



**ASC NOTICE 21-703**  
**REQUEST FOR COMMENT RE:**  
**PROPOSED RECOGNITION OF**  
**NET ENERGY INC. AS AN EXCHANGE**

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**December 5, 2014**

The Alberta Securities Commission (the **Commission**) seeks comment on a proposed order for the recognition of Net Energy Inc. (**Net Energy**) as an exchange under section 62 of the *Securities Act* (Alberta) (the **Act**). The proposed recognition order (the **Order**) is attached as an Annex to this notice. In order to obtain and maintain the requested recognition, a derivatives exchange based in Alberta must demonstrate compliance with certain requirements set forth in the Order, at the time of application and thereafter.

Since 2005, Net Energy has operated a crude oil trading system in Alberta. Net Energy's trading system includes electronic trade execution, which facilitates the interaction of orders between multiple buyers and sellers of crude contracts. Net Energy offers contracts based on Canadian crude oil indices compiled, maintained and published by Net Energy.

Net Energy has licensed the use of its crude oil indicies to the New York Mercantile Exchange (**NYMEX**). NYMEX lists futures contracts based on these indicies, which Net Energy co-markets, and through this arrangement offers these products on the Exchange Trading Platform (as defined in the Order). Once a trade is executed on the Exchange Trading Platform, the trade is submitted by Net Energy to Chicago Mercantile Exchange (**CME**) through specific accounts set up by CME clearing members. The block trades are reported publicly by NYMEX or the CME exchanges. The Exchange Trading Platform provides pre-trade transparency to the exchange participants on the platform.

Net Energy has applied, pursuant to section 144(1) of the Act, for an exemption from the registration requirement for exchange participants who enter into Net Energy's standard form agreement. Net Energy has also applied for exemption from the registration requirement arising from their business model, which includes voice brokers (**Voice Brokers**). The Voice Brokers may: (i) accept orders and place them on the Exchange Trading Platform on behalf of exchange participants; (ii) draw attention to existing orders, placing any new or revised orders on the Exchange Trading Platform immediately; and (iii) accept soft orders that are not immediately actionable and try to find interest from exchange participants in such orders. Based on the information provided by Net Energy as part of its application, the Commission has determined that the activities of the Voice Brokers go beyond "voice-assisted trading". The Commission proposes to grant the registration relief to Net Energy in the Order, which requires, among other things, Net Energy to comply with a number of additional requirements under Appendix B of the Order.

The Order requires the Voice Brokers to comply with the rules of the Exchange Trading Platform and with provisions in the Order. Under the Order, the Commission will be the primary

regulator for the Voice Brokers and Net Energy as one entity. The Commission would be the primary regulator of the voice brokerage regardless of whether Net Energy, or an affiliated entity of Net Energy, was subject to a separate registration requirement due to the activities of the Voice Brokers. The Commission can effectively regulate both aspects of Net Energy's business under a single recognition framework. While this will allow Net Energy to operate with minimal disruption to its business structure, Net Energy is required to ensure it can identify and mitigate potential conflicts that may arise as a result of the business. On this basis and other additional factors, the Commission proposes to grant the application for recognition as an exchange, under the terms and conditions set out in the Order.

In the United States (US), Net Energy is registered as an introducing broker. Net Energy is not registered as a marketplace in the US. During the period where Net Energy may be recognized as an exchange in Canada, and not registered as a marketplace in the US, Net Energy trades will be reported publicly by NYMEX, and at least in aggregate, will be reported publicly as having been executed on the Exchange Trading Platform.

Net Energy has applied for exemptive relief from National Instrument 21-101 *Marketplace Operation (NI 21-101)* and from Part 4 of National Instrument 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces (NI 23-103)*. The applicable requirements under NI 21-101 and NI 23-103, respectively, have been incorporated into the Order and tailored for the operations of a derivatives exchange. On this basis, the Commission proposes to grant exemptive relief from NI 21-101 and Part 4 of NI 23-103.

The Commission invites written comments on the proposed Order by February 3, 2015. Comments will be publicly available and will be published on the Commission website at [www.albertasecurities.com](http://www.albertasecurities.com).

Please direct any comments to:

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**ANNEX**

**ALBERTA SECURITIES COMMISSION**

**RECOGNITION ORDER: EXCHANGE**

INCLUDES COMMENT LETTERS

ALBERTA SECURITIES COMMISSION

RECOGNITION ORDER: EXCHANGE

Citation: Re Net Energy Inc., 2014 ABASC [XXX]

Date: 2014XXXX

Net Energy Inc.

**Background**

1. Net Energy Inc. (the **Applicant**) has applied to the Alberta Securities Commission (the **Commission**) pursuant to section 62 of the *Securities Act* (Alberta) (the **Act**) for recognition as an exchange; pursuant to section 144(1) of the Act for an exemption from the registration requirement for the Applicant and Exchange Participants (as defined below) who enter into the Applicant's Customer User Agreement (as defined below) (**Registration Relief**); pursuant to section 15.1(1) of National Instrument 21-101 *Marketplace Operation* (**NI 21-101**) for relief from NI 21-101; and pursuant to section 10(1) of National Instrument 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces* (**NI 23-103**) for relief from Part 4 of NI 23-103.

**Interpretation**

2. Terms defined in the Act or National Instrument 14-101 *Definitions* have the same meaning in this order unless otherwise defined herein.

**Representations**

3. The Applicant represents:

***The Applicant***

- (a) The Applicant is a corporation incorporated under the laws of the Province of Alberta and based in Calgary, Alberta.

***The Exchange Trading Platform***

- (b) The Applicant offers contracts based upon Canadian crude oil indices compiled, maintained and published by the Applicant (**Contracts**).
- (c) Trades in Contracts are executed by exchange participants of the Applicant (**Exchange Participants**) that have entered into the Applicant's standard Customer User Agreement (the **Customer User Agreement**). Exchange Participants execute trades in Contracts on the electronic trading platform owned and operated by the Applicant (the **Exchange Trading Platform**), in accordance with rules, including the rulebook, Customer User Agreement and related regulations, specifications and policies (the **Rules**), established, monitored and enforced by the Applicant. Orders are entered directly by Exchange Participants into the Exchange Trading Platform, or indirectly through voice brokers employed by the Applicant (**Voice Brokers**).

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- (d) All Contracts offered for trading by the Applicant are executed on the Exchange Trading Platform during hours prescribed by the Applicant for trading in Contracts. The Exchange Trading Platform provides a competitive, open and efficient market and mechanism for executing transactions that protects the price discovery process, including pre-trade transparency, of trading on the Exchange Trading Platform.

***Access Requirements***

- (e) The Applicant has established, monitors and enforces compliance with Rules concerning access to the Exchange Trading Platform.
- (f) Access to the Exchange Trading Platform is restricted to Exchange Participants.
- (g) An Exchange Participant may trade on the Exchange Trading Platform solely as principal either (i) directly, through an electronic, browser-based connection to the Exchange Trading Platform, whereby an Exchange Participant may transmit orders and enter trades on the Exchange Trading Platform, or (ii) indirectly, through Voice Brokers. Voice Brokers may: (i) accept orders and place them on the Exchange Trading Platform on behalf of Exchange Participants; (ii) draw attention to existing orders, placing any new or revised orders on the Exchange Trading Platform immediately; or (iii) accept soft orders that are not immediately actionable and try to find interest from Exchange Participants in such orders.
- (h) The Applicant does not unreasonably prohibit, condition or limit access by a person or company to services offered by the Applicant or permit unreasonable discrimination among Exchange Participants.

***Fees***

- (i) All fees imposed by the Applicant are equitably assessed and consistent with the requirements for access to the Exchange Trading Platform set out herein. The Applicant's process for setting fees is fair and appropriate and the fee model is transparent.

