June 3, 2011

VIA ELECTRONIC SUBMISSION

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

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Re: Global Comment: Treatment of Transactions Among Affiliated Entities Under the Dodd-Frank Act

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 certain proposed rulemakings ("Dodd-Frank Rulemakings") under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[1] that impact transactions among affiliated entities within a corporate group.[2] Shell Trading submits these comments consistent

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

[2] These comments address all aspects of the Commission's proposed rulemakings related to swaps between affiliated entities within a corporate group, including, but not limited to, the following proposed rulemakings: (i) *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 76 Fed. Reg. 29818 (proposed May 23, 2011) [RIN 3038-AD46] ("*Further Definition of "Swap" Release*"); (ii) *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 (proposed Dec. 21, 2010) [RIN 3235-AK65] ("*Further Definition of "Swap Dealer" Release*"); (iii) *Registration of Swap Dealers and Major Swap Participants*, 75 Fed. Reg. 71379 (proposed Nov. 23, 2010) [RIN 3038-AC95] ("*Registration Release*"); (iv) *Capital Requirements of Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 27802 (proposed May 12, 2011) [RIN 3038-AD54] ("*Capital Release*"); (v) *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 23732 (proposed April 28, 2011) [RIN 3038-AC97] ("*Margin Release*"); (vi) *Position Limits for Derivatives*, 76 Fed. Reg. 4752 (proposed Jan. 26, 2011) [RIN 3038-AD15 and 3038-AD16] ("*Position Limits Release*"); (vii) *End-User Exception to Mandatory Clearing of Swaps*, 75 Fed. Reg. 80747 (proposed Dec. 23, 2010) [RIN 3038-AD10] ("*End-User Release*"); (viii) *Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 6715 (proposed Feb. 8, 2011) [RIN 3038-AC96] ("*Documentation Release*"); (ix) *Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants*, 75 Fed. Reg. 81519 (proposed Dec. 28, 2010) [RIN 3038-AC96] ("*Portfolio Reconciliation Release*"); (x) *Real-Time Public Reporting of Swap Transaction Data*, 75 Fed. Reg. 76140 (proposed Dec. 7, 2010) [RIN 3038-AD08] ("*Real-Time Reporting Release*"); and (xi) *Swap Data Recordkeeping and Reporting Requirements*, 75 Fed. Reg. 76574 (proposed Dec. 8, 2010) [RIN 3038-AD19] ("*Swap Data Recordkeeping Release*").

with the Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act issued by the Commodity Futures Trading Commission ("Commission") on May 4, 2011.[3]

Shell Trading understands that Commission staff generally are considering the extent to which "inter-affiliate swaps should be treated differently from other swaps in the context of the Commission's other [Dodd-Frank Act] Title VII rulemakings."[4] As noted in prior submissions to the Commission,[5] Shell Trading is concerned that the Commission's treatment of transactions between affiliated entities under the Dodd-Frank Act, if overly aggressive in its application, may well increase costs to consumers and undermine the efficiencies that certain end-user market participants currently realize from the use of centralized hedging affiliates, a result that Shell Trading believes would be inconsistent with the intent of Congress. Shell Trading encourages the Commission to clarify that certain of the requirements applicable to "swap" transactions and "swap dealing" activities do not apply to transactions among affiliated entities because such inter-affiliate transactions do not implicate the concerns for systemic risk and market integrity that the Dodd-Frank Act is intended to address and there is very limited potential for fraudulent conduct.

Although the discussion below sets forth specific examples as to why it is inappropriate and inconsistent with the Dodd-Frank Act to apply to inter-affiliate transactions certain requirements of the Dodd-Frank Rulemakings applicable to "swaps" and "swap dealers," Shell Trading urges the Commission to consider *each and every* Dodd-Frank Rulemaking in light of the discussion of inter-affiliate transactions herein. Inter-affiliate transactions do not represent the same risks that are intended to be redressed by the requirements applicable to "swaps" under the Dodd-Frank Act, and thus inter-affiliate transactions should not be regulated under the Dodd-Frank Rulemakings in the same manner as swaps between unaffiliated entities.

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.

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[3] *Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 76 Fed. Reg. 25274 (May 4, 2011).

[4] *Further Definition of "Swap" Release*, 76 Fed. Reg. at 29821, fn. 22.

