

# ANNUAL ASSESSMENT REPORT 2013

NATURAL GAS EXCHANGE INC.



OCTOBER 2014

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## Introduction

This report summarizes the Alberta Securities Commission's (ASC) assessment of compliance by Natural Gas Exchange Inc. (NGX) with its obligations under the Securities Act (Alberta) (the Act) and the Recognition Orders (as defined below) for the 2013 calendar year (the Reporting Period).

In the ASC's view, NGX has demonstrated compliance with its obligations under Alberta securities laws and the Recognition Orders during the Reporting Period.

## Background

### (A) NGX's Regulatory Status

NGX, a wholly-owned subsidiary of TMX Group, Inc. (TMX Group), carries on business as an exchange in Alberta. NGX is recognized as an exchange under section 62 of the Act by ASC Recognition Order dated October 9, 2008, as varied by ASC orders dated April 9, 2009 and July 11, 2012 (Exchange Recognition Order). As a recognized exchange, NGX is required under section 63(2) of the Act to regulate the operations, standards of practice and business conduct of its participants in accordance with its rules and practices.

NGX is required to comply with the operating principles, reporting requirements, and all other undertakings specified by the ASC under the Exchange Recognition Order. Under the Memorandum of Understanding respecting the Oversight of Exchanges and Quotation and Trade Reporting Systems effective January 1, 2010 (Exchange MOU), the ASC is the lead regulator of NGX and is primarily responsible for its oversight.<sup>1</sup>

NGX also provides clearing and settlement services to contracting parties. NGX is recognized as a clearing agency under section 67 of the Act by ASC Recognition Order dated October 9, 2008, as varied by ASC orders dated April 9, 2009, July 11, 2012, and December 19, 2013 (Clearing Agency Recognition Order). NGX is subject to regulatory oversight based on compliance with the clearing principles, reporting requirements, and all other undertakings specified by the ASC under the Clearing Agency Recognition Order.

NGX has been granted exemptions from the Ontario Securities Commission, Autorité des marchés financiers, British Columbia Securities Commission, Manitoba Securities Commission and the Financial and Consumer Affairs Authority of Saskatchewan. These exemptions are based, in part, on

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<sup>1</sup> Under the lead regulator model in Canada, the jurisdiction in which the head office is located recognizes the exchange and is the lead regulator having primary responsibility for the oversight of the exchange, while other jurisdictions in which the exchange carries on business exempt the exchange, subject to appropriate terms and conditions, and rely on the oversight carried out by the lead regulator. In the case of certain exchanges in Canada, including NGX, the lead regulator model has been partially effected under the terms of the MOU respecting the Oversight of Exchanges and Quotation and Trade Reporting Systems effective January 1, 2010 Exchange MOU among the ASC, British Columbia Securities Commission, Autorité des marchés financiers, Ontario Securities Commission and Manitoba Securities Commission.

the ASC's recognition of NGX as an exchange, consistent with the lead regulator model set out in the Exchange MOU.

In May 2013, NGX was registered as a foreign board of trade (FBOT) with the United States Commodity Futures Trading Commission (CFTC) in order to permit NGX's contracting parties and other participants located in the United States to enter trades directly onto NGX's trading system. Prior to registration as an FBOT, NGX operated in the United States as an exempt commercial market under the oversight of the CFTC. In addition, NGX operates in the United States as a derivatives clearing organization registered with the CFTC. A Memorandum of Understanding Concerning Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Clearing Organizations was established between the ASC and the CFTC in June 2010 to allow for effective regulation of NGX by Canada and the United States.

## **(B) Current Business Operations and History**

In 2004, the TMX Group acquired 100 per cent of the outstanding shares of NGX. NGX currently operates an electronic trading and clearing system based in Calgary for the trading, clearing and settlement of natural gas, power, and crude oil physical and financial contracts.

Prior to the ASC recognizing NGX as an exchange and as a clearing agency under the Recognition Orders in October 2008, NGX had been operating an electronic trading, clearing and settlement system in Alberta for the trading of natural gas, electricity and related contracts under a series of exemptive relief orders granted by the ASC beginning in 1993.

In 2007, NGX entered into an agreement with Intercontinental Exchange, Inc. (ICE) to form a technology and clearing alliance for the North American natural gas and Canadian power markets. Under the arrangement, the cleared and uncleared markets for North American physical natural gas and Canadian electricity operated by NGX were listed on ICE's electronic trading platform as of February 2008.

