

Annual Assessment Report  
Natural Gas Exchange Inc.

**2012  
Report**

Alberta  
Securities  
Commission

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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 2012 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 (the 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 (Operating Principles) and reporting requirements 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 (the 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 and July 11, 2012 (the Clearing Agency Recognition Order). NGX is subject to regulatory oversight based on compliance with the clearing principles (Clearing Principles) and reporting requirements specified by the ASC under the Clearing Agency Recognition Order. In this report, the Exchange Recognition Order and the Clearing Agency Recognition Order are collectively referred to as the Recognition Orders.

NGX has been granted exemptions from the requirement to be recognized as an exchange, subject to certain terms and conditions, by the Ontario Securities Commission, Autorité des marchés financiers, British Columbia Securities Commission, and Manitoba Securities Commission. These exemptions are based, in part, on the ASC's recognition of NGX as an exchange, consistent with the lead regulator model set out in the Exchange MOU.

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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.

In May 2013, NGX was registered as a foreign board of trade (FBOT) with the United States Commodity Futures Trading Commission (the CFTC), in order to permit NGX's members 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 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 U.S.

## **(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 October 2008, when the ASC recognized NGX as an exchange and as a clearing agency under the Recognition Orders, 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 since 1993.

In 2007, NGX entered into an agreement with IntercontinentalExchange, 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 bilateral markets for North American physical natural gas and Canadian electricity operated by NGX were listed on ICE's electronic trading platform in 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 in 2009 acquired NetThruPut Inc. (NTP), 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, TSX Venture Exchange and 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.

## **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 includes:

- 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; and

- identifying 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.

**(a) Regulatory Filings**

For the Reporting Period, the ASC received all required filings under the Recognition Orders. 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 NGX materials filed during this time frame.

As per the reporting requirements outlined in the Recognition Orders, NGX is required to report, no later than 2 business days after their occurrence, key events including significant changes to senior management, per section 2 of Appendix B of the Exchange Recognition Order. Additionally, per section 6(g) of the Clearing Agency Recognition Order, NGX is required to notify the ASC 10 business days in advance of any significant change in the operation of NGX's "Clearing System" (as that term is defined in the Clearing Agency Recognition Order). During the Reporting Period, NGX reported the following changes:

- retirement of Peter Krenkel, President and CEO, effective December 21, 2012;
- appointment of Jim Oosterbaan as President and CEO, effective November 1, 2012; and
- final implementation of a new clearing system.

**(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.

**(c) Oversight Review**

During the Reporting Period, ASC Staff also concluded a compliance oversight review of NGX for the period January 1, 2011 to June 30, 2012. The oversight review included detailed reviews of various NGX functions 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.

**NGX Business and Regulatory Activities**

**(a) Summary of NGX's Business Activities**

For the Reporting Period, NGX achieved 14.3 million terajoules in total energy volume<sup>2</sup> compared to 15.5 million terajoules in 2011. The volume decline was driven by declines in natural gas and crude oil volumes. Natural gas volumes declined due to market conditions, while declines in crude oil volumes reflect continued resistance to NGX's crude oil clearing services and increased competition from voice

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<sup>2</sup> NGX total energy volume includes trading and clearing in natural gas, crude oil and electricity.

brokers, including from Shorcan Energy Brokers. By contrast, cleared power volumes increased by 48.5 per cent as the power market shifted to increased clearing after the implementation of new regulations in the U.S. (arising from implementation of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*).

NGX added several products during the Reporting Period, including natural gas products for four U.S. hubs. NGX, in conjunction with ICE also re-launched its financial futures contract for Western Canada Select crude and added a new contract for synthetic crude. NGX removed natural gas products for one hub.

In February 2012, NGX advised the ASC that it was relocating its offices and that this would necessitate the relocation of its backup data center. As part of the move, NGX initiated a review of its business continuity and disaster recovery plans.

NGX exited the Reporting Period with two net new customers, a total of 246 active customers and 99.96 per cent availability of its trading and clearing systems.

## **(b) Summary of NGX's Regulatory Initiatives**

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.

## **Conclusion**

In the view of ASC staff, NGX has demonstrated compliance with its obligations under Alberta securities laws and the Recognition Orders during the Reporting Period. Going forward, ASC staff will continue to conduct oversight of NGX's operation as a recognized exchange and clearing agency.