[5] 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 Reilley, 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.

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.

Energy companies such as Shell often use an integrated approach to physical trading and supply management and financial hedging that permits the corporate group to participate simultaneously as a trader and marketer in the relevant commodity markets through one entity. Designated legal entities within the group enter into physical transactions to help manage risk and optimize the physical portfolio of commodity assets owned and controlled by the corporate group and can centralize the group's hedging and risk management function through the use of various financial products. . Such an approach achieves efficiencies of scale, reduces and consolidates risk, and lowers administrative costs. By consolidating such physical market and financial activity through specified entities, this model reduces overall risk to the markets.[6] Inter-affiliate swaps facilitate this process.

II. The Definition of "Swap Dealer"

The Commission has suggested that, for purposes of determining whether an entity is "accommodating demand" for swaps (a factor in the analysis of whether an entity is a "swap dealer"), it is amenable to treating swaps among affiliates differently from swaps that face a neutral third party. Specifically, the Commission stated that certain inter-affiliate transactions do not bear the "hallmarks" of dealer activity because such transactions do not "involve [] interaction with unaffiliated persons."[7] Shell Trading believes transactions among affiliated entities within a corporate group should not be considered "swap dealing" activities subject to the panoply of requirements of the Dodd-Frank Rulemakings. As discussed in detail below, Shell Trading believes that Congress did not intend to subject internal risk management transactions between affiliated entities within a corporate group to the requirements of the Dodd-Frank Act because such transactions have no impact on general systemic risk or market integrity in the derivatives market.

A. Inter-Affiliate Transactions Do Not "Accommodate Demand" For Swaps

Transactions among affiliates within a corporate group should not be treated as transactions that "accommodate demand" because, as between affiliates within a corporate group, the concepts of "supply" and "demand" for transaction counterparties does not apply – i.e., there is no "market" for an inter-affiliate transaction; there simply is a corporate need for two specified entities within the corporate group to transfer a specified risk between them. Common corporate ownership

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[6] Such an approach facilitates, for instance, a sophisticated approach to intra-company netting of transactions and allows a broader base for the netting of counterparty-facing transactions. Netting arrangements are generally highly favored as a risk reducing instrument in the Dodd-Frank Act.

[7] *See Further Definition of "Swap Dealer" Release*, 75 Fed. Reg. at 80183. The Commission further indicated that it may be amenable to treating in such a manner transactions with partially-owned affiliates, as well as wholly-owned affiliates.

between such affiliates causes them to have shared financial and organizational interests in transacting with each other which are independent of the limited trade-by-trade fee incentives that characterize transactions with a "dealer" that faces the market openly. A swap dealer that "accommodates demand" for swaps has no obligation to transact with its counterparty aside from the per-transaction profit motive, and the counterparty to such a market transaction may be able obtain the same economic result it desires with any given unaffiliated swap dealer. As between affiliates, however, the purpose and effect of the transaction is not merely to obtain the economics of a trade, but to efficiently manage risks within the organization. Therefore, an internal transaction between affiliated entities is a transaction that generally cannot be replicated by facing an unaffiliated counterparty. To consider such activities as "swap dealing" subject to the Dodd-Frank Rulemakings places form over substance.

In general, a swap dealer will interact with many unaffiliated counterparties who wish to trade certain financial instruments under a swap agreement. The swap dealer will consider the identity of the counterparty for swap trading eligibility purposes, whether there are special documentation requirements applicable to the instruments the counterparty wishes to trade, the fees the swap dealer will charge for trading swaps, and the credit terms on which it will trade. Such considerations aid the swap dealer in determining whether it will trade with an unaffiliated counterparty. If the swap dealer chooses to trade, the credit terms often define the prices at which the swap dealer will trade with the counterparty. In contrast, an affiliate of a commercial end user (i.e., a centralized hedging affiliate)[8] does not extensively scrutinize the credit risk of an affiliated counterparty before initiating a trading relationship with it – rather, affiliates trade with one another because of several economies and synergies, including the potential benefits of intra-company netting of the exposures of various affiliates.[9] Because such "hallmarks" of dealing are not present in inter-affiliate trades, such trades do not represent "accommodating demand" for swaps and, thus, do not represent "swap dealing" activities.[10]

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

[9] *See supra* note 5.