***Rules of the Applicant***

- (j) The Applicant has established, monitors and enforces compliance with formal written Rules for the Exchange Trading Platform and Voice Brokers that are not contrary to the public interest, and that are designed to: (i) appropriately govern and regulate the operation of the Exchange Trading Platform, including the terms and conditions of any Contracts traded on the Exchange Trading Platform; (ii) ensure compliance with Alberta securities laws; (iii) prevent fraudulent, manipulative and abusive acts and practices; (iv) promote fair, orderly, just and equitable trading on the Exchange Trading Platform; and (v) foster cooperation and coordination with persons or companies engaged in regulating, clearing, settling, and processing information relating to trading on the Exchange Trading

Platform. Without limiting the foregoing, the Applicant has established, monitors and enforces compliance with the Rules that:

- (i) prohibit trade-related abuses by Voice Brokers;
- (ii) whether directly, or indirectly through a regulation services provider, govern the conduct, operations and activities on or related to trading on the Exchange Trading Platform by Exchange Participants;
- (iii) incorporate the additional requirements under Appendix B of this Order;
- (iv) as is necessary and appropriate, impose position limits or position accountability levels in respect of Contracts, to reduce the potential threat of market manipulation or congestion on the Exchange Trading Platform;
- (v) ensure the financial integrity of Contracts traded on the Exchange Trading Platform, including the clearance and settlement of transactions with a clearing agency that is permitted to carry on business in Alberta;
- (vi) authorize the Applicant to collect and examine any information from Exchange Participants relevant to their respective conduct and activities, and to make enquiries, or conduct investigations relating, to the conduct and activities of Exchange Participants on the Exchange Trading Platform, on both a routine and non-routine basis, in order to monitor compliance with and enforce the Rules;
- (vii) require Exchange Participants to keep records of their trading activities on the Exchange Trading Platform, including records of their activity in any underlying commodity and related derivatives markets for 7 years from the date of trade;
- (viii) authorize the Applicant to exercise emergency authority, including the authority to A. liquidate or transfer open positions in Contracts; B. suspend or curtail trading in Contracts; or C. require Exchange Participants in Contracts to meet special margin requirements;
- (ix) require that for any decision made by the Applicant that affects an Exchange Participant, or an applicant to be an Exchange Participant, including a decision in relation to access or discipline, the Applicant ensures that A. parties are given an opportunity to be heard or make representations; and B. the Applicant keeps a record of and gives reasons for its decisions and provides for appeals or reviews of its decisions;
- (x) provide a mechanism and facilities for the resolution of disputes between A. Exchange Participants and other Exchange Participants; and B. Exchange Participants and Voice Brokers;

- (xi) minimize conflicts of interest in the decision-making process of the Applicant and establish a process for appropriately identifying and resolving conflicts of interest; and
- (xii) ensure disclosure and dissemination of information to the Commission, Exchange Participants and the public regarding current and new product listings, current and new Rules, Rule amendments or other changes to previously disclosed information.

***Financial Integrity of Transactions***

- (k) Trading in Contracts on the Exchange Trading Platform is restricted to Exchange Participants that are members of a clearing agency or use a clearing agency through members of the clearing agency permitted to carry on business in Alberta and which clear Contracts traded on the Applicant's Exchange Trading Platform.
- (l) Chicago Mercantile Exchange Inc. (the **Clearing Agency**), a corporation incorporated under the laws of Delaware and a wholly-owned subsidiary of CME Group Inc., clears, settles and guarantees to its members (**CME Clearing Members**) the performance of all transactions in Contracts executed on the Exchange Trading Platform.
- (m) The Applicant regularly establishes, maintains and monitors compliance by Exchange Participants with the Applicant's minimum financial standards, routinely receives and promptly reviews financial and related information from Exchange Participants, and continuously monitors the positions of Exchange Participants. Pursuant to the Rules, Exchange Participants must demonstrate sufficient financial resources and operational capacity to perform their obligations under the transactions on the Exchange Trading Platform and satisfy the meaning of a "qualified party" pursuant to the Blanket Order 91-506 *Over-the-Counter Trades in Derivatives*.
- (n) The Applicant routinely reviews the default rules and procedures of the Clearing Agency to wind-down operations, transfer customers, or otherwise protect customers in the event of a default of a CME Clearing Member or the Clearing Agency.

***Regulation of Market Participants***

- (o) The Applicant has implemented and enforces procedures pursuant to section 3(j)(ix) of this Order that empowers it to: (i) prosecute violations of the Rules; (ii) provide protection to parties accused of such violations according to fair and clear standards; and (iii) impose appropriate sanctions for such violations.
- (p) The Applicant monitors the conduct of Exchange Participants and Voice Brokers.

***Prevention of Market Disruption***

- (q) The Applicant has designed the Rules to prevent manipulation, price distortion and disruptions of the delivery or cash-settlement process for Contracts through market surveillance, compliance and enforcement practice and procedures, including: (i) methods for conducting real-time monitoring of trading on the Exchange Trading Platform; and (ii) comprehensive and accurate trade reconstructions.
- (r) The Applicant: (i) collects and evaluates data on the activity of each Exchange Participant and Voice Broker on an ongoing basis to detect and prevent manipulation, price distortions and, where possible, disruptions of the delivery or cash-settlement process; (ii) monitors and evaluates general market data from the Exchange Trading Platform to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand; and (iii) conducts real-time monitoring of trading and comprehensive and accurate trade reconstructions. Intraday trade monitoring conducted by the Applicant includes: (i) the capacity to detect abnormal price movements, unusual trading volumes, impairments to market liquidity, and position-limit violations; and (ii) either manual processes or automated alerts that are effective in detecting and preventing trading abuses.
- (s) The Applicant regularly monitors, for a Contract, the availability and pricing of the commodity making up the index to which such Contract will be settled; and the continued appropriateness of the methodology for deriving such index. The Applicant promptly amends any index methodologies that result, or are likely to result, in manipulation, price distortions, or market disruptions, or imposes new methodologies to resolve the threat of manipulation, market disruptions or price distortions.
- (t) If a Contract is settled by reference to the price of a contract or commodity traded in another venue, including a price or index derived from prices on another derivatives exchange, the Applicant requires Exchange Participants to provide the Applicant with their positions in the reference markets as the Contract approaches settlement, unless the Applicant has entered into an information sharing agreement with the other venue or derivatives exchange for the purpose of obtaining such information directly from the other venue or derivatives exchange.
- (u) The Applicant has established and implemented risk control mechanisms to reduce the potential risk of market disruptions, including but not limited to market restrictions that pause or halt trading in market conditions prescribed by the Applicant. If a Contract is linked to, or is a substitute for, other Contracts on the Exchange Trading Platform or on other trading venues, such risk control mechanisms are, to the extent practicable, coordinated with any similar controls placed on those other Contracts.

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- (v) The Applicant has the capacity to reconstruct, accurately, all trading on the Exchange Trading Platform.

***Contracts Not Readily Susceptible to Manipulation***

- (w) Contracts traded on the Exchange Trading Platform are not readily susceptible to manipulation.

***Information Sharing and Regulatory Cooperation***

- (x) The Applicant has mechanisms in place to enable it to share relevant information and otherwise co-operate with the Commission, recognized self-regulatory organizations, other recognized exchanges, investor protection funds, and other appropriate regulatory bodies, including for the purpose of carrying out such relevant international information-sharing agreements as the Commission may require.

***Availability of Information***

- (y) The Applicant makes available to the Commission, Exchange Participants and the public, accurate information concerning: (i) the terms and conditions of Contracts; (ii) the Rules and mechanisms for executing transactions on the Exchange Trading Platform; (iii) the Rules describing the operation of the Exchange Trading Platform; and (iv) the Rules with respect to the activities of Voice Brokers.
- (z) The Applicant ensures that the Rules available to the public are accurate, complete and current.
- (aa) The Applicant reports to the public directly, or indirectly through an information vendor, daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded Contracts.
- (bb) The Applicant complies with Principles for Oil Price Reporting Agencies Oversight (**PRAs**) developed by the Board of the International Organization of Securities Commissions (**IOSCO**). The Applicant will continue to comply with the PRAs, as amended from time to time, to the extent such principles do not contravene Alberta securities laws.

