alintaenergy

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Mr Laurence White
Senior Manager, Post-trading and OTC Derivatives
Financial Market Infrastructure
Australian Securities and Investments Commission
Level 5, 100 Market Street
SYDNEY, NSW 2000

Lodged Via OTCD@asic.gov.au

Dear Mr White

Derivative Transaction Reporting – Consultation Paper 205

Alinta Energy writes in response to the *Derivative Transaction Reporting* consultation paper, released by the Australian Securities and Investments Commission (ASIC).

Alinta Energy is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta Energy has over 2500MW of generation facilities in Australia (and New Zealand), and maintains approximately 700,000 retail customers across Australia.

Entities within the Alinta Energy corporate structure hold an Australian Financial Services Licence and are active participants in Australian electricity derivatives markets, and trade Over-The-Counter (OTC) and Australian Stock Exchange electricity products. Alinta Energy also has exposure to non-energy related derivative markets.

Based on the information contained within the consultation paper, Alinta Energy expects to be directly impacted by the reporting requirements. The purpose of this submission is to outline Alinta Energy's perspectives on the proposal including aspects that lack appropriate clarity.

<u>Electricity and commodity derivatives</u>

Alinta Energy notes that a decision relating to the mandatory obligation of OTC electricity derivatives will only be assessed following the conclusion of the financial resilience review, presently being undertaken by the Australian Energy Market Commission.

Whilst awaiting completion of the review, Alinta Energy notes, as outlined in previous submissions, the low probability of financial contagion within the electricity market and the limited justification for impeding management of spot market risk as a result of additional transaction costs and regulatory burdens.

The highly developed risk mitigation practises within individual businesses and the underlying physical nature of the market severely limits the value of the proposal's application to electricity derivatives, and arguably commodities more generally.

It is important to appreciate the distinguishing nature of bespoke OTC derivatives within the energy industry, and the flexibility they provide counter-parties across the supply chain. These bilateral

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agreements are distinctively tailored towards individual participants risk exposures and as such the amount of collateral required, or the need for collateral, varies depending on the credit worthiness of participants. Any move away from these bespoke contracts is likely to increase, not decrease risk.

In this context, Alinta Energy believes that there is an absence of evidence to suggest that the present OTC derivative risk mitigation processes within the energy industry are not operating correctly. As such, there is no firm justification for including energy derivatives within any current or future proposed derivative transaction reporting framework.

<u>Appendix A</u> further expresses Alinta Energy's view on the value of energy derivative exclusions from mandatory trade reporting.

Commodities more broadly

Alinta Energy notes the exclusion for electricity within the legislation is complicated by its inclusion in a broader commodities class. This is unfortunate and suggests the legislative exclusion may have been better drafted at the commodity, not electricity level.

This is because many of the sound justifications for the electricity exclusion apply at the broader commodity level. Notably, Alinta Energy has reservation regarding how the arrangements moving forward would potentially impact marginal products in the developing gas market.

Given the gas market continues to develop from purely bi-lateral arrangements to a combination of contracting options and facilitated markets, impeding market development to regulate a negligible amount of trades would be unjustifiable from a policy, economic and consumer standpoint.

Notably, commodity transactions are not a priority for G-20 commitment purposes, there is an absence of evidence to support significant regulatory requirements, and the number of trades across the other commodity classes is minimal. For all of these reasons, Alinta Energy proposes that commodity derivatives not be listed at this point in time.

<u>International consistency and compliance</u>

Alinta Energy understands that these rules have been drafted with the notion of promoting consistency with overseas OTC derivative transaction reporting schemes and compliance with internationally agreed standards.

Nonetheless, it is important to acknowledge that no single G-20 member jurisdiction has of yet implemented, or even outlined their intention to fully implement all G-20 commitments. The Financial Stability Board concluded that as of April 2013, less than half of eligible jurisdictions currently have the appropriate legislative and regulatory frameworks in place to facilitate OTC trade reporting and only five jurisdictions are presently reporting to trade repositories[1].

In this context, Alinta Energy stresses that whilst attempts at improving risk mitigation practises are understood, they will be unwelcome if they do not take into account the nature of the risk at hand or the benefits of the risk management arrangements within affected industries and entities at present. The current approach could place upon Australian businesses unnecessary and financially burdensome reporting obligations, for little risk reducing benefit.