In April 2009, the terms of NGX's recognition as an exchange and clearing agency were varied to permit NGX to trade and clear crude oil contracts. In addition, the TMX Group acquired NetThruPut Inc. (NTP) in 2009, an electronic crude oil trading and clearing platform, and integrated the operations of NTP into NGX as part of a consolidation of TMX Group's energy trading and clearing operations.

In May 2011, the Maple Group Acquisition Corporation applied to the ASC for various orders in connection with its intention to directly acquire 100 per cent of the outstanding shares of TMX Group and, indirectly, NGX. In June 2012, the terms of NGX's recognition as an exchange and clearing agency were further varied to require NGX to establish, maintain and comply with policies and procedures to identify and manage conflict of interest and confidentiality issues arising from NGX's operations or regulatory functions.

In August 2013, NGX entered into an alliance with the NASDAQ OMX Commodities Clearing Company, which resulted in NGX listing for trading and clearing physical electricity products for the Texas market (ERCOT).

On December 19, 2013, the ASC varied the NGX Clearing Agency Recognition Order to include the undertaking that NGX “operate the Clearing System in compliance with the Principles for Financial Market Infrastructures (PFMIs) issued jointly by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO), as the same may be amended, or any successor standards, principles and guidance for central counterparties and financial market infrastructures adopted by CPSS and IOSCO Technical Committee, in the manner determined by the Commission.”

## **Market Regulation’s Oversight Program**

In order for NGX to maintain its recognition as an exchange and as a clearing agency under the Act, NGX must continue to comply with Alberta securities laws and the Recognition Orders. The ASC’s oversight program primarily included:

- determining the adequacy of NGX’s policies and procedures in order to ensure ongoing compliance by NGX with its obligations under Alberta securities laws and the Recognition Orders;
- identifying potential issues in NGX’s operating and compliance procedures that may need to be addressed in order to ensure ongoing compliance by NGX with its obligations under Alberta securities laws and the Recognition Orders; and
- reviewing NGX’s progress towards observance of the PFMIs.

### **(A) Regulatory Filings**

During the reporting period, NGX filed the following regulatory filings, in accordance with the reporting requirements outlined in Appendix B of the Recognition Orders:

- 2012 Annual Report, including audited financial statements and a self-assessment;
- Quarterly reports, including interim financial statements;
- Contracting Party Agreement amendments; and
- Key event reporting, including the enactment of their Business Continuity Plan during the Calgary floods.

ASC staff conducted analysis of all filed materials, including any required follow up with NGX staff. ASC staff do not have any outstanding concerns regarding any materials filed by NGX during the Reporting Period.

### **(B) Regulatory Reviews**

During the Reporting Period, ASC staff engaged in regular communication with NGX executive and operational staff members. ASC staff coordinated quarterly meetings with the NGX President

to review NGX's operational results and future business plans. Additionally, ASC staff maintained an ongoing dialog with NGX regarding their observance of the Principles for Financial Market Infrastructures and the remediation of any identified gaps.

### **(C) Oversight Reviews**

ASC staff concluded the 2012 oversight review of NGX (Oversight Review) during the Reporting Period. The Oversight Review included detailed reviews of certain NGX functions for the period January 1, 2011 to June 30, 2012 in order to assess compliance by NGX with its obligations under the Act and the Recognition Orders. In conducting the Oversight Review, the ASC found that NGX demonstrated compliance with its obligations under the Act and the Recognition Orders. No further oversight reviews were conducted by the ASC during the Reporting Period.

## **NGX Regulatory Activities**

In addition to complying with the Act and its Recognition Orders, NGX seeks to comply with regulatory developments across the various jurisdictions in which NGX operates. As the ASC is the lead regulator for NGX, the ASC requires NGX to provide periodic updates regarding its ongoing regulatory status with other jurisdictions. The ASC has been notified of the regulatory submissions NGX has made to other regulatory jurisdictions during the Reporting Period and has reviewed materials accordingly.

In the U.S., NGX originally submitted an application to the CFTC in May 2010 in connection with the FBOT registration requirement. This application was updated and resubmitted in February 2012 and further updated in December 2012 and January 2013. As noted above, NGX was registered as an FBOT with the CFTC in May 2013.

In September 2013, NGX applied for recognition as a third country central counterparty with the European Securities and Markets Authority under Article 25 of the European Market Infrastructure Regulation. The European Securities and Markets Authority (ESMA) is still reviewing the application.

## **Conclusion**

In the ASC's view, NGX has demonstrated compliance with its obligations under Alberta securities laws and the Recognition Orders during the Reporting Period.