***Trade Information***

- (cc) The Applicant maintains Rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the Applicant to use the information to assist in the prevention of customer and market abuses, and provide evidence of any violations of the Rules. Without limiting the foregoing, the Applicant maintains an audit trail program, including through a transaction data system that captures and retains all order, trade-related and other data sufficient: (i) to detect, investigate and prevent violations of the

Rules, as well as trading and market abuses; and (ii) to reconstruct all transactions in Contracts within a reasonable period of time. The Applicant's audit trail program includes:

- (i) original source documents that are unalterable, sequentially-identified records on which trade execution information is originally recorded. Records for Exchange Participant orders, including Voice Broker-facilitated orders (whether filled, unfilled or cancelled, each of which is retained or electronically captured) reflect the terms of the order, an identifier that relates back to the Exchange Participant and Voice Broker, and the time of order entry;
  - (ii) an electronic transaction history database that includes a history of all orders and trades, and also includes all data that are inputted into the trade entry or matching system for the transaction to match and clear; timing and sequencing data adequate to reconstruct trading; and identification of each account to which fills are allocated;
  - (iii) electronic analysis capability with respect to all audit trail data in the transaction history database. Such electronic analysis capability permits the sorting and presentation of data in the transaction history database so as to reconstruct trading and identify possible violations of the Rules; and
  - (iv) the capability to safely store all audit trail data retained in its transaction history database. Such safe storage capability includes the capability to store all audit trail data in the database in a manner that protects it from any alteration, as well as from accidental erasure or other loss. Data must be retained in accordance with the record-keeping requirements set out in undertaking 4(k) of this Order.
- (dd) The Applicant has established a program for the effective enforcement of its audit trail and record-keeping requirements. The Applicant enforces its audit trail and record-keeping requirements through annual reviews of all Exchange Participants to verify their compliance with the Applicant's audit trail and record-keeping requirements. Such reviews include, but are not limited to: (i) reviews of randomly selected samples of front-end audit trail data for order routing systems; (ii) a review of the process by which user identifications are assigned and user identification records are maintained; (iii) a review of usage patterns associated with user identifications to monitor for violations of user identification rules; and (iv) reviews of account numbers and customer type indicator codes in trade records to test for accuracy and improper use.

***Governance***

- (ee) The Applicant has implemented and enforces appropriate fitness standards for directors and officers of the Applicant, Exchange Participants, each person or company that owns or controls, directly or indirectly, more than 10 percent of the

Applicant or an Exchange Participant, and any party affiliated with any of the foregoing persons. Without limiting the foregoing, the Applicant ensures that each officer or director of the Applicant is a fit and proper person for that role and the past conduct of each such officer or director affords reasonable grounds for belief that the officer or director will perform his or her duties with integrity.

- (ff) The governance structure and governance arrangements of the Applicant ensure: (i) effective oversight of the Exchange Trading Platform; (ii) that business and regulatory decisions are in keeping with the Applicant's public interest mandate; (iii) fair and meaningful representation on the board of directors of the Applicant and any committees of the board, including appropriate representation of independent directors, a proper balance among the interests of the different persons or companies using the services and facilities of the Applicant, and that the views of Exchange Participants can be considered; and (iv) that the composition of such bodies reflects a broad and diverse pool of qualified candidates.

#### *Market Surveillance*

- (gg) The Applicant has implemented an automated trade surveillance system which detects and investigates potential trade practice violations, including Voice Broker practices, on the Exchange Trading Platform (the **Surveillance System**). The Surveillance System maintains all data reflecting the details of each order entered into the Exchange Trading Platform, including all order modifications and cancellations, and details of each transaction executed on the Exchange Trading Platform. The Surveillance System loads and processes daily orders and trades no later than 24 hours after the completion of the trading day. The Surveillance System has the capacity to detect and flag specific trade execution patterns and trade anomalies; compute, retain, and compare trading statistics; compute trade gains, losses and positions; reconstruct the sequence of market activity; perform market analysis; and support system users to perform in-depth analyses and *ad hoc* queries of trade-related data.
- (hh) The Applicant conducts real-time market monitoring of all trading activity on the Exchange Trading Platform to promote orderly trading and identify any market or system anomalies. The Applicant has the authority to adjust trade prices or cancel trades when necessary to mitigate market disrupting events caused by malfunctions on the Exchange Trading Platform or errors in orders submitted by Exchange Participants and Voice Brokers. Any trade price adjustments or trade cancellations are made transparent to the market.

#### *System Safeguards*

- (ii) The Applicant has established and maintains a program of risk analysis and oversight to identify, manage and minimize sources of operational risk, through the development of appropriate controls and procedures, and the development of automated systems that are reliable, secure and have adequate scalable capacity.

The Applicant's program of risk analysis and oversight addresses each of the following categories of risk analysis and oversight: information security; business continuity-disaster recovery planning and resources, capacity and performance planning, systems operations, systems development and quality assurance, and physical security and environmental controls. In addressing the foregoing categories of risk analysis and oversight, the Applicant follows generally accepted standards and best practices with respect to the development, operation, reliability, security and capacity of automated systems.

- (jj) The Applicant has established emergency procedures, backup facilities, and a plan for disaster recovery and resumption of operations sufficient to enable timely recovery, resumption of its operations, and resumption of fulfillment of its responsibilities and obligations as a derivatives exchange following any disruption of its operations. Such responsibilities and obligations include, without limitation, order processing and trade matching; transmission of matched orders to the Clearing Agency; price reporting; and market surveillance and maintenance of a comprehensive audit trail.
- (kk) The Applicant is able to resume trading on the Exchange Trading Platform during the next business day following the end of a disruption.
- (ll) The Applicant conducts regular objective testing and review of its automated systems to ensure that they are reliable, secure and have adequate scalable capacity. The Applicant also conducts regular objective testing and review of its business continuity-disaster recovery capabilities. Both types of testing are conducted by qualified, independent professionals, who may be independent contractors or employees of the Applicant, but who are not responsible for development or operation of the systems or capabilities being tested. All records of such tests are stored in accordance with undertaking 4(k) of this Order.
- (mm) The Applicant periodically conducts tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, transmission of matched orders to the Clearing Agency for clearing, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail that: (i) permits the Applicant to track Exchange Participants' and Voice Brokers' orders from the time of receipt through fill, allocation or other disposition; and (ii) includes both order and trade data. The Applicant has procedures in place to address trading errors, trading halts and circuit breakers.
- (nn) To the extent practicable, the Applicant:
  - (i) coordinates its business continuity-disaster recovery plan with Exchange Participants upon whom the Applicant depends to provide liquidity, in a manner adequate to enable effective resumption of activity in its markets following a disruption causing activation of the Applicant's business continuity-disaster recovery plan;

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- (ii) initiates and coordinates periodic, synchronized testing of its business continuity-disaster recovery plan and the business continuity-disaster recovery plans of Exchange Participants upon whom the Applicant depends to provide liquidity; and
- (iii) ensures that its business continuity-disaster recovery plan takes into account the business continuity-disaster recovery plans of its essential service providers.

***Resources and Outsourcing***

- (oo) The Applicant has sufficient financial, operational and managerial resources, including by delegation or outsourcing to third parties, to fulfil its functions and regulatory responsibilities including effective audit trail reviews; trade practice surveillance, financial and market surveillance; real-time market monitoring; protection of customer funds; enforcement of clearing and settlement provisions; and other compliance and regulatory responsibilities.
- (pp) The Applicant conducts a reasonable calculation of its projected operating costs over a 12-month period to determine it has sufficient financial resources pursuant to the quarterly reporting requirement set out in Appendix A, section 6(e) of this Order. For purposes of the foregoing, financial resources shall be considered sufficient if their value is at least equal to the total amount that would enable the Applicant to cover its operating costs for a period of at least one year, calculated on a rolling basis.
- (qq) The Applicant establishes and maintains sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, financial and market surveillance, and real-time market monitoring. The Applicant has sufficient compliance staff to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner.
- (rr) The Applicant conducts an annual assessment of the size and workload of its compliance staff in order to ensure that its compliance resources and staff are at appropriate levels. In determining the appropriate levels of compliance resources and staff, the Applicant considers projected trading volume increases, the number of new Contracts projected to be listed for trading, any new responsibilities expected to be assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, and any other actions suggesting the need for increased resources or staff.
- (ss) Where the Applicant outsources any of its key functions, it has appropriate and formal arrangements and processes in place that permit it to meet its regulatory obligations and that are in accordance with industry best practices.

