



1 May 2013

Mr Laurance White
Senior Manager, Post-trading and OTC Derivatives
Financial Market Infrastructure
Australian Securities and Investment Commission
Level 5, 100 Market Street
Sydney NSW 2000

Submitted by e-mail: OTCD@asic.gov.au

Dear Mr White

Consultation Paper 205 - Derivative transaction reporting

Origin Energy (Origin) appreciates the opportunity to comment on the Australian Securities and Investment Commission (ASIC) Consultation Paper (CP) 205 on derivative transaction reporting (reporting).

Origin is the leading Australian integrated energy company focused on gas and oil exploration and production, power generation and energy retailing. A member of the S&P/ASX 20 Index, the company has more than 5,800 employees and is a leading producer of gas in eastern Australia. Origin is Australia's largest energy retailer servicing 4.3 million electricity, natural gas and LPG customer accounts and has the country's largest and one of the most flexible generation portfolios with approximately 5,900 MW of capacity, through either owned generation or contracted rights. Origin's strategic positioning and portfolio of assets provide flexibility, stability and significant opportunities for growth across the energy industry.

In that context, Origin has committed significant resources across the supply chain in Australian energy markets and has an interest in understanding how this proposed reporting regime could apply, particularly to commodity over-the-counter (OTC) derivatives, like energy. In committing the resources to comply with any proposed reporting regime, we consider ASIC needs to identify what tangible objective it is seeking to achieve or what market failure it is attempting resolve by progressing and developing reporting rules for energy derivatives.

We understand that this consultation is part of a broader work program to deliver on Australia's G-20 commitments to strengthen the international framework for OTC derivatives. We appreciate the international implementation timeframe guiding ASIC to establish reporting rules to meet the Government's G20 commitment to institute trade reporting in 2013. We consider, however, that the broad based approach ASIC is taking is likely to give rise to unintended consequences in underlying markets, particularly where derivatives are used to manage physical positions.

Origin requests that ASIC consider a different implementation approach. We consider ASIC should use appropriate urgency where a need is identified, but use greater care and deliberation when implementing a regime where market abuse or market failure has not been identified. ASIC can minimise the potential for negative unintended consequences by focusing on the implementation of reporting rules for the systemically important asset classes, but then allowing additional time to consider the appropriate reporting requirements for the other identified asset classes.

We note ASIC's approach to consult on electricity OTC derivatives after the completion of the Australian Energy Market Commission (AEMC) National Electricity Market (NEM) financial markets resilience review. Without predetermining the outcome of the AEMC Review and the response of ASIC, we agree that if a reporting regime for electricity were considered appropriate, an extended implementation timeframe would be appropriate. There are significant outstanding questions as to how to quantify and report the range of bespoke contracts, and questions as to whether the industry would have a consistent methodology by which to assess those values. Such discussions would take time to resolve prior to applying any reporting obligations.

Application to the energy sector

Origin continues to maintain that applying the G-20 reform agenda to derivatives used to hedge physical positions in domestic markets - for example the NEM - is not appropriate. We understand the primary focus for the G-20 reform agenda is liquid international markets for systemically important OTC derivatives, including foreign exchange and interest rate OTC derivatives. Commodity derivatives used to hedge physical positions, like those used in electricity, have not been identified as an urgent asset class to capture under the G-20 reform agenda.

Since the start of the NEM in 1998, electricity derivatives have evolved to manage the spot market risk of physical market participants. The bespoke nature of many OTC derivatives has developed to manage market risk under a range of market conditions; peak and off-peak periods for example. Origin considers industry risk management practices, including those for managing the credit risk from the counterparty to an OTC derivative trade, are robust and fit for purpose. ASIC has previously disagreed with this assessment, however, raising a number of concerns in its *Consultation Paper 177 Electricity derivative market participants: Financial requirements*, which focused the risk management framework for managing counterparty credit risk.

It remains unclear how ASIC considers OTC derivative trade reporting addresses credit risks or what overall objective ASIC considers trade reporting for commodity derivatives promotes. It is not clear how the individual options or load shape of the OTC derivative for either counterparty could be captured accurately. It is also unclear how to determine the underlying value for flexible volume transactions (which are in megawatt hours - not dollars) or, in another case, until its expiry where it is not known whether or not an option will be exercised. These are technical challenges that require a consistent industry approach to resolve should a reporting requirement apply in the future.

While enhanced transparency from reporting is expected to be a perceived benefit, visibility over OTC derivatives only provides insight in one aspect of physical market participant's hedge portfolio. It would not capture the complementary products used to hedge a spot market exposure, like exchange traded futures and swaps or physical generation. Without clearly articulated objectives, it is difficult to determine the overall regulatory impact for the sector and net benefit for implementing the reporting regime as proposed in CP 205.

