TransAlta Corporation
Box 1900, Station "M"
110-12th Avenue S.W.
Calgary, Alberta
T2P 2M1
T (403) 267 7110

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VIA electronic submission

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

c/o:
Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax: 514-864-6381
consultation-en-cours@lautorite.qc.ca

c/o:
Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: Comment Letter on CSA Notice and Request for Comment – Proposed National Instrument 93-102 Derivatives: Registration and Proposed Companion Policy 93-102 Derivatives: Registration.

TransAlta Corporation **("TransAlta"**) and its affiliates hereby respectfully submit comments on the Canadian Securities Administrators (**"CSA"**) notice and request for comment. TransAlta appreciates the opportunity to share its feedback and looks forward to continued collaboration following the submission.

<u>TransAlta Background:</u>

TransAlta is a publicly traded generator and marketer of electricity and renewable power. TransAlta owns, operates and manages a highly contracted and geographically diversified portfolio of assets that utilize a broad range of generation fuels including natural gas, coal, hydro, wind and solar. TransAlta's major markets are Canada, the U.S. and Australia, managing a total of 8,266 MW across these jurisdictions.

TransAlta's primary objectives as a generation and marketing company are to mitigate and optimize exposures to short-term, spot market power prices, to hedge price risks associated with fuel inputs, and to proprietary trade within a limited and well-defined risk framework. TransAlta utilizes a variety of instruments to manage its price exposure, including physical forward contracts for electricity, natural gas and environmental commodities, and financial derivative transactions based on those same commodities. Much of TransAlta's trading activity takes place on regulated electronic exchanges and clearing platforms, such as ICE (Intercontinental Exchange) and NGX (Natural Gas Exchange), but also through third-party brokered transactions and directly with counterparties. Interest rate and foreign exchange derivatives are transacted by our centralized treasury function and are entered into solely for the purpose of risk mitigation. TransAlta is a registered "market participant" in the Alberta wholesale electricity market constituted as the Alberta "Power Pool" under the Electric Utilities Act of Alberta (the **"EUA"**) and is also a licensed "retailer" (as defined in the EUA) of electricity services to large commercial and industrial customers in the Alberta retail electricity market.

General Comments:

First, we would like to state that we support the efforts of the CSA to design and implement a derivatives regulatory regime that addresses Canada's G-20 commitments. We also commend the Committee for amending the Proposed National Instrument to address many of the comments already submitted by affected market participants. The specific comments raised below address some of the areas in the National Instrument that TransAlta feels are still of concern.

TransAlta is also aware of the comments submitted by Eversheds Sutherland (US) LLP, on behalf of The Canadian Commercial Energy Working Group, in a letter dated August 2, 2018 (the **"Sutherland Letter"**). Although TransAlta is not associated with the Canadian Commercial Energy Working Group, we support the comments in the Sutherland Letter and respectfully urge the CSA to adopt the proposed revisions to the Proposed National Instrument set forth in the Sutherland Letter.

Specific Comments:

BUSINESS TRIGGERS

The CSA's proposed Business Triggers, while we take the CSA's word that they intended to be applied holistically, provide limited clarity to market participants and remain a source of confusion. The CSA should consider adopting further interpretative explanation and indicia of derivatives dealers, including borrowing language used by the CFTC. This could include: entering into derivatives to satisfy the business or risk management needs of a counterparty (as opposed to entering into derivatives to accommodate one's own desire to participate in a particular market); allocating separate staff and resources to dealer-type activities including client onboarding, document negotiation, confirmation generation, credit and portfolio reconciliation, etc.; creating new derivatives products; and other dealer-trader distinctions.

EXEMPTION FOR CERTAIN DERIVATIVES END-USERS[1]

The term 'regularly' is used in both (c) and (d), but the Companion Policy is silent in this area on how to interpret the term. The CFTC has provided clarification that a regular business means activities that are usual and normal in the person's course of business and identifiable as a swap dealing business. The CSA could provide something equivalent but contextualize it in the CSA's distinct language of derivatives regulation, such as linking the discussion provided in the Companion Policy on page 95 under 'Factors in determining a business purpose – general' with the 'Exemption for certain derivatives end-users' section.

GENERAL DE MINIMIS EXEMPTION ($250M OVER 24 MOS) AND COMMODITY DE MINIMIS EXEMPTION ($1B OVER 24 MOS)

We appreciate that to calculate our room under the de minimis exemptions we must first remove physicals, exchange-traded / cleared and inter-affiliate transactions from the equation. However, we believe that excluding commercial hedges is also required. The $1B calculation in particular should not include commercial hedging transactions, as these are ultimately a measure of the size of a generator / producer's portfolio of assets, not its dealing or trading activity in OTC markets.

For example, corporate renewable PPAs are becoming increasingly popular in the US to backstop the development of new wind and solar facilities. They provide corporate and government off-takers the ability to demonstrate their sustainability goals by supporting the growth of new renewable energy sources.[2] These PPAs are typically papered as financial contracts-for-difference and as such are reportable derivatives (Canada) / swaps (US). They also have large notional amounts. For example, a 15-year PPA on a 90MW wind farm at $42/MWh would have a $500M notional amount (using the CPMI-IOSCO definition). Developing two wind farms in this manner equates to $1B notional and would eliminate the ability for a Canadian energy parent and its affiliate marketing arm to rely upon the Commodity Derivatives Exemption in the Proposed National Instrument.