[10] *See Further Definition of "Swap Dealer" Release*, 75 Fed. Reg. at 80183.

B. Inter-Affiliate Transactions Merely Represent An "Allocation of Risk Within a Corporate Group"

The Commission has indicated that the determination of whether an entity is a swap dealer depends on the "economic reality" of swaps and whether such swaps merely "represent an allocation of risk within a corporate group."[11] Shell Trading agrees. Transactions between affiliates are specifically intended to rationalize internal risk allocations within a corporate group. Inter-affiliate swaps that are used to transfer risk from one entity within a corporate group to another should not be counted when evaluating whether an entity is "accommodating demand" for purposes of the definition of "swap dealer."

C. Centralized Hedging Affiliates Act Much Like "Aggregators"

Centralized hedging affiliates act much like "aggregators." Although the activities of "aggregators" may be viewed as similar to those of a "swap dealer" (i.e., "it holds itself out as willing to enter into a potentially large number of swaps"), the "aggregator" does not induce an undefined cross-section of market participants to enter into swap transactions (i.e., it does not "make a market" in swaps). Rather, it merely consolidates existing transactions of specific market participants (in the case of a centralized hedging affiliate, such participants would all be affiliated entities within a corporate group) in order to enable those market participants to obtain better transaction terms against a neutral third party swap dealer. The Commission appears inclined to provide relief from the definition of "swap dealer" for entities that aggregate swap positions in order to provide financing efficiency to participants in the "aggregator."[12] The Commission should extend such relief to transactions between affiliates.

III. Extraterritorial Reach of Swap Dealer Registration Requirements

The Commission has suggested that swap transactions between a non-U.S. entity and U.S. persons *will likely be considered* to have a "direct and significant connection with activities in, or effect on, U.S. commerce" when determining whether the non-U.S. entity may be required to register as a swap dealer by virtue of its swap dealing activities.[13] For the same reasons outlined above, Shell Trading does not believe that inter-affiliate transactions between U.S. and non-U.S. affiliates should count towards "swap dealing" activities because such transactions merely represent an allocation of risk within a corporate group and do not have the "hallmarks" of "holding oneself out as a dealer or being commonly known as a dealer." This principle applies regardless of whether an affiliate within a corporate group is a U.S. or non-U.S. entity. Therefore, swap transactions within a corporate group should not be considered when evaluating whether a non-U.S. entity within the corporate group is engaged in "swap dealing" activity.

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[11] *Id.*

[12] *See Further Definition of "Swap Dealer" Release*, 75 Fed. Reg. at 80183.

[13] *See Registration Release*, 75 Fed. Reg. 71382.

IV. End-User Exception To Mandatory Clearing

A. The Commission Should Not Exclude From The End-User Exception Transactions That Face An Affiliated Swap Dealer

The language of Dodd-Frank Act § 723[14] suggests that swaps between an end-user and an affiliated swap dealer may not be eligible for the end-user exception from mandatory clearing and exchange trading, while the same swap facing an unaffiliated swap dealer would be eligible for the exception. As stated in a prior submission to the Commission,[15] Shell Trading believes that transactions between a commercial end-user and an *affiliated* swap dealer should be eligible for the end-user exception from mandatory clearing just as readily as transactions facing an unaffiliated swap dealer. Use of the end-user exception should not be conditional on the end-user not facing an affiliated swap dealer. The purpose of the end-user exception is to provide relief from heightened regulatory requirements applicable to swaps *for the benefit of end-user counterparties*. If the Commission interprets the end-user exception as being available only to transactions between an end-user (on the one hand) and other (affiliated or unaffiliated) end-users or unaffiliated swap dealers (on the other hand), the end-user may be forced to transact with non-affiliated entities even though the transaction is more costly and less efficient than the same transaction with an affiliated entity. The end-user exception was not intended to disadvantage inter-affiliate transactions.

Further, mandating the clearing of an inter-affiliate transaction between an end-user and an affiliated swap dealer is counter-intuitive because clearing is intended to reduce credit risk, and, as discussed in greater detail in Section VI below, credit risk is generally lower between affiliated entities as compared to unaffiliated entities. Requiring clearing of the former type of transaction, but not the latter, is inconsistent with the purpose of the clearing requirement in the Dodd-Frank Act.