Mandating reporting could also have unintended consequences for risk management in the NEM. Increasing the costs for trading in OTC derivatives to comply with reporting obligations could lead to a shift to standardised exchanged traded products, away from individually tailored bespoke contracts. This could constrain efficient risk management for NEM participants as exchange traded derivatives lack the flexibility to match the exposure in size or profile of participants, potentially leading to under or over hedging of the spot market risk. Ultimately, Australian electricity consumers bear the

consequences. It is, therefore, important that any cost imposed on participants and consumers is justified by a clearly defined market benefit.

Defining a clear objective for reporting

Origin provides in-principle support for ASIC's stated OTC objective for derivative trade reporting - to enhance transparency, promote financial stability and prevent market abuse. These are quite broad objectives, however. The relevance of this objective to each class of derivative is likely to differ for each of the five derivative asset classes identified by ASIC. ASIC acknowledges this by stating:

We consider there are four categories of OTC derivative transaction that are of immediate interest to Australian regulators and therefore should be a reportable transaction....The first two categories go primarily to mitigating systemic risk in Australia....The last two categories will also assist the goal of protecting against and identifying market abuse in Australia through transactions undertaken on OTC derivatives markets.¹

We seek clarification from ASIC on which asset classes are deemed systemically important to financial stability and which ones are of interest to minimise market abuse. It is also important for ASIC to identify the asset class that is not of immediate interest on the grounds of systemic importance or market abuse.

This clarity is important for assessing the regulatory impact of the overall trade reporting requirements. The costs and the implications for mitigating the identified risks need to be assessed against the benefits for each derivative class, and then mapped back to the overarching regime objectives. A more detailed and transparent understanding of the derivative class-objectives can help define and shape the most appropriate application and, consequentially, reporting requirements.

Implementing the regulatory framework for the G-20 reform agenda in an Australian context would require periodic review over time to ensure the reporting rules are delivering on the objectives of the reform agenda. We therefore consider it important for ASIC to define how it intends to measure success against its objectives and what ongoing review program it considers appropriate to ensure the reporting requirements are and continue to be fit for purpose.

Relevance of international experience to Australia's regime

Origin appreciates ASIC's approach is to promote consistency between the Australian reporting regime and other regimes already established internationally. This approach enables the harmonisation of Australian rules and standards to those applied in the larger economies of the United States (Dodd-Frank Act 2010) and Europe (European Union Infrastructure Regulation in 2012). It is worthwhile noting that other countries, including Japan, Hong Kong, Singapore and Canada, have previously commenced consultation on their approach and standards to meeting their obligation to the G-20 reform agenda.²

Australia has the opportunity to learn from the international experience with the implementation of the regime and impact on covered asset classes. Origin considers there is a careful balance between implementing a harmonised and internationally consistent regime and ensuring the approach taken is the most appropriate one for

¹ ASIC 2013, *Consultation Paper 205 Derivative transaction reporting*, Sydney 2013, p. 14.

² Council of Financial Regulators 2012, *OTC Derivative Market Reform Considerations*, Sydney 2012, p. 11-13.

Australia. While consistency can reduce compliance costs, it can also give rise to adverse consequences; this particularly the case where the underlying market and industry designs and structures differ between countries.

We encourage Government and ASIC to focus on the priority derivative asset classes - systemically important, followed by those with concern over market abuse - and progress reforms using appropriate urgency. For financial sectors where the differences across countries are not substantive, adopting an international reporting approach may be appropriate. However, where the underlying market structures differ - for example, energy markets - a rushed implementation is likely to give rise to unforeseen and adverse consequences.

Origin appreciates the Government's commitment to implement a broad-reaching internationally consistent reporting regime. However, we strongly encourage ASIC to take the time to understand the underlying markets for each of the five OTC derivative asset classes and potential consequences for the use of derivatives and markets prior to implementing a "one-size-fits all" type scheme. We discuss possible alternative implementation approaches below.

Alternative staged implementation approach

Origin notes that different reporting entities within Australia are in various stages of preparedness to comply with the G20 reporting requirements. Large financial intermediaries that are already captured through international regimes, require an accredited Australian scheme to allow them to meet their own reporting requirements in a cost effective manner. Given such a significant proportion of their domestic and international business involves trading systemically important OTC derivative classes - like foreign exchange and interest rate derivatives - we expect these entities have already committed significant resources to develop the systems and processes required to comply with a range of reporting requirements.