As this outcome remains a possibility, Alinta Energy urges regulators not to resolutely pursue reporting obligations without appreciating the wider impacts. An instance where Australia is one of only a handful of countries participating in costly reporting requirements would represent a poor policy outcome with no benefit to end users.

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[1] "*OTC Derivatives Market Reforms – Fifth Progress Report on Implementation*" (2013), Financial Stability Board, pg 9.

Delegation of reporting obligations

Limiting the introduction of new burdensome administrative obligations for entities that already operate in a highly regulated environment is a critical objective. In terms of operational efficiency, Alinta Energy is unaware of any logical reason for regulators to collect identical duplicated reporting data from participants.

For this reason, Alinta Energy is supportive of the ability of participants to delegate reporting obligations to counter parties or third parties such as trading platforms.

Single trade repository

The foundation of any well functioning market is competition; this can by suitably applied to not only trading markets participants, but also trading platforms.

In this context, there remains concern that a single trade repository service provider will be unsuitable with the ability to raise prices with no fear of losing customers whom are lawfully obliged to use their service.

Alinta Energy suggests that in order to deter monopolistic behaviour from a single trade repository, that there are no legal barriers to entry for financial institutions who are able to offer their trade repository services to the market.

Deadline for reporting of liable transactions

The time between a transaction and reporting needs to be considered against two criteria: one, cost of compliance; and two, value of early reporting to the regulator.

Alinta Energy notes the proposal for a T+1 reporting requirement to a trade repository and suggests that the practicalities of requiring participants to partake in frequent reporting within this short timeframe is an administrative burden likely to prove excessive to many participants with little benefit to regulators.

Unless regulators have an expectation of dynamic intervention in the market, then daily reporting is not required. Further, should regulators hold this view all industry would likely be particularly alarmed. OTC derivative reporting, should it be imposed, will only provide a segmented view of the industry and never in real time. As such, the value of reporting data will be retrospective analysis which does not require daily reporting.

Alinta Energy suggests that several possible alternatives are available for reporting requirements including an end of week, month, T+ 90, T+ 60 or T+ 30 basis. These scenarios are likely to be more suited to businesses settlement procedures, reducing some of the administrative and time constraints on participants.

Information to be reported

Alinta Energy notes the proposed move to standardise reporting obligations in relation to: commodity derivatives; credit and equity derivatives; foreign exchange derivatives; and interest rate derivatives.

Like many businesses, Alinta Energy has direct exposure to foreign currency risks, including through overseas markets for specialised generation and mining equipment services. As such, Alinta Energy would be required to report derivative position information in relation to all OTC foreign exchange derivatives.

As Alinta Energy is only a small end user of foreign exchange derivatives, it is hard to see what potential value could be achieved from their mandatory reporting, especially considering regulators would be unaware of Alinta Energy's portfolio exposures to the market.

In light of the above, there is an absence of evidence as to what meaningful value, if any, can be gained from the reporting and storage of large volumes of potentially immaterial and insignificant data with no context of its usage in individual business practise.

<u>Privacy concerns</u>

As outlined in previous submissions, Alinta Energy is concerned that there remains some confusion over the interaction between Australian privacy laws and reporting to a centralised trading repository.

Alinta Energy notes a lack of analysis and identification of consequences of privacy concerns within ASIC's current consultation paper. It is still unclear as to how the proposed reporting scheme will link internationally given various countries unique privacy laws and blocking statues.

This includes the validity of any mechanisms to override client confidentiality and privacy agreements in order to meet trade reporting obligations. As such, this aspect of mandatory reporting needs to be better explored and explicitly outlined to participants with a view to maintaining a high degree of integrity.

<u>Implementation timetable</u>

Alinta Energy notes the current implementation and is supportive of the "opt in" interim preference being available to participants seeking to comply with overseas obligations.

However, in the same regard, Alinta Energy urges consideration that if it becomes apparent during the process of implementation, that certain commodities prove problematic to report, and correspondingly the cost of regulation on participants outweighs the potential benefits, that the regulator reassess and potentially extends the proposed implementation plan with a specific consideration of costs on smaller "end user" participants.

<u>Conclusion</u>

In summary, Alinta Energy remains concerned with the mandatory reporting obligations as outlined in consultation paper. Many of the outlined reforms are in clear need of a comprehensive cost benefit analysis so they do not run the risk of increasing costs on business, for little to no benefit to the market.