B. The "Financial Obligation Notice" For End-User Swaps Should Not Be Required On A Trade-by-Trade Basis

Under the Commission's End-User Release, affiliates within a corporate group that enter into uncleared swaps under the end-user exception must notify the Commission of how such end-user affiliates "generally meet[their] financial obligations associated with entering into non-cleared swaps" *for each such uncleared swap*.[16] As stated in a prior submission to the Commission,[17] the "Financial Obligation Notice" requirement in connection with uncleared swap trading should be a one-time notice containing general information regarding the end-users' methods for managing credit risk, which may be subject to periodic updating to such information as

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[14] CEA Section 2(h)(7)(D).

[15] *See* Letter to David A. Stawick, Secretary, from Robert Reilley, Vice President, Shell Energy, *Comments on Notice of Proposed Rulemaking Regarding End-User Exception to Mandatory Clearing of Swaps*, at pages 6-7 (Feb.22, 2011).

[16] *See* CEA Section 2(h)(7)(A)(iii); *End-User Release*, 75 Fed. Reg. at 80749.

[17] *See supra* note 15 at pages 8-9.

necessary. Further, the proposal to require an end-user to certify on a trade-by-trade basis that an uncleared swap is being used to "hedge or mitigate commercial risk" is overly burdensome and is not required by the Dodd-Frank Act. The Commission should permit affiliated counterparties to satisfy such a requirement by allowing the parent company with common control to file a notice saying that the end-user is entering into swap transactions with its affiliates for the purpose of "hedging or mitigating commercial risk."[18]

V. Position Limits For Derivatives

Section 737 of the Dodd-Frank Act extended the Commission's position limit authority to transactions in certain "swaps." Consequently, Shell Trading is concerned that the Commission may treat transactions among affiliated entities as covered positions for position limits purposes. As the Commission acknowledges in the Position Limits Release, the purpose of position limits is to prevent "sudden or unreasonable price fluctuations attributable to 'excessive speculation'."[19] As discussed in Section II above, affiliates do not enter into transactions merely to obtain the economics of a trade – they transact to transfer risk within the organization. Concerns for market manipulation, excessive speculation, and pricing transparency are not implicated by inter-affiliate trades. Counting trades among affiliates for position limits purposes does not promote market integrity because an inter-affiliate trade is a risk allocating transaction that is unique to the organization and does not impact pricing or volumes on the market in general. Applying position limits to such trades would merely place an artificial limitation on the risk management capabilities of an industrial enterprise, which is clearly not what Congress intended in subjecting "swaps" to the Commission's position limits authority. Accordingly, Shell Trading requests the Commission to clarify that inter-affiliate transactions are not covered positions under the Position Limits Release.[20]

VI. Capital and Margin Requirements for Uncleared Swaps

The Commission is required to consider two factors with respect to the capital and margin requirements it adopts under Section 731 of the Dodd-Frank Act – the requirements must (i) "help ensure the safety and soundness of the swap dealer," and (ii) "be appropriate for the risk associated with the non-cleared swaps held as swap dealer."[21] Shell respectfully submits that certain aspects of the requirements of the Capital Release and Margin Release if applied to transactions between affiliated entities, including a commercial end-user and an affiliated swap

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[18] Note that the effect of a misrepresentation in standard ISDA swap documentation generally would be a default permitting the counterparty to terminate the relevant transaction before its scheduled expiry date. Shell Trading believes that such consequences of a false claim that an uncleared swap qualifies as a hedging transaction is an appropriate deterrent to abuse of the exception.

[19] *See Position Limits Release*, 76 Fed. Reg. at 4754.

[20] Shell Trading has separately submitted comment on the Position Limits Release and incorporates those comments herein by reference. *See* Letter to David A. Stawick, Secretary, from Robert Reilley, Vice President, Shell Energy, *Shell Trading (US) Company and Shell Energy North America (US), L.P. – Position Limits for Derivatives*, (March 28, 2011).

[21] Dodd-Frank Act § 731 (adding CEA Section 4s(e)(3)(A)).

dealer would not ensure the safety and soundness of the swap dealer and therefore are inappropriate in light of the risk associated with such inter-affiliate transactions.