In that context, ASIC has identified a greater urgency for transparency and financial stability for systemically important OTC derivatives, like foreign exchange and interest rate OTC derivatives. For other derivative classes, there is still an outstanding question as to what problem trade reporting is aiming to solve, the size of that problem today and how reporting will address it. For example, it is unclear whether there is clear practice of market abuse in trading credit or equity or commodity OTC derivatives. As such, a more pragmatic implementation approach would be to focus on implementing and consolidating the regulatory regime for the systemically important sectors, and then once the adequacy of the regime has been assessed, turning attention to the other derivative classes.

Based on the G-20 objectives identified by ASIC, there is an outstanding question as to the capture of commodity OTC derivatives. In many cases, derivatives are used by industry participants hedging a physical position. From the evidence put forward domestically and internationally, there appears to be limited justification for covering this class of OTC derivatives early in any reporting regime, if at all as there is no clear case that they are systemically important or used to abuse the underlying markets.

We consider further assessment is required to confirm the net benefit arising from reporting commodity OTC derivatives. However, if a regime is to apply, we propose an extended transition period for all non-essential OTC derivatives, like commodities. Importantly, this would provide time to assess the reporting regime for existing OTC derivatives and to assess the appropriate application to this broader class of assets.

Deferring reporting for commodities would also allow a licensed or prescribed repository to become established in the Australian market. This would provide an opportunity for reporting entities - whose core business is not trading financial products - to know the reporting requirements prior to committing the resources to develop the systems and processes to comply with the reporting rules. This is a relevant consideration, particularly given there are no trade reporting entities currently operating in Australia.

Ensuring adequate consultation

Origin recognises the prudent progression to date of the domestic implementation of the G-20 reform agenda. The passing of the Corporations Legislation Amendment (Derivative Transactions) Bill 2012 and ensuing Senate Inquiry into the Derivative Transaction Bill has allowed for stakeholder engagement with the legislative process. This has meant, however, that Australia is not as advanced in consulting and implementing the required rules as the larger G-20 economies and others of our region. As noted above, we consider this to be advantageous where a clear and urgent need for implementation to cover specific asset classes has not been identified.

Origin agrees with the principle enunciated by the Reserve Bank that:

...[regulators] should proceed with all appropriate urgency where needed but with deliberate care wherever possible, being conscious of the limits to our knowledge as regulators and the likelihood of unintended consequences from steps we might take.³

Origin makes two observations regarding the ASIC consultation process in this context:

- the consultation period for and CP 201 and CP 205 was under four weeks; and
- the transition for reportable transactions is short being from 31 December 2013 to 30 June 2015.

For large financial intermediaries operating in offshore markets for foreign exchange or interest rate OTC derivatives, they may already be complying with the relevant reporting requirements in the relevant jurisdiction. Their focus may be to ensure harmonious requirements given they are already complying with one set of reporting requirements.

For other domestic entities not currently operating in jurisdictions with reporting regimes, four weeks is not sufficient to: (1) understand and consider the scope of reporting requirements from a practical perspective; and (2) understand and determine possible implications and consequences for underlying physical markets. In addition, these entities are unlikely to be able to commit the resources required to develop systems and resources to comply with a reporting regime until there is clarity around how the regime will work in practice. This uncertainty is compounded by there being no trade repository currently licensed in Australia.

Origin agrees with the principle for regulators to act with urgency where required but with deliberation and care when possible. However, commodity derivatives, especially energy derivatives have not been identified as being either systemically important or subject to abuse. Deferring the reporting for this derivative class would enable ASIC and industry to work together to ensure any reporting requirements capture appropriate and relevant information in a way that is meaningful and practical for the underlying

³ Glenn Stevens, *Financial Regulation: Australia in the Global Landscape*, Address to the Australian Securities and Investments Commission Annual Forum, Sydney 2012, p. 4.

commodity participants. Origin would welcome opportunities to work collaboratively with ASIC.

Conclusion

Origin appreciates the time pressures ASIC is under to establish rules to meet the Government's G20 commitment to institute trade reporting in 2013. We request, however, that ASIC consider its proposed staged implementation and reassess its approach to capture all five asset classes up front (e.g. in the first six months for large financial institutions). Allowing additional time to consider what the appropriate reporting requirements are for each asset class can deliver better regulatory outcomes for Australia in the long term, particularly with a clearer statement from ASIC as to what its specific reporting objectives are for each asset class.

Should you have any questions or wish to discuss this information further, please contact Hannah Heath (Manager, Wholesale Regulatory Policy)

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Phil Moody', with a stylized, cursive script.

Phil Moody
Group Manager - Energy Markets Regulatory Development
Energy Risk Management