**Undertakings**

4. The Applicant undertakes:

- (a) to make best efforts to ensure the representations remain accurate in all material respects and to satisfy the undertakings herein;
- (b) to employ reasonable procedures for monitoring and enforcing compliance with the undertakings herein;
- (c) to investigate any possible violation of the Rules promptly upon request from the Commission staff;
- (d) unless reasonably necessary or appropriate, not to adopt any rule or take any action that results in any unreasonable restraint of trade, or to impose any material burden upon competition;
- (e) not to provide, and to take reasonable steps to prevent third parties, Exchange Participants or Voice Brokers from providing access to the Exchange Trading Platform to persons unauthorized by the Applicant;
- (f) prior to the Applicant implementing a significant new or amended Rule, to file in the form and manner requested by the Executive Director and in accordance with the Commission's approved process, not later than 10 business days prior to implementing the new or amended Rule, a submission containing a certification by the Applicant that the new or amended Rule complies with Alberta securities laws;
- (g) prior to the Applicant listing a new or amended Contract for trading on the Exchange Trading Platform, to file in the form and manner requested by the Executive Director and in accordance with the Commission's approved process, not later than one business day prior to the new or amended Contract's listing, a submission containing a certification by the Applicant that the new or amended Contract complies with Alberta securities laws;
- (h) on the date of implementation of a new or amended Rule, on the same day a new or amended Contract is listed for trading on the Exchange Trading Platform, or the day any changes to previously-disclosed information take effect, to publish or post all new or amended Rules, both substantive and non-substantive, and details of the new or amended Contracts listed;
- (i) to provide accurate and complete information to and not omit material information from any communication with the Commission, and any information required to be transmitted or made available to Exchange Participants and the public;
- (j) to cooperate with the Commission with respect to arrangements established to address cross-market oversight issues, including surveillance, emergency actions and the monitoring of trading;

- (k) to maintain records of all activities relating to the Applicant's business in a form and manner acceptable to the Commission and for a period of at least 7 years. Without limiting the foregoing, the Applicant undertakes to keep records of the Applicant's decisions, and reasons therefor, for any decision made by the Applicant that affects an Exchange Participant, or an applicant to be an Exchange Participant, including a decision in relation to access, denial or limitation of access, or discipline;
- (l) to require each Exchange Participant to:
  - (i) file with the Applicant a written representation, executed by a person with the authority to bind the Exchange Participant, stating that as long as the Exchange Participant is granted access to the Exchange Trading Platform, the Exchange Participant agrees and submits to the jurisdiction of the Commission with respect to activities conducted pursuant to the Applicant's operation as a recognized exchange;
  - (ii) file with the Applicant a valid and binding appointment of an agent for service of process in Alberta, if an Exchange Participant's registered office is located outside of Alberta, pursuant to which the agent is authorized to accept delivery and service of communications issued by or on behalf of the Commission; and
  - (iii) maintain with the Applicant a written undertaking, executed by a person with the authority to bind the Exchange Participant, stating that the Exchange Participant will provide promptly to the Commission such information as the Commission may request, and access to all premises in or from which the Exchange Participant operates;
- (m) to provide access to the Commission to all trade information, including that to be supplied in accordance with Representations (cc) and (dd) of this Order;
- (n) to file with the Commission a copy of all material filed by the Applicant, concurrently with such filing with any other regulatory body;
- (o) to establish systems to identify and resolve conflicts of interest between Exchange Participants and Voice Brokers in accordance with the requirements set out in Appendix B to this Order;
- (p) to report to the Commission in accordance with the reporting requirements set out in Appendix A to this Order;
- (q) to comply with any request from the Executive Director of the Commission, to supply information related to the Clearing Agency in the event that the recognition order of the Commission for Chicago Mercantile Exchange Inc. (cited

as *Chicago Mercantile Exchange Inc., Re*, 2012 ABASC 177) is revoked or materially revised;

- (r) to comply with any request from the Executive Director of the Commission, to assist the Commission in its oversight of the Applicant as an exchange; and
- (s) to ensure that all material filed with the Commission hereunder shall, if required to be executed, be signed by a senior officer of the Applicant who has the authority to bind the Applicant and shall be based on such officer's personal knowledge.

**Decision**

Based on the representations and undertakings herein, the Commission, being satisfied that it would not be prejudicial to the public interest to do so:

- (a) under section 62 of the Act, recognizes the Applicant as an exchange;
- (b) under section 144(1) of the Act, grants the Registration Relief;
- (c) under section 15.1(1) of NI 21-101, exempts the Applicant from NI 21-101; and
- (d) under section 10(1) of NI 23-103, exempts the Applicant from Part 4 of NI 23-103

for so long as the Applicant satisfies its undertakings herein.

This decision expires on the earlier of the 180<sup>th</sup> day after the coming into force of a rule or rules of the Commission creating a regime for the (a) regulation of derivatives trading platforms, and (b) the registration of derivatives dealers.

**For the Commission:**

\_\_\_\_\_  
Tom Cotter  
Vice-Chair

\_\_\_\_\_  
Stephen Murison  
Vice-Chair



**APPENDIX A**  
**Reporting Requirements**

The Applicant will report to the Commission as follows:

***Prior Notification***

1. The Applicant will notify the Commission not later than 10 business days in advance of:
  - (a) entering into an agreement to outsource key Exchange Trading Platform functions;
  - (b) any significant change in the operation of the Exchange Trading Platform, subject to an event resulting from a *force majeure* or other event occurring outside the control of the Applicant that renders the notification above impossible;
  - (c) any change in the beneficial ownership of the Applicant;
  - (d) planned changes to automated systems that may impact the reliability, security, or adequate scalable capacity of such systems; and
  - (e) planned changes to the Applicant's program of risk analysis and oversight.
2. The Applicant shall use its best efforts to provide the information required in paragraphs 1(a) to (e) above earlier than specified, when possible.

***Immediate Reporting***

3. The Applicant will report immediately upon occurrence or upon becoming aware of the existence of:
  - (a) any electronic trading halts and systems malfunctions that occur for 15 minutes or more; cyber security incidents or targeted threats that actually or potentially jeopardize automated system operation, reliability, security, or capacity; or activation of the Applicant's business continuity-disaster recovery plan;
  - (b) any event or circumstance or situation that renders, or is likely to render, the Applicant unable to comply with Alberta securities laws or an order of or undertaking to the Commission, or renders any of its representations to the Commission untrue;
  - (c) any monetary default, insolvency or bankruptcy of the Applicant or any Exchange Participant that may have a material adverse effect on the financial or operational viability of the Applicant, or the Exchange Trading Platform, including the particulars of the default and the resolution proposed. The

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Applicant must also provide the Commission with information regarding the impact of the default on the adequacy of the Applicant's financial resources;

- (d) any order, sanction or other directive received from, or imposed by, a regulatory or government body;
- (e) any investigations of the Applicant by a regulatory or government body;
- (f) any criminal or quasi-criminal charges brought against the Applicant, any of its subsidiaries or affiliates, or any of the officers or directors of the Applicant and its subsidiaries or affiliates; and
- (g) any civil suits brought against the Applicant, any of its subsidiaries, or any of the officers or directors of the Applicant, that would likely have a significant impact on the Applicant's business.

***Key Event Reporting***

- 4. The Applicant will report as soon as possible and in any event no later than 2 business days from the date of occurrence:
  - (a) each appointment or resignation of a member of the Applicant's board of directors;
  - (b) each change to the senior management team;
  - (c) each new or amended pricing methodology for indices upon which any Contracts are based; and
  - (d) each significant change to an agreement or a material contract between the Applicant and any third party.
- 5. In the event that a default by an Exchange Participant under an agreement between the Applicant and an Exchange Participant is not resolved within 2 business days, the Applicant will report such default including particulars of the default, the parties involved in the default, and the method of resolution proposed.