The risk of counterparty default or non-payment on transactions between affiliated entities is very low when such entities are merely utilizing swaps to efficiently allocate various risks within a larger corporate group. Affiliated entities within a non-financial corporate group may share managerial resources, financial obligations and incentives, and a substantial amount of operational and risk management information with one another. In some cases, including that of Shell Trading, the volume of physical commodities transferred between affiliates is much greater than the volume of swap transactions. In comparison to unaffiliated swap counterparties that transact in the public market, affiliates are better informed regarding the risk profile of the affiliated counterparty as a result of common corporate ownership. Among *un*affiliated swap counterparties that transact merely to obtain the economics of a transaction on the public market, a holistic view of a counterparty's risk profile is not available, and consequently, from a credit risk management point of view, heightened capital and margin requirements such as the Commission has proposed may be appropriate and may help ensure the safety and soundness of the swap dealer. Accordingly, Shell Trading requests the Commission to re-evaluate certain aspects of the proposed rules that would apply to transactions between affiliated entities, including a commercial end-user and an affiliated swap dealer in light of the limited credit risk associated with such transactions.

A. Transactions Among Affiliates Should Not Attract The Same Credit Risk Charge As Transactions Facing An Unaffiliated Third Party

The Capital Release proposes to apply a fixed 50% credit risk charge across all counterparties, regardless of the identity of the counterparty.[22] Shell Trading respectfully submits that such a requirement does not distinguish adequately among credit risks of varying counterparties, as is required of Commission rulemakings regarding capital and margin of swap dealers under CEA Section 4s(e)(3)(A), as amended by the Dodd-Frank Act. In particular, such a fixed credit risk charge for all counterparties does not recognize that there is little to no credit risk associated with transactions among affiliated entities.

The Commission should clarify that the credit risk charge with respect to covered uncleared swap transactions between affiliated entities should carry a lower, or no, weighting. This is consistent with the fact that affiliates are specially positioned to monitor each other for credit risk. For example, where affiliates are consolidated into the balance sheet of a parent company, they generally bear no credit risk as between themselves. Establishing such a preferential credit risk treatment among affiliates is consistent with Dodd-Frank's mandate to set capital

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[22] *See Capital Release*, 76 Fed. Reg. at 27809. Note that a swap dealer may apply to the Commission for approval to assign varying credit risk weightings of 20, 50, or 150% to specific counterparties, but it is unclear why such an applicant would seek approval to assign a 150% risk weight when a 50% risk weight would otherwise prevail.

requirements that are "appropriate for the risk associated with the non-cleared swaps" of a swap dealer.[23]

B. Mandatory Calculation Of "Hypothetical" Margin Requirements For Uncleared Swaps Between Affiliated Counterparties Does Not Enhance Risk Management

As to uncleared swaps between an end-user and an affiliated swap dealer, the Margin Release would require the affiliated swap dealer to calculate "hypothetical" initial and variation margin requirements for uncleared swaps on each day. However, the Commission acknowledges that "different types of counterparties may pose different levels of risk"[24] and that the "hypothetical" margin calculations serve only as "risk management tools." Under Section 731 of the Dodd-Frank Act, the Commission's margin rulemaking must "help ensure the safety and soundness of the swap dealer."[25]

Requiring "hypothetical" margin calculations with respect to unmargined, uncleared trades may be an unnecessary addition to current credit management practices in the energy industry, in general, but that is certainly the case as regards exposures between affiliated entities. Such a process would not help ensure safety and soundness of the swap dealer because such "hypothetical" margin calculations do not aid the swap dealer in managing its risk under such unmargined, uncleared swaps. Imposing a requirement to make daily calculations of "hypothetical" margin payments with respect to inter-affiliate transactions for which no specified margin is required[26] does not aid in risk management, but only creates burdensome operational requirements that have no ascertainable risk-management benefits. In the legislative history accompanying the Dodd Frank Act, Congress made clear its desire not to make commercial participants' use of the swaps markets to manage their commercial risk more costly and more burdensome.[27]

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[23] CEA Section 4s(e)(3)(A)(ii).

[24] *See Margin Release*, 76 Fed. Reg. at 23734.

[25] *See* Dodd-Frank Act § 731 (adding CEA Section 4s(e)(3)(A)(i)).

[26] Note, under the Margin Release, margin must be posted based only on the terms of credit support documentation existing between the parties. *See Margin Release*, 76 Fed. Reg. at 23736.