Instead the CSA should include commercial hedging language within the exemptions. The CSA used the following definition of hedging in Model Provincial Rule 91-303[3], and while the final rule ultimately dropped this concept, we feel the inclusion of this concept within the Proposed National Instrument on Derivatives Registration would make these exemptions available to commercial energy companies seeking to hedge or mitigate their commercial price exposure[4]:

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[1] Proposed National Instrument 93-103 *Derivatives: Registration*. Page 59 Section 49. (2)

[2] https://www.utilitydive.com/news/salesforce-kaiser-permanente-add-to-boom-in-corporate-renewable-ppas/532328/

[3] CSA Staff Notice 91-303: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20131219_91-303_mandatory-counterparty-clearing-derivatives.htm

[4] As well as providing consistency with US and European de minimis exemptions.

Interpretation of hedge or mitigation of commercial risk

3. In this Rule, a derivative is held for the purpose of hedging or mitigating commercial risk when all of the following apply:

(a) it establishes a position which is intended to reduce risks relating to the commercial activity or treasury financing activity of the counterparty or of an affiliate, and, alone or in combination with other derivatives, directly or through closely correlated financial instruments meets any of the following:

> (i) that derivative covers the risks arising from the change in the value of asset, services, inputs, products, commodities or liabilities that the counterparty or its group owns, produces, manufactures, processes, provides, purchases, merchandises, leases, sells or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the normal course of its business;
>
> (ii) that derivative covers the risks arising from the indirect impact on the value of assets, services, inputs, products, commodities or liabilities referred to in subparagraph (i), resulting from fluctuation of interest rates, inflation rates, foreign exchange rates or credit risk;

(b) such position is not held for any of the following purposes:

> (i) for a purpose that is in the nature of speculation;
>
> (ii) to offset or reduce the risk of another derivative transaction, unless that other position itself is held for the purpose of hedging or mitigating commercial risk.

To ensure that market participants apply the guidance appropriately, the CSA could include an anti-evasion clause allowing it to request confirmatory information from market participants, thereby conditioning the use of the de minimis exemption on the market participant demonstrating, upon a specific request from the relevant provincial regulator, that it had a reasonable basis for its characterization of a transaction intentioned to hedge or mitigate commercial risk as a bona fide hedge.

METHODOLOGY TO DETERMINE NOTIONAL AMOUNT

The CSA proposes two alternate methodologies: 1) the CPMI-IOSCO methodology, which TransAlta critiqued during its consultation period; and 2) the Regulatory Notional methodology. Neither of these methodologies are without fault, and we believe it would beneficial for the CSA to pause and align itself with the CFTC methodology that will result from its ongoing consultation, given the harmonization and consistency benefits that could result.

As TransAlta's comments to IOSCO have previously identified, the CPMI-IOSCO methodology calculates basis swaps and options notional amounts incorrectly. The option calculation grossly overstates or understates the notional amount when the strike is above or below the underlying price, respectively (even though the economic profile and risk on each option may be the same). The basis swap calculation also biases the notional by using the spot price, when the price spread is the true value of the product exchanged.

The CSA's Regulatory Notional methodology substitutes the fixed notional volume for a prorated monthly equivalent. In our example in the section above for corporate renewable PPAs, this would 'scale down' the 15-year deal into a smaller monthly equivalent. On the other hand though, this methodology may be biased against active short-term markets, such as in electricity and natural gas. Electricity forward markets in particular exhibit a strong 'term structure' of liquidity, with near-term hourly, daily and weekly contracts being exchanged at large multiples of the volume of quarterly or calendar year contracts for settlement further into the future. These near-term contracts would 'scale up' to a monthly equivalent, with each one somewhat paradoxically potentially matching the size of the 15-year PPA. While the use of only 'outstanding' commodity derivatives in the de minimis calculation may mitigate this bias somewhat, this methodology might also have unintended consequences on trading activity during month ends and natural gas bidweeks when commodity companies often do a majority of their hedging and optimizing. Additionally, the Regulatory Notional still has issues on the price side of the equation for certain derivative instruments, such as commodity basis swaps where it is unclear why the CSA chose 'the greater of' the two legs instead of the price spread.

The advantages of pausing and assessing the CFTC's proposal are many. Most derivative market participants in Canada see it as fair and reasonable that only financial institutions and three very large commodity participants have been provisionally registered as swap dealers in the US. The scenario testing that accompanied the CFTC's recent decision to maintain their $8B de minimis swap dealing threshold proved that this level was robust and appropriately tuned.[5] The CFTC's proposed standardized notional amount guideline is equally anticipated and expected to be just as robust, and the CSA would benefit from the discussion of competing methodologies and calculation variations for specific derivative instruments that should arise from the CFTC's consultation. If consistency between the two jurisdictions can be achieved, this also reduces the work required by market participants to develop their notional amount calculations for testing against the respective de minimis thresholds.

Conclusion:

TransAlta would like to thank the Committee for the opportunity to provide comments on CSA Staff Notice 93-102 and we support the great undertaking of OTC derivatives market reform. TransAlta looks forward to additional opportunity for comment and consultation on the Committee's efforts to design and implement OTC reform. If you have any questions or concerns regarding our comments, please contact either of the undersigned.

[5] https://www.gpo.gov/fdsys/pkg/FR-2018-06-12/pdf/2018-12362.pdf

Sincerely,

/s/ Daryck Riddell

Daryck Riddell
Manager, Operations & Trading Compliance
Ph: 403-267-7906 Cell: 403-701-1251
Email: daryck_riddell@transalta.com

/s/ Kendra Fergusson

Kendra Fergusson
Trading Compliance Risk Analyst
Ph: 403-267-7409
Email: kendra_fergusson@transalta.com