***Quarterly Reporting***

- 6. The Applicant will provide, within 60 days of the end of each quarter of the financial year:
  - (a) a description of any significant margin requirement exceptions that the Applicant allowed during that quarter;
  - (b) an up-to-date list of Exchange Participants;

- (c) interim financial statements, including at minimum, a condensed statement of financial position, a condensed statement or condensed statements of profit or loss and other comprehensive income, a condensed statement of changes in equity, a condensed statement of cash flows and selected explanatory notes of the Applicant, as of the last business day of the Applicant's financial quarter. Such interim financial statements must be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises and disclose an unreserved statement of compliance with International Accounting Standard 34 *Interim Financial Reporting*, as amended from time to time;
- (d) any non-significant amendments to the Rules or Contracts;
- (e) a reasonable calculation of the Applicant's projected operating costs over a 12-month period to determine if the Applicant's financial resources are sufficient. Financial resources available to satisfy the requirements of this paragraph (e) may include the Applicant's own capital, and any other financial resource deemed acceptable by the Commission. However, financial resources allocated by the Applicant to meet the requirements of this paragraph (e) must include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities) equal to at least 6 months operating costs. If any portion of such financial resources is not sufficiently liquid, the Applicant may take into account a committed line of credit or similar facility for the purpose of meeting this requirement. The Applicant shall have reasonable discretion in determining the methodology used to compute such projected operating costs;
- (f) the current market value of each financial resource used to meet the Applicant's obligations under paragraph (e) above. Reductions in value to reflect market and credit risk must be applied as appropriate; and
- (g) documentation sufficient to explain the methodology used to compute the Applicant's financial requirements under paragraph (e) above, the basis for the Applicant's determinations regarding the valuation and liquidity requirements set forth in paragraphs (e) and (f) above, and copies of any agreements establishing or amending a credit facility, insurance coverage, or other arrangement evidencing or otherwise supporting the Applicant's conclusions.

### ***Annual Reporting***

7. The Applicant will provide:

- (a) within 30 days after the end of each financial year, a certificate, executed by a senior officer of the Applicant, that the representations herein remain accurate except to the extent of any change previously disclosed to the Commission hereunder;

- (b) within 90 days of the end of each financial year:
- (i) annual audited financial statements prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises and will disclose an unreserved statement of compliance with IFRS. Such annual audited financial statements must be:
    - A. audited in accordance with Canadian GAAS and be accompanied by an auditor's report that expresses an unmodified opinion, identifies all financial periods presented for which the auditor has issued an auditor's report, and is in the form specified by Canadian GAAS for an audit of financial statements prepared in accordance with fair presentation framework; and
    - B. prepared and signed by a person or company that is authorized to sign an auditor's report under the laws of a jurisdiction in Canada and that meets the professional standards of that jurisdiction;
  - (ii) a self-assessment of the accomplishments and the challenges faced during the year, which will include, but is not limited to:
    - A. a summary of the Applicant's business activity for the year;
    - B. a summary of new Contracts introduced and expansion plans that were implemented during the year;
    - C. a report detailing the testing undertaken to ensure the adequacy of system safeguards including, but not limited to, risk management methodologies, emergency procedures and disaster recovery plans, business continuity and proper functionality of backup facilities;
    - D. a summary of staffing changes at the Applicant during the year; and
    - E. any additional information that the Applicant considers important.

***Other Reporting***

8. The Applicant must, before ceasing to operate; before suspending, discontinuing or winding up all or a significant portion of its operations; or before disposing of all or substantially all of its assets:
- (a) provide the Commission at least 6 months' prior written notice; and
  - (b) comply with any requirements the Commission may impose.

9. The Applicant will report, in the form and manner requested by the Commission or the Executive Director as the case may be:
  - (a) upon the request of the Executive Director or Commission, audit-trail data and reconstructions of trading on the Exchange Trading Platform;
  - (b) upon the request of the Executive Director or Commission, current copies of the Applicant's business continuity-disaster recovery plan and other emergency procedures, its assessments of its operational risks, and other documents requested by Commission staff for the purpose of maintaining a current profile of the Applicant's automated systems; and
  - (c) pursuant to applicable securities legislation, any further information that the Executive Director or the Commission direct to be reported.

**APPENDIX B**  
**Additional Requirements**

*Compliance System*

1. The Applicant must establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to:
  - (a) provide reasonable assurance that the Applicant and Voice Brokers comply with securities laws; and
  - (b) manage the risks associated with its business in accordance with prudent business practices.

*Chief Executive Officer*

2. The chief executive officer (**CEO**) of the Applicant must do all of the following:
  - (a) supervise the activities of the Applicant that are directed towards ensuring compliance with securities legislation by the Applicant and Voice Brokers; and
  - (b) promote compliance by the Applicant and Voice Brokers with securities laws.

*Chief Compliance Officer*

3. The Applicant must designate an individual as the chief compliance officer (**CCO**) to perform the functions described in paragraph 6 below.
4. The Applicant must not designate an individual to act as the Applicant's CCO unless the individual is an officer of the Applicant.
5. If an individual who is designated as the Applicant's CCO ceases to meet the conditions listed in paragraph 4 above, the Applicant must designate another individual to act as its CCO.
6. The CCO of the Applicant must do all of the following:
  - (a) establish and maintain policies and procedures for assessing compliance by the Applicant and Voice Brokers with securities laws;
  - (b) monitor and assess compliance by the Applicant and Voice Brokers with securities laws;

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- (c) report to the CEO as soon as possible if the CCO becomes aware of any circumstances indicating that the Applicant, or any Voice Broker, may be in non-compliance with securities laws and any of the following apply:
  - (i) the non-compliance creates, in the opinion of a reasonable person, a risk of harm to an Exchange Participant;
  - (ii) the non-compliance creates, in the opinion of a reasonable person, a risk of harm to the Applicant's market; and
  - (iii) the non-compliance is part of a pattern of non-compliance; and
- (d) submit an annual report to the Applicant's board of directors for the purpose of assessing compliance by the Applicant and Voice Brokers with securities laws.

***Books and Records***

- 7. The Applicant must maintain records to:
  - (a) accurately record its business activities, financial affairs, and transactions; and
  - (b) demonstrate the extent of the Applicant's and Voice Brokers' compliance with applicable requirements of securities laws.
- 8. The records required under paragraph 7 above include, but are not limited to, records that do the following:
  - (a) demonstrate compliance with internal control procedures;
  - (b) demonstrate compliance with the Applicant's policies and procedures;
  - (c) demonstrate compliance with complaint-handling requirements;
  - (d) document correspondence with Exchange Participants; and
  - (e) document compliance and supervision actions taken by the Applicant.

***Conflicts of Interest***

- 9. The Applicant must take reasonable steps to identify existing material conflicts of interest, and material conflicts of interest that the Applicant in its reasonable opinion would expect to arise, between the Applicant, including Voice Brokers, and Exchange Participants.
- 10. The Applicant must resolve an existing or potential conflict of interest identified under paragraph 9 above through disclosure, avoidance or mitigation.

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11. If an Exchange Participant would reasonably expect to be informed of a conflict of interest identified under paragraph 9 above, the Applicant must disclose, in a timely manner, the nature and extent of the conflict of interest to the Exchange Participant.

***Best Execution***

12. The Applicant and Voice Brokers must take reasonable efforts to achieve best execution when acting on behalf of Exchange Participants.

***Duty of Care***

13. The Applicant and Voice Brokers must deal fairly, honestly and in good faith with Exchange Participants.

***Confidential Information***

14. The Applicant must establish, monitor and enforce appropriate procedures for the containment of material non-public information.
15. Voice Brokers must not engage in activities prohibited by section 93.3 of the Act, as such activity relates to a derivative rather than a security.

***Proficiency***

16. Voice Brokers must not trade unless the individual has the education, training and experience that a reasonable person would consider necessary to perform the activity competently.