[27] *See* Letter from Chairman Debbie Stabenow, *et. al.* to Secretary Timothy Geithner, Department of Treasury, *et. al.* (April 6, 2011); Letter from Chairman Christopher Dodd, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, and Chairman Blanche Lincoln, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate, to Chairman Barney Frank, Financial Services Committee, United States House of Representatives, and Chairman Collin Peterson, Committee on Agriculture, United States House of Representatives (June 30, 2010); *see also* 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Lincoln).

VII. Documentation and Portfolio Reconciliation Requirements

A. Affiliated Swap Counterparties Within a Corporate Group Should Not Be Required To Execute Swap Trading Relationship Documentation

The Documentation Release requires all swap dealers to execute a series of documents containing specified terms with all swap counterparties, and Section 23.151 of the Margin Release requires all swap dealers to have credit support arrangements in place with all counterparties.[28] Shell Trading does not believe Section 731 of the Dodd-Frank Act, which requires the Commission to prescribe standards for swap dealers related to the timely and accurate confirmation, processing, netting, documentation, and valuation of swaps,[29] requires the Commission to impose specific documentation requirements as to swaps between affiliated counterparties. As the Commission has noted, the documentation standards of the Dodd-Frank Act are intended to address the risk that "inadequate documentation of open swap transactions could result in collateral and legal disputes, thereby exposing counterparties to significant counterparty credit risk."[30] As discussed above, transactions among affiliated entities, such as a commercial end-user and an affiliated swap dealer, do not pose the type of credit and operational risks that such standards are intended to address. Moreover, legal disputes between commonly-owned affiliates are not a likely scenario.

Affiliated counterparties have shared financial and organizational interests in transacting that transcend the trade-by-trade relationship that is characteristic of transactions between any given counterparty and a neutral swap dealer on the public market. Affiliated entities may not post collateral to one another under their swap transactions, and requiring them to have in place executed credit support arrangements does not further the purpose of the Dodd-Frank Act. The swap documentation requirements of Dodd-Frank are intended to enhance swap market transparency and reduce the potential for trade and collateral valuation disputes.[31] As between affiliated entities that transact merely to allocate risk within the larger corporate group, valuation and trade disputes do not occur because the counterparties to such transactions do not have conflicting interests with respect to the pricing of a trade. Accordingly, Shell Trading encourages the Commission to eliminate the requirement, as between swap counterparties that are affiliated entities within a corporate group, to execute credit support arrangements or any other documentation required to be executed between a swap dealer and its counterparties under the Commission's Documentation Release.

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[28] *See Margin Release*, 76 Fed. Reg. at 23736. Credit support arrangements must be consistent with the Commission's rules under the Documentation Release.

[29] *See Documentation Release*, 76 Fed. Reg. at 6715.

[30] *Documentation Release*, 76 Fed. Reg. at 6717.

[31] *See id.* at 6718.

B. Affiliated End-User Counterparties Should Not Be Subject To Portfolio Reconciliation And Compression Requirements

The Portfolio Reconciliation Release requires swap dealers to engage in periodic portfolio compression and reconciliation exercises with respect to the swap dealer's portfolio of trades with specified counterparties.[32] With respect to non-swap dealer counterparties, the Portfolio Reconciliation Release prescribes greater flexibility in the timing and technique of portfolio compression and reconciliation, but the requirements remain. Shell Trading does not believe reconciliation and compression is appropriate with respect to portfolios of transactions between a centralized hedging affiliate and its commercial end-user affiliates because the activities of a centralized hedging affiliate are specifically geared towards such compression and reconciliation.[33] As discussed in Section II.B and C above, transactions between an end-user and a centralized hedging affiliate are entered into to allocate risk within a corporate group. The centralized hedging affiliate which is counterparty to such transactions manages the commercial risk of the corporate group as a whole by evaluating the group's various exposures and entering into any necessary hedging transactions on the open market. Accordingly, imposing such requirements on a centralized hedging affiliate would not appear to further the market integrity goals of Section 731 of the Dodd-Frank Act, would impose substantial burdens and would potentially interfere with the hedging function that such a centralized hedging affiliate provides.