Apart from these considerations, Alinta Energy appreciates much of the work of ASIC in reviewing the issues at hand and looks forward to continuing engagement. Should you have any queries in relation to this submission, please do not hesitate to contact me on, telephone, .

Yours sincerely,

Jamie Lowe
Manager, Market Regulation

Appendix A – Energy Market Risk Management

Understanding the purpose for which energy market participant's trade OTCs

The National Electricity Market is the most well known energy market in Australia. Exchange in the market occurs between producers and consumers through the pool, also referred to as the spot market, where the output for all generators in each individual region are aggregated, ranked by price in a merit order, and dispatched to provide the lowest cost generation to meet demand at that point in time. The pool price, or spot price, is set every 5 minutes and settled half-hourly for each region at prices between -$1000 and $12,900. The spot market is driven by short-run incentives which ensure cost-efficient outcomes. This cost-efficient process underpins much of the success of the National Electricity Market in utilising assets and promoting efficiency.

Nevertheless, the spot market creates risk for participants, both exposure to unmanageable costs for retailers and generators and a limited ability to recover fixed costs for generators that encourages contracting between market participants. This management of market risk is the key driver of energy market hedging and is a reason that the vast majority of participants are domestic based and physical participants.

Alinta Energy estimates less than 10% of exchange traded products would be traded internationally, and that is considered a high estimate, while very few OTC trades are conducted with international participants - Alinta Energy staff, drawn from a range of companies, could only identify a few such known trades in recent years.

The way in which a retailer uses OTC and futures provides an insight into what drives derivatives trading in the electricity market and suggests the proposed framework may be superfluous.

Current risk management within the energy sector

Alinta Energy retains the view that the financial relationships and financial markets that underpin the operation of the National Electricity Market are robust. As such, the counterfactual for any change should be less prescription and regulatory intervention not more.

Currently the energy sector employs a variety of risk mitigation practices including the usage of letters of credit or parent guarantees in credit support risk management. The use of cash as collateral is not required between established counterparties with good credit.

The underlying value of bespoke OTC derivatives currently used in the electricity sector is the flexibility they provide both in regions with high liquidity and those without. There exists no commercial enticement for the energy sector to move away from some use of bilateral agreements as they are specifically tailored towards individual participants' risk exposures.

Alinta Energy, as with similar entities, currently posts credit support with the Australian Energy Market Operator, has credit support arrangements in place with entities it trades with taking into account those entities credit ratings, uses centrally cleared futures to balance credit risk and market risk, and posts credit supports with network service providers, amongst other risk management arrangements prevalent in this sector.

While a range of concerns have been expressed there has been little in the way of concrete evidence that there has been, is, or will be any significant risks that can be regulated out of existence. On the contrary, the energy market continues to operate efficiently and entities have well developed and sophisticated risk management expertise underpinned by continued market participation. This is true of major load, generators, retailers and vertically integrated entities.

Undue regulation processes such as mandatory reporting, if imposed on the energy sector would likely discourage new investment and entrants due to unnecessary and costly obligations. The result of this policy would be a less competitive market as well as higher energy prices.

At no point has any party clearly highlighted the relationship between risk and the proposal or provided evidence that the proposal will improve risk outcomes. A definite outcome of the proposal, should it proceed in regard to electricity derivatives, would be increased costs for not only market participants but energy consumers including 'mom and dad' households.

Further regulation increases complexity and creates duplication

The Reserve Bank of Australia has previously outlined that regulators are interested in further increasing regulatory obligations in conjunction with mandatory trade reporting. The main tools proposed by the Reserve Bank of Australia include:

- due diligence and counter party approvals;
- agreement of robust legal documentation; and
- collateralisation of exposures.

These conditions are all already met by energy market participants who achieve an appropriate balance between credit risk and market risk exposure. Therefore mandatory obligations are not warranted in this area.

If there was a real identified risk that needed to be managed, above and beyond existing comprehensive risk management processes, companies in the electricity sector would have an interest in management of that risk; however, no such risk has been identified and as such there is no case to undermine or redirect resources from existing enterprise wide risk management practices.

In closing

Given the absence of evidence of systemic failure within the electricity sector, there is no justification or basis for regulators to agitate or openly canvas further regulation in relation to OTC electricity derivative trade reporting.

As Alinta Energy has previously indicated, regulatory interventions and burdens continue to undermine the delivery of cost-reflective energy to consumers and damage the financial viability of otherwise prudently operated businesses.