***Trade Confirmation***

17. The Applicant, including Voice Brokers, must promptly deliver to the Exchange Participants a written confirmation of a transaction entered on behalf of such Exchange Participant, setting out the following key transaction details, as applicable:
  - (a) the name of Voice Broker, if any, associated with the transaction;
  - (b) the price associated with the transaction;
  - (c) the volume or number of Contracts associated with the transaction;
  - (d) the Contract name.

***Account Statement***

18. The Applicant must deliver a statement to Exchange Participants every month a transaction is effected by or on behalf of an Exchange Participant.



19. A statement delivered under paragraph 18 must include all of the following information for each transaction made for an Exchange Participant during the month covered by the statement:
- (a) the date of the transaction;
  - (b) whether the transaction was a purchase or sale;
  - (c) the name of the Contract;
  - (d) the number of Contracts;
  - (e) the price per Contract; and
  - (f) trade execution fees.



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February 3, 2015

VIA EMAIL: elizabeth.coape-arnold@asc.ca

Elizabeth Coape-Arnold  
Alberta Securities Commission  
Suite 600, 250 – 5<sup>th</sup> Street SW  
Calgary, Alberta T2P 0R4

RE: Proposed Exchange Recognition Order – Net Energy Inc.

Dear Ms. Coape-Arnold:

Natural Gas Exchange Inc. ("NGX") welcomes the opportunity to comment on the proposed order (the "Proposed Order" or "Net Energy Order") for the recognition of Net Energy Inc. ("Net Energy") as an exchange under section 62 of the *Securities Act* (Alberta) (the "Act"). As we detail below, NGX strongly disagrees with the scope of activities determined by the Alberta Securities Commission ("ASC") in the Net Energy Order as falling within the purview of an "exchange". As discussed in greater detail below, the inclusion of voice brokering activities in the recognition order of an exchange will undoubtedly cause confusion and move regulation under the Act in a direction that is out of step both with other Canadian provinces and with international regulators. Capitalized terms used in this letter and not otherwise defined shall have the meanings ascribed to them in the Net Energy Order.

#### **NGX**

NGX, headquartered in Calgary, Alberta, provides electronic trading, central counterparty clearing and data services to the North American natural gas and electricity markets. It is a wholly owned subsidiary of TMX Group Limited and its key affiliates operate cash and derivative markets for multiple asset classes, including equities, fixed income and energy.

#### ***a) Voice Brokering Is Not Typically an Authorised Exchange Activity***

The inclusion of voice brokering as an authorised activity under the Net Energy Order is contrary to the common understanding of exchange activities shared by Canadian and international regulators, and runs counter to the developing international regulatory framework that authorizes such activities to be carried

out in trading facilities that are similar to, but separate from, exchanges. These new forms of regulated trading facilities provide for additional or more flexible trading mechanisms, which may include voice brokering. Regulators, by developing specialized regulatory frameworks applicable to these new forms of markets are able to address the particular issues that are raised by these hybrid trading facilities, while at the same time maintaining clarity with respect to the role, functions and regulation of exchanges.

Inclusion of such voice brokering activities in the recognition of Net Energy as an exchange fails to differentiate voice brokering activities from traditional exchange activities. It is counter to the strong regulatory trend to regulate such hybrid trading facilities separate from exchanges, and fails to address the particular conflict of interest and market transparency issues raised by such a hybrid trading mechanism.

*i) Voice Brokering Activities Under the Net Energy Order*

The Net Energy Order permits Net Energy's participants to trade indirectly on the proposed exchange through voice brokers. "Voice Brokers," the Order states, "may: (i) accept orders and place them on the Exchange Trading Platform on behalf of Exchange Participants; (ii) draw attention to existing orders, placing any new or revised orders on the Exchange Trading Platform immediately; or (iii) accept soft orders that are not immediately actionable and try to find interest from Exchange Participants in such orders."<sup>1</sup> The Order recognizes that these voice brokering activities go beyond "voice-assisted trading," but does not place limits on the nature and extent of the permitted intermediation activity in which the Net Energy voice brokers may engage.

As a general matter, voice brokering involves the active intermediation by the broker between a buyer and seller. When a seller, for instance, calls a voice broker, the voice broker may collect more information than just the price and quantity to which the seller is willing to commit. This additional qualitative information, which is often referred to as "market colour," can be valuable to the voice brokers' customers because it allows the broker to match natural counterparties that otherwise would have difficulty finding each other. Market colour can best be described as non-payoff-relevant information about short-lived variations in supply and demand that voice brokers collect from interactions with their customers. This additional information will be conveyed because there is repeated interaction between the broker and his customers, and the customer trusts that the broker will reveal the information only to a natural counterparty. The broker, understanding the market and his customer, can interpret this qualitative information and bring together natural counterparties for difficult trades.<sup>2</sup> Absent a regulatory

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<sup>1</sup>Net Energy Order

<sup>2</sup>The difference between exchange trading and voice brokerage is readily observable. For example, in a study conducted into the role of human intermediation through voice brokers in trading in U.S. Treasury Bills, the researchers found that on days when exchange trading is less active, when it is more costly to supply liquidity by placing a firm limit order, when trades are larger, and when a dealer has a larger imbalance between buying and selling, trades are less likely to occur through electronic means, and that at such times, the value of a voice brokers' services are greatest. The Michael J. Barclay, Terrence Hendershot and Kenneth Kotz, "Automation versus Intermediation: Evidence from Treasuries Going Off the Run" in *The Journal of Finance*, Vol. LXI, No. 5, Oct. 2006, pp. 2398-2399.

requirement, voice brokers do not have a duty to inform all market participants of potential contra-side interest impartially, nor to treat their counterparties anonymously.

Voice brokering activity, as described above, contrasts sharply with the role of an 'exchange' which treats all market participants equally. To be sure, exchanges typically maintain marketing departments and engage in a number of routine marketing activities. These are necessary in order to respond to on-going needs of market participants for assistance in understanding exchange rules, processes and procedures relating to trading, clearing and deliveries. In addition, marketing departments typically perform outreach activities to inform potential participants of the possible benefits of trading on a centralized market, or in the commodities listed for trading on its market. This may include educating such potential participants with respect to the benefits of hedging, the required trading, clearing and settlement protocols and procedures of the market and its clearing house, respectively, and the responsibilities and obligations of membership or participation. Marketing departments may carry out these functions in a variety of methods, including personal contact, focused advertisements, participation in trade shows, appearances at conferences and similar efforts.

Some exchanges also provide the limited and infrequent service to members of informing members of possible contra-side interest in trading. This infrequent service typically is provided as a necessary accommodation when the central limit order book at any particular time for a particular product may lack active bids or offers in sufficient depth. This service is essential to address unusual situations, such as where a member or participant has a position that it otherwise would be unable to exit, needs to enter into an otherwise un-executable odd-sized transaction, or has a similar exigency. Exchange efforts are always anonymous and conducted without active intermediation. In contrast to voice brokers, exchange employees have self-regulatory obligations to protect the confidentiality of member information and do not express an opinion or provide exchange members or participants with market advice, market colour, or perform any other traditional broker activity. This difference is a critical distinction between the role of an exchange and typical voice broker activities.<sup>3</sup>

The Net Energy Order, including Appendix B, fails to adequately address the potential conflicts of interest when an exchange also acts as an intermediary. For example, Appendix B of the Net Energy Order does not provide guidance or impose regulatory requirements regarding potential conflicts of interest that may arise when an exchange employee, acting as a voice broker, provides market colour to his or her client. Nor does Appendix B address whether a Net Energy voice broker may disclose the positions of market participants in an effort to arrange a transaction. It does not provide guidance on whether the Net Energy voice broker employee has a duty to provide all market participants with the same information as provided to his or her client, or whether a voice brokered transaction can be arranged without any manner of pre-trade transparency. It does not specifically address potential trading abuses that may be expected, does not provide specificity on how "best execution" requirements apply to the market and to the voice brokers, and does not require separation of functions by an exchange employee performing the dual role of broker, as agent for a customer, and as an employee of an exchange.

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<sup>3</sup> *Ibid.*, p. 2412.

