ERM Power Limited
Level 3, 90 Collins Street
Melbourne VIC 3000
ABN 28 122 259 223
+61 3 9214 9333
ermpower.com.au

Friday, 19 October 2018

Dr Kerry Schott
Chair
Energy Security Board

Dear Dr Schott

RE: OTC transparency in the NEM

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Energy Security Board's (ESB) consultation paper on over