VIII. Reporting and Recordkeeping Requirements

A. Real-Time Public Reporting of Inter-Affiliate Swaps Should Not Be Required Because Such Reporting Does Not "Enhance Price Discovery"

The purpose of the requirement for real-time public reporting of swap transaction data under Section 727 of the Dodd-Frank Act is to increase market liquidity and enhance price discovery in the derivatives markets.[34] Real time public reporting of transaction data regarding swaps between affiliated entities within a corporate group does not contribute to either goal, although reporting of primary economic terms on inter-affiliate swaps on a non-real-time basis may be appropriate.[35] Thus, Shell Trading believes the Commission should clarify that real-time public

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[32] *See generally Portfolio Reconciliation Release*, 75 Fed. Reg. at 81520.

[33] The Portfolio Reconciliation Release describes portfolio compression as: "a mechanism whereby substantially similar transactions among two or more counterparties are terminated and replaced with a smaller number of transactions of decreased notional value in an effort to reduce the risk, cost, and inefficiency of maintaining unnecessary transactions on the counterparties' books." *See Portfolio Reconciliation Release*, 75 Fed. Reg. at 81512. Portfolio reconciliation is essentially a tool for minimizing the impact of trade and collateral valuation disputes. *See id.* at 81523. As discussed in Section VII.A above with respect to credit support documentation, trade and collateral valuation disputes are unlikely to occur as between commonly-controlled affiliates.

[34] *See* Dodd-Frank Act § 727 (adding CEA Section 2(a)(13)(B)).

[35] Shell Trading reserves the right to submit further, more detailed comments on the inappropriateness of real-time public reporting requirements to inter-affiliate transactions in the future.

reporting requirements under Section 727 of the Dodd-Frank Act do not apply to inter-affiliate transactions.

B. Mere End-Users Are Not Prepared To Comply With Swap Data Recordkeeping Requirements

Under the Swap Data Recordkeeping Release, all "Non-SD/MSP Counterparties" (i.e., non-swap dealer commercial end-users within a corporate group) would be required to comply with recordkeeping requirements with respect to swaps throughout the existence of the swap and for five years following final termination of the swap.[36] Shell Trading respectfully submits that such a detailed record maintenance requirement with respect to otherwise unregulated end-users is unworkable, and that records relating to such swaps will continue to be maintained by the swap dealer counterparties to such end-user swaps.

Commercial end-users that are not registered as swap dealers and are not subject to the extensive risk management requirements of the Commission's other proposed rulemakings are not likely prepared to comply with such a requirement because they have no extant records management systems that would make compliance feasible. The Dodd-Frank Act provides the Commission considerable discretion in determining how books and records of "Non-SD/MSP Counterparties" relating to uncleared swaps must be maintained.[37] The Commission should clarify that, consistent with the intent of the Dodd-Frank Act with respect to the treatment of end-users, "Non-SD/MSP Counterparties" are not subject to the detailed recordkeeping requirements proposed in the Swap Data Recordkeeping Release, in particular as regards inter-affiliate transactions.

IX. Conclusion

Given the benefits that a centralized hedging affiliate offers in terms of reducing overall risk to a corporate group, and the fact that application of the Dodd-Frank Rulemakings to inter-affiliate transactions will not serve the purposes of the Dodd-Frank Act, the Commission should promulgate rules consistent with the above proposals. Shell Trading suggests that the Commission not apply its rules to inter-affiliate transactions in the same manner as transactions between unaffiliated entities, and that it only impose such rules as it deems necessary after carefully evaluating how affiliate transactions are utilized within a corporate group. This is especially important with respect to commercial firms as the resources that would be required to meet the compliance obligations of the Dodd-Frank Rulemakings are substantial.

Shell Trading appreciates the opportunity to provide these comments. We would be pleased to provide any additional information regarding our views on the regulation of affiliates under the Dodd-Frank Act at your request

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[36] *See Swap Data Recordkeeping Release*, 75 Fed. Reg. at 76579; Proposed Rule 45.4(b)(2).

[37] *See* CEA Section 4r(c)(2) (books and records must be maintained "in such form, in such manner, and for such period as the Commission may require").

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

Respectfully submitted,

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Vice President – Regulatory Affairs
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cc: ChairmanGensler
CommissionerDunn
CommissionerChilton
CommissionerSommers
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Daniel Berkovitz, General Counsel