In order to address these, and other, critical issues regulators have developed, or are developing, specialized regulatory frameworks to govern such hybrid trading facilities. Other regulators which have considered the issue have not simply permitted voice brokerage to operate within the regulatory framework applicable to exchanges as would the proposed Net Energy Order.

*ii) CSA Consultation Paper*

On January 29, 2015, Canadian Securities Administrators (“CSA”) issued Consultation Paper 92-401 *Derivatives Trading Facilities* (“CP 92-401” or the “Consultation Paper”) which seeks to provide a framework to address many of the issues noted above. For example, the CSA recommended that a regulatory framework be adopted to govern a:

. . . facility or market that brings together buyers and sellers of OTC derivatives, brings together the orders of multiple buyers and multiple sellers, and uses methods under which the orders interact with each other and the buyers and sellers agree to the terms of trades. OTC derivative is used in this paper in its customary sense to refer to a derivatives contract that is traded other than on a formal exchange, such as on a dealer network.<sup>4</sup>

The Consultation Paper further recommended that “hybrid” systems that permit both electronic and voice trading be traded under this new form of specialized market regulation, stating that:

In practice, discretion allows platform operators to run “hybrid systems,” consisting of both electronic trading and voice broking, that allow for the periodic execution of trading interests. Such discretion enables platform operators to facilitate the pre-arrangement or pre-negotiation of transactions prior to execution. A DTF [derivatives trading facility] exercising discretion would have additional requirements placed upon it, as described above. Even so, discretionary execution methods may not be permitted for products that are mandated to trade on a DTF.<sup>5</sup>

CP 92-401 grapples with how conflicts of interest that are raised by hybrid trading facilities should be dealt with, particularly with respect to discretionary trading systems, such as voice communications,<sup>6</sup> stating:

At this time, we have not defined a DTF to exclude platforms or facilities that engage in discretionary trading methods. This approach is consistent with the regulatory objective of regulating all multilateral facilities for trading in OTC derivatives. The Committee is considering whether to recommend allowing a DTF operator to exercise discretion for trading in some OTC derivatives. If the Committee does recommend allowing discretion, in order to address issues such

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<sup>4</sup> CP 92-401 at p. 4.

<sup>5</sup> *Ibid.* at p. 7.

<sup>6</sup> The Consultation Paper made clear in footnote 55 that the discretion addressed in the report is “the situation where a party plays an active role in brokering the deal between the two participants, such as the role typically played by an interdealer broker in contacting potential counterparties and negotiating price and volume on behalf of (a typically undisclosed) client.”

as conflicts of interest we contemplate that DTFs that employ discretionary trading methods would be subject to additional requirements similar to those that apply to a dealer. Requirements currently under consideration by the Committee include requirements to act in the best interests of a client, including best execution obligations. Furthermore, if the Committee does recommend allowing discretion, it may nevertheless recommend that discretion not be permitted in the execution of trades in products that have been mandated to be traded on a DTF [text in square brackets added].<sup>7</sup>

We note that if allowing such discretion on a DTF, which is intended to be a more flexible form of exchange, is still the subject of debate, this may suggest that such activities would be even less appropriate on a full exchange.

The Net Energy Order by including voice broker activity under the recognition order of an exchange, rather than a separate market regulatory tier, is fundamentally inconsistent with the approach of the CSA encompassed in the Consultation Paper.

### *iii) United States Regulation*

Like the framework proposed in the Consultation Paper, the U.S. regulatory framework clearly distinguishes between traditional exchanges—designated contract markets (“**DCMs**”)—and other forms of trading facility. DCMs may list for trading futures or option contracts based on any underlying commodity, index or instrument. Part 38 of the Commodity Futures Trading Commission (“**CFTC**”) regulations, 17 C.F.R. Part 38, details the procedures and requirements, including twenty-three core principles, for operating as a DCM. Core Principle 9, stipulates that a board of trade must provide a “competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralised market”<sup>8</sup>; the rules of a board of trade may authorize, for bona fide business purposes, only “(a) transfer trades or office trades; (b) an exchange of (1) futures in connection with a cash commodity transaction; (2) futures for cash commodities; or (3) futures for swaps; or (c) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or derivatives clearing organisation.”<sup>9</sup> Moreover, DCMs are required to ensure the financial integrity of transactions, to publish and store information in respect of trading information, and follow specified governance standards and procedures to avoid conflicts of interest.

Certain swaps are required to be executed on either a DCM, or on a separately regulated trading facility known as a Swap Execution Facility (“**SEF**”). SEFs are regulated under a more flexible regulatory

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<sup>7</sup>*Ibid.* at p. 26.

<sup>8</sup> Section 5(d)(9) of the Commodity Exchange Act, 7 U.S.C. §1 et seq (“**CEA**”); 7 U.S.C. §7(d)(9); see also 17 C.F.R. § 38.500 – Core Principle 9.

<sup>9</sup> *Ibid.*

framework than DCMs and may include a variety of transaction execution methodologies. As recently described by CFTC Commissioner Giancarlo:

Under Title VII of the Dodd-Frank Act<sup>10</sup> (“**Dodd-Frank**”) most cleared swaps must be executed on a DCM or swap execution facility. The SEF was a new category of trading facility created under Dodd-Frank intended to address the episodic nature of swaps liquidity trading in swap markets. A SEF is defined in the new rules as a “trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, *through any means of interstate commerce*, [emphasis added]” including through a trading facility that is not a DCM<sup>11</sup>. The term “interstate commerce” has long been interpreted by U.S. Federal Courts to cover almost an unlimited range of commercial and technological enterprise and, as has been suggested, its inclusion in the definition of SEF indicates the intent of Congress to provide flexibility in trade execution methods for SEFs in contrast to DCMs. Intermediation methods and techniques for swaps have typically varied widely according to product trading characteristics. Where liquidity is not continuous, trading platforms will provide a range of liquidity fostering methodologies and technologies that include methods of broadcasting completed trades, auctions, and phone lines and email and texting technologies – methods that are not permitted under an exchange’s (DCM’s) electronic matching platform or trade execution facility.<sup>12</sup>

iv) *European Union Regulation*

The European Union also differentiates between exchanges and more flexible trading venues. For example, in the aftermath of the European Market Infrastructure Regulation (“**EMIR**”), reforms to the Markets in Financial Instruments Directive (“**MiFID II**”) established a new type of multilateral trading venue called the ‘organised trading facility’ (“**OTF**”). Although there are some differences, OTFs are “broadly akin to a U.S. swap execution facility, which permits discretionary execution and limited matched principal trading.”<sup>13</sup> Distinct from a regulated market (“**RM**”) or a multilateral trading facility (“**MTF**”), an OTF is limited to “buying and selling interests in bonds, structured finance products, emission allowances or derivatives.”<sup>14</sup> Unlike RMs and MTFs, an OTF is permitted to execute orders on a discretionary basis, subject to certain requirements. The OTF venue has been designed to encompass much of the inter-dealer market and includes the ability to execute trades via voice brokerage as well as electronic trading.<sup>15</sup>

<sup>10</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

<sup>11</sup> CEA section 1a(51); 7 U.S.C. 1a(51)

<sup>12</sup> *Ibid.*, Statement from Commissioner J. Christopher Giancarlo.

<sup>13</sup> FIA Europe, “Special Report Series: Market Infrastructure Under MiFID II” (June 13, 2014), available at <http://www.futuresindustry.org/downloads/Special%20Report%20--%20Market%20infrastructure%20under%20MiFID%20II.pdf>.

<sup>14</sup> Directive 2014/65/EU, of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU, art. 4.

