Senior Manager, Post-trading and OTC Derivatives
Financial Market Infrastructure
Australian Securities and Investments Commission

email: OTCD@asic.gov.au

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Dear Sir / Madam,

CP 205 – Derivative Transaction Reporting

GDF SUEZ Australian Energy (GDFSAE), formerly International Power-GDF SUEZ Australia, appreciates the opportunity to comment on ASIC's consultation paper 205 – Derivative transaction reporting (consultation paper). GDFSAE is wholly owned by GDF SUEZ S.A. and is a business line of GDF SUEZ Energy International.

In Australia, the company owns and operates 3,500MW (gross) of renewable, gas-fired and brown coal-fired plants in Victoria, South Australia and Western Australia. GDFSAE also includes the second tier retailer Simply Energy which has more than 300,000 electricity and gas accounts in Victoria, South Australia and New South Wales.

Treasury have indicated that it will consider the appropriateness of imposing mandatory obligations in relation to electricity derivatives following the completion on the AEMC financial resilience review. GDFSAE continues to argue that there is a very low probability of financial contagion manifesting in the electricity industry due to the underlying physical nature of the market, and the well-developed risk mitigation arrangements.

It therefore remains our view that the proposed derivative transaction reporting arrangements should continue to exclude electricity derivatives. However, GDFSAE has considered the potential implications should the derivative transaction reporting obligations be applied to the electricity sector, and has outlined below, a number of specific issues that this would present.

Range of risk management techniques

The utilisation of derivatives in relation to electricity aims to contend with the underlying exposures which are highly complex and difficult to evaluate. For example, electricity demand is volatile and half hourly market prices can vary across a wide range from -$1000 to $12,900 $/MWh. Businesses involved in commodity trading utilise derivatives as one form a risk management. However, derivatives are not the only form of risk management that commodity businesses employ. For example in electricity markets, there are a range of risk management processes used including strategies to mitigate physical risk of plant failure, physical hedging (vertical integration), collateral requirements on trading partners, OTC derivatives and exchange based financial instruments.

In addition to the range of categories of risk mitigation outlined above, a number of customised approaches are used in electricity risk management to suit the particular circumstances. For example, the risk factors and exposures experienced by a base load generator that generates electricity essentially 24 hours per day

GDF SUEZ Australian Energy
Level 33, Rialto South Tower, 525 Collins Street
Melbourne, Victoria 3000, Australia
Tel. +61 3 9617 8400 Fax +61 3 9617 8301
www.gdfsuezau.com
INTERNATIONAL POWER (AUSTRALIA) PTY LTD
ABN 59 092 560 793

are very different to the exposures of a peak generator that may generate only for a few hours per year necessitating the use of different risk management products and strategies.

Given the nature of the underlying exposures and the range of risk management approaches used it would be virtually impossible to make any meaningful assessment of the overall risk profile by examining OTC derivatives alone. Even if all the risk management information were available to an outside party, it would be very difficult to draw any meaningful comparisons without a complete understanding of the underlying exposures and risk management products used. For example the output of a peaking plant may comprise only a small fraction of its potential output yet it could be financially hedged using cap products with a volume of many times its output. The casual or non-expert observer could easily arrive at an incorrect conclusion regarding the net exposure of this asset.

For these reasons, a simple volume based comparison of commodity derivatives as suggested by ASIC would not provide a meaningful account of the overall electricity risk position.

Inconsistent terminology

The draft derivative transaction rules set out the information requirements in schedule 2, which includes a number of tables of data requirements. The proposed data fields in the schedule 2 tables suggest that the terminology outlined is consistently applied across businesses. However in examining the terms, it is apparent that they could be interpreted differently by different businesses, which makes comparison and aggregation of results meaningless. To overcome this problem, it would be at least necessary to establish a detailed glossary of definitions that all participants are able to understand and apply.

Standardised products

Electricity derivatives have been established by industry participants to suit a range of particular circumstances for a range of different technologies and commercial situations. These customised products enable counterparties to adjust their risk positions to suit their particular circumstances and risk appetite. If there is a drive to force electricity participants into standardised hedging products, it is possible that counterparties will not be able to adjust their risk positions as effectively. Electricity businesses may be forced to take on unwanted risks over and above their desired risk appetite or competency, which could have been better managed by other participants. This will ultimately lead to increased costs for consumers.

Commercially sensitive

Some of the information that is being sought would be regarded by electricity businesses to be commercially sensitive. This needs to be appropriately taken into account in the storage of information and publication of reports.

Reporting timeframe

The requirement to report derivative transactions within one business day seems an unnecessarily short time period, and is likely to add unnecessary costs and regulatory risk on businesses. A reporting timeframe of one week or one month would seem more appropriate.

Mark to market

Requiring a report of mark to market potentially on a daily basis seems unnecessarily prescriptive. A more reasonable approach would perhaps require reporting of mark to market on a monthly basis. Businesses should have the option of a more regular reporting cycle, if that suits their current business practices. Furthermore, the concept of 'mark to market' should be replaced by the concept of 'fair value' as defined under the recognised accounting standards (AASB 139 / IFRS 13).

Implementation and operational costs

The reporting requirements will impose new costs on all businesses. These new costs will include those required for establishing new IT processes and systems, new policies and procedures and new compliance functions. Once established, there will then be ongoing costs associated with data capture and entry, compliance and audit. Although it is difficult to estimate what these costs are likely to be in total, they will not be insignificant, and should therefore be considered against whatever benefit is perceived to emerge from this initiative.

Implementation timeframe

The implementation timetable, which commences at the end of 2013, seems unnecessarily fast. Commodity based derivatives in particular, should be provided with additional time to work through a range of issues, including those outlined in this submission. If there are particular drivers for financial derivatives to be reported as soon as possible, then the implementation timeframe should focus on those particular derivatives.

Basket derivatives

Some businesses are required to deal with a range of commodities; for example, gas, electricity, carbon permits, etc. Such businesses are likely to use some derivatives which include a basket of these commodities. This raises the question as to whether a basket derivative which includes an electricity component would be excluded from the current reporting obligations. Clarification is sought from ASIC on this point.

Should you have any enquiries regarding this submission, please do not hesitate to contact me on
.

Yours sincerely,

Chris Deague
Senior Market Specialist