centralized hedging affiliate may further consider the overall exposures

²⁰ See 18 C.F.R. § 284.403; *Policy Statement On Natural Gas And Electric Price Indices*, Docket No. PL03-3-000 (July 24, 2003). The Policy Statement was issued “to take immediate steps to improve the existing mechanisms for price discovery” in the natural gas and electricity markets.

²¹ FERC Transaction Report Form No. 552: Annual Report of Natural Gas Transactions.

²² See *Transparency Provisions of Section 23 of the Natural Gas Act*, 75 Fed. Reg. 35632, 35635 (June 23, 2010).

²³ See FERC Order No. 704-A, Docket No. RM07-10-001 [124 FERC ¶ 61269] (Sept. 18, 2008).

²⁴ Centralized hedging affiliates are commonly used by many commercial enterprises to rationalize commodity and foreign exchange exposures across the enterprise. Centralized hedging lowers the firm’s funding costs, facilitates the use of more sophisticated hedging techniques, reduces operational risk, and lowers the overall

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of the commercial enterprise as a whole and determine whether, or not, to lay off similar or certain other risks on the broader market via a market-facing transaction. The market-facing transaction would be with an unaffiliated party, likely a registered swap dealer, and would be subject to the real-time public reporting requirements of CEA Section 2(a)(13). Real-time public reporting of the market-facing transaction enhances price discovery because that transaction generally faces a swap dealer that prices the swap in a way that reflects credit risk and various costs, none of which may be present with a swap between affiliates.

In contrast, public reporting of data regarding inter-affiliate trades that may precede or be related to a transaction that ultimately faces the market are not necessarily probative of the price a neutral third party would pay to give or take the underlying asset or risk on the open market. For instance, credit cost with respect to inter-affiliate swaps is not probative of swap pricing in the public market because default risk among affiliated entities within a corporate group is negligible.²⁵ Similarly, an inter-affiliate swap does not price hedging costs the same as a market-facing swap because each inter-affiliate swap is entered into on the general assumption that the market risk of all transactions within the corporate group will be hedged by the centralized hedging affiliate under a market-facing transaction.

Accordingly, real time dissemination of anonymous data regarding inter-affiliate swaps that price credit and market risk at or near zero might distort price discovery in the public swap market, rather than enhance it. Consequently, Shell Trading believes that public reporting of inter-affiliate swap transaction data could *reduce* the quality of price discovery in the broader swap market, and therefore is inconsistent with the mandate of the Dodd-Frank Act to enhance price discovery in the swaps market by requiring real-time public reporting of certain swaps.

IV. The Commission Should Require Real-Time Reporting Only With Respect To Transactions That Further The Price Discovery Goals of The Dodd Frank Act

In related rulemakings, the Commission has seen fit to marry the literal language of the Dodd-Frank Act with existing commercial practices and practical realities of the markets for commodities and derivatives tied to those commodities. For example, the Commission stated that, irrespective of the literal language of the definition of “swap dealer,” the crux of the definition is “that persons who enter into swaps as a part of a ‘regular business’ are those persons whose function is to *accommodate demand* for swaps from other parties.”²⁶ The Commission then acknowledged that the “economic reality of any swaps [a market participant] enters into

credit risk the corporate group poses to the market generally by netting out intercompany exposures. *See supra* note 6 at page 5.

²⁵ Shell Trading has separately submitted comments regarding the distinctions between the credit risk of inter-affiliate trades, on the one hand, and trades facing an unaffiliated counterparty on the open market, on the other hand. *See* Letter to David A. Stawick, Secretary, from Robert Reilley, Vice President, Shell Energy, *Treatment of Transactions Among Affiliated Entities By Proposed Rulemakings Under the Dodd-Frank Act*, at pages 8-10 (June 3, 2011).