<sup>15</sup> *Ibid.*

As discussed above, Canadian Securities Administrators are in the process of recommending a framework that would encompass ‘discretionary execution’ methods such as voice brokering. In developing this framework the CSA are taking into consideration whether specific regulations must be tailored to address such transactions. Moreover, both the U.S. and E.U. regulatory frameworks have adopted the approach of distinguishing between the regulation of exchanges and new hybrid trading facility models. Both the Ontario Securities Commission and the ASC have recognized that these models are distinct from traditional exchanges, and while SEFs entering the Canadian marketplace over the past couple of years have been exempted from the requirement to be recognized as an exchange, their exemption orders from both the Ontario Securities Commission and the ASC make clear that these are not actually exchanges, but SEFs. The Net Energy Order’s inclusion of voice brokering as a permitted activity of an exchange is inconsistent with international regulatory frameworks and the direction that Canadian regulators currently are taking. We therefore respectfully suggest that the ASC examine whether there is a role in Alberta’s markets to recognize a second tier of trading facility –similar to the SEF in the United States, the OTF in the EU, and the DTF as proposed by Canadian securities regulators –where liquidity fostering methodologies and technologies are permitted under a regulatory framework tailored to address the issues that they raise. But we also suggest that the concept of an ‘exchange’ –being a neutral facility that is distinct from the role of agency broker –be protected. Doing otherwise, would cause fundamental confusion as to the meaning of ‘exchange’ under the Act, and is contrary to the understanding of the regulatory regimes of the United States, the E.U. and the other Canadian provinces.

**b) Role confusion**

In addition, the Net Energy Order recognizes that Net Energy is registered in the U.S. as an Introducing Broker and on that basis submits transactions to be cleared by the Chicago Mercantile Exchange.<sup>16</sup> It also requires that Net Energy “ensure the financial integrity of Contracts traded on the Exchange Trading Platform, including the clearance and settlement of transactions with a clearing agency that is permitted to carry on business in Alberta.” However, there is a fundamental confusion as to its role. All transactions submitted for clearing, regardless of whether on the Trading Platform or through its voice brokers, will be submitted for clearing under its U.S. registration as an Introducing Broker.

This unorthodox mixing of roles will likely entail considerable confusion as to the actual roles of Net Energy and NYMEX. Block trades in the U.S. are treated as being transacted as contracts “*subject to the rules* of a board of trade which has been designated . . . by the [Commodity Futures Trading] Commission.”<sup>17</sup> Thus, these trades are submitted to CME clearing as block trades of NYMEX contracts. It is clear that as an Introducing Broker, Net Energy may arrange NYMEX block trade transactions; however, Net Energy transactions that take place on the Net Energy market are potentially transactions subject to

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<sup>16</sup> Net Energy Order at p. 2. “In the United States (US), Net Energy is registered as an introducing broker. Net Energy is not registered as a marketplace in the US. During the period where Net Energy may be recognized as an exchange in Canada, and not registered as a marketplace in the US, Net Energy trades will be reported publicly by NYMEX, and at least in aggregate, will be reported publicly as having been executed on the Exchange Trading Platform.”

<sup>17</sup> See Section 4(a) of the Commodity Exchange Act.



the rules of two markets—NYMEX and Net Energy. Such an overlap is likely to create regulatory and legal confusion.

**c) Product and Trading Platform Characterization**

Net Energy’s contracts are considered futures contracts in the United States in part because, as noted above, they are subject to the rules of a designated board of trade – NYMEX. We understand that one of the reasons Net Energy may be seeking recognition as a full exchange is so that it may continue to offer futures contracts. Pursuant to CFTC regulations, both futures and swap contracts may be listed for trading on an exchange (i.e. a DCM or a foreign board of trade<sup>18</sup>) However, only swaps are permitted to be traded on the more flexibly regulated Swap Execution Facility.<sup>19</sup> Generally, futures and swaps may be economically similar contracts. Accordingly, the characterization of a derivatives contract as either a futures contract or a swap will depend largely upon the choice of trading platform through which the contract is offered. If a trading platform wishes to offer futures contracts, it must abide by the CFTC’s exchange (i.e. DCM) regulations and if it wishes to offer swaps, it must abide by the CFTC’s SEF regulations.

CP 92-401 proposes a regulatory regime that would govern trading platforms comparable to SEFs.<sup>20</sup> DTFs are platforms for OTC derivatives,<sup>21</sup> but the concept of OTC derivatives is broader than just bilaterally traded derivatives and refers to “a derivatives contract that is traded other than on a formal exchange” and may include cleared contracts. Nothing in CP 92-401 prohibits physically-settled contracts from being considered “OTC derivatives” and the paper does not make reference to Proposed Multilateral Instrument 91-101 *Derivatives: Product Determination*. It appears that the term ‘OTC derivative’ is intended to be similar to the US term, ‘swap,’<sup>22</sup> and therefore the fact that a product is traded on a trading platform does not preclude it from being an OTC derivative. DTFs will be regulated very similarly to exchanges (i.e. they will also be subject to requirements relating to transparency, record-keeping, fair access, systems, business continuity planning, financial resources, outsourcing, conflicts of interest and reporting). It appears, in CP 92-401, that the most substantial ways in which a DTF will be regulated differently from an exchange is that a DTF (i) “would be permitted to use a variety of execution methods, for example...hybrid voice-electronic execution methods”; (ii) may be permitted to “exercise a degree of discretion in the manner of executing transactions between its participants [which] allows platform operators to run ‘hybrid systems’ consisting of both electronic trading and voice broking...to facilitate the pre-arrangement or pre-negotiation of transactions prior to execution”; and (iii) “[e]xcept in the case of derivatives that are

<sup>18</sup> The CFTC has made clear that the basis for FBOT registration is a finding that the foreign exchange is regulated in its home jurisdiction comparably to regulation by the CFTC of a DCM, saying,

final § 48.2(b) restrict the universe of FBOTs that are eligible to be registered under part 48 to those that possess “the attributes of an established, organized exchange or other trading facility.” This provision is intended to limit FBOT registration eligibility to the types of entities to which direct access no-action relief has been granted in the past (e.g., entities that are comparable in operation and regulation to registered DCMs).

See, “Registration of Foreign Boards of Trade,” 76 *Fed. Reg.* 80674, 80686 (December 23, 2011)

<sup>19</sup> Compare 17 C.F.R. §38.4 (providing DCMs may list futures, swaps or options) to 17 C.F.R §37.4 (providing SEFs may list swaps).

<sup>20</sup> CP 92-401 (p. 9) states that an example of a foreign-based DTF would be a swap execution facility based in the United States.

<sup>21</sup> CP 92-401 Executive Summary.

<sup>22</sup> *Ibid.* at p. 18.

mandated to trade on a DTF..., would not be required to provide a particular level of pre-trade transparency.”

Given the ways in which DTFs most substantially differ from exchanges and given the way in which Net Energy appears to most substantially differ from other exchanges, it seems clear that the appropriate characterization of Net Energy would be as a DTF and not as a full exchange. The fact that Net Energy’s products may be currently classified as futures products in the United States should be irrelevant to the classification determination of the trading facility. The determination should be based upon the exchange operations and the platform’s ability to comply with the applicable rules of a particular form of recognition.

**d) Unlevel Playing Field**

One of the objectives of the ASC is the maintenance of fair and efficient capital markets. Fostering such an environment requires that the rules are fair and evenly applied. We would suggest that allowing Net Energy to conduct liquidity fostering activities as an exchange, as the Proposed Order suggests, while not allowing other recognized exchanges to do so, creates a competitive advantage for Net Energy and an unlevel playing field. As discussed, all authorities have provided greater flexibility for trading swaps (or, in Canada, “OTC derivatives”) on new hybrid markets. If Net Energy chooses to list and trade futures, it should be required to adhere to futures exchange market regulations. Not doing so, gives them an unfair advantage by permitting them to engage in a type of regulatory arbitrage – getting the advantages of futures style trading and clearing, but also enjoying the regulatory flexibility afforded to swaps (or, in Canada, OTC derivatives).

NGX appreciates the opportunity to provide comments with respect to the Rule and looks forward to further dialogue on clearing agency requirements generally. We hope that you will consider our concerns and suggestions and would be happy to discuss these at greater length. Please feel free to contact Jim Oosterbaan, President and CEO, at [REDACTED] or Corrine Fiesel, Senior Legal Counsel, at [REDACTED] if you have any question regarding our comments.

Respectfully submitted,

[REDACTED]

James Oosterbaan