²⁶ *See* 75 Fed. Reg. at 80177.

with affiliates (i.e., legal persons under common control with the person at issue), including whether those swaps . . . simply represent an allocation of risk within a corporate group,” is particularly relevant in determining whether that person is a swap dealer.²⁷ The Commission appears poised to exclude from “accommodating demand” inter-affiliate swap transactions because they do not have the “hallmarks” of dealing.²⁸

Shell Trading believes that the express language of Section 2(a)(13)(B), which provides the Commission with the authority to make swap transactions and pricing data available to the public “in such form and at such times” as it determines to be appropriate, affords the agency with discretion to similarly account for differences between swap transactions between affiliated and unaffiliated counterparties. Given the significant differences between the purposes underlying swap transactions between affiliated versus unaffiliated entities, the terms of these transactions, and the risks associated with such transactions, Shell Trading urges the Commission to exercise this discretion to implement the reporting rules in a way that both ensures that the goal of enhancing price discovery under Section 2(a)(13)(B) is effectuated, and that avoids extending the full panoply of reporting obligations to those swap transactions that do not enhance – and in some cases may distort – the price discovery function. The Commission has the authority to exclude inter-affiliate transactions from real-time public reporting requirements under the Dodd-Frank Act and by exercising this authority can accomplish these twin goals.

V. Reporting of Inter-Affiliate Swaps to a Swap Data Repository Will Ensure An Adequate Level of Transparency With Respect to Such Swaps

The Commission should note that excluding inter-affiliate swaps from real-time public reporting requirements will not limit the access of regulatory authorities to transaction data regarding such swaps. Separately from the Real-Time Reporting Release, the Commission has proposed swap data reporting and recordkeeping requirements under Sections 727 and 728 of the Dodd-Frank Act (the “**Swap Data Release**”) which would subject all cleared and uncleared swaps, including the inter-affiliate swaps discussed above, to certain recordkeeping requirements and requirements to report such swaps to a swap data repository (“**SDR**”) (or, if no such SDR will accept reporting of such swaps, to the Commission).²⁹

The Swap Data Release reporting requirements require swap counterparties to report to SDRs certain minimum “primary economic terms” regarding executed swaps. “Primary economic terms” would include specific data elements regarding the “generic economic terms and

²⁷ See *id.* at 80183.

²⁸ Shell Trading has separately submitted comment regarding why an end-user that enters into transactions with affiliated entities should not be treated as “accommodating demand” for swaps for purposes of the definition of “swap dealer” under the Dodd-Frank Act. See *supra* note 25 at pages 2-5.

²⁹ See *Swap Data Recordkeeping and Reporting Requirements*, 75 Fed. Reg. 76574 (proposed Dec. 8, 2010). The Swap Data Release refers to swap counterparties that are not swap dealers or major swap participants as “non-SD/MSP counterparties.” Non-SD/MSP counterparties are subject to the same requirements as any other swap participant under the Dodd-Frank Act and the Swap Data Release.

conditions common to . . . the asset class” underlying the reported swap.³⁰ Thus, the swap pricing data that is the subject of the Real-Time Reporting Release is already subject to reporting under the Swap Data Release.³¹ However, as the Commission notes in the Swap Data Release, “Dodd-Frank does not specify the timeframes for reporting of swap data to SDRs for regulatory purposes (as opposed to real time reporting).”³² Accordingly, the Swap Data Release affords counterparties a reasonable degree of flexibility in the timing of such reporting.³³

Such flexibility in the scope and timing of such reporting is consistent with the general swap data reporting requirement in the Dodd-Frank Act applicable to uncleared swaps.³⁴ Indeed, the Dodd-Frank Act does not prescribe the timing or content of swap data reporting that must be made under Sections 728 and 729.³⁵ With respect to inter-affiliate swaps, Shell Trading believes the proposed SDR reporting requirement in the Swap Data Release should be limited to the following “primary economic terms:” (i) contract type; (ii) effective date; (iii) notional amount or quantity; (iv) termination date; and (v) underlying commodity.³⁶ In addition, Shell Trading believes that timing of SDR reporting with respect to inter-affiliate swaps, consistent with the flexibility of the reporting requirement in Section 729 of the Dodd-Frank Act, should be within 3 business days following execution of the swap.

Shell Trading also recommends that the Commission should not require reporting of “continuation data” (such as changes in valuation or daily “snapshot” data regarding the transaction) for inter-affiliate swaps. Given the nature of such transactions among affiliates, there is little need for such information internally, and cost of preparation of reports providing continuation data would be unwarranted because the information would have no discernable value to the public. Further, should the Commission at any time require access to such information, Dodd-Frank Act Section 729 provides the Commission authority to request such information directly from swap counterparties.³⁷

The Commission has explicitly noted that its approach in the Swap Data Release “effectuates a policy choice made by Congress in Dodd-Frank to place lesser burdens on non-SD/MSP

³⁰ See 75 Fed. Reg. at 76580.

³¹ Specifically, under the Swap Data Release a reporting party must report to an SDR specified “primary economic terms” and “confirmation” data at the creation of a swap, and must report certain “continuation” data regarding a swap until termination of the swap.

³² 75 Fed. Reg. at 76582.

³³ “[T]he Commission recognizes that the amount of time needed for reporting could vary depending on, among other things, the extent to which the swap is standardized, and whether execution of the swap and verification by the parties of the primary economic terms of the swap occur electronically or manually.” *Id.*

³⁴ See Dodd-Frank Act § 729 (CEA § 4r(a)(1)).

³⁵ See Dodd-Frank Act § 729 (CEA § 4r(d)). Data reported by counterparties is merely required to be consistent with what SDRs are required by Commission rule to collect.

³⁶ See 75 Fed. Reg. at 76607.

³⁷ See Dodd-Frank Act § 729 (CEA § 4r(c)(1)).

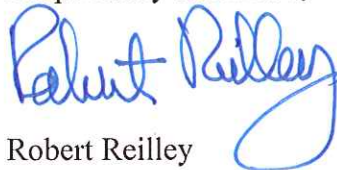
counterparties to swaps, where this can be done without damage to the fundamental systemic risk mitigation, transparency, standardization, and market integrity purposes of the legislation.”³⁸ The Commission should note that the Dodd-Frank Act provides the Commission substantial control over how SDRs must collect and maintain swap data that is reported to them,³⁹ and that SDRs may disclose aggregated data regarding reported swaps so long as such data cannot be attributed to individual transactions or market participants.⁴⁰

VI. Conclusion

Shell Trading appreciates the opportunity to provide these comments. We would similarly welcome the opportunity to work with the Commission to develop an approach to meeting the mandate of Congress as it applies to real-time public reporting of swap transaction data.

Please contact me at (713) 767-5632 if you have any questions regarding these comments.

Respectfully submitted,



Robert Reilley
Vice President – Regulatory Affairs
Shell Energy North America (US), L.P.

cc: Chairman Gensler
Commissioner Dunn
Commissioner Chilton
Commissioner Sommers
Commissioner O’Malia
Daniel Berkovitz, General Counsel

³⁸ 75 Fed. Reg. at 76579.

³⁹ See Dodd-Frank Act § 728 (CEA § 21(b)(2)); 75 Fed. Reg. at 76575.

⁴⁰ See *Swap Data Repositories*, 75 Fed. Reg. 80898, 80908 (proposed Dec. 23, 2010) (“SDR information that is not subject to real-time public reporting should be treated as non-public and strictly confidential, so that it may not be accessed, disclosed, or used for purposes not related to SDR responsibilities under the CEA or the regulations thereunder, unless such use is explicitly agreed to by the reporting entities (i.e., the submitter(s) of the data). However, *aggregated data that cannot be attributed to individual transactions or market participants may be made publicly available by SDRs.*”) (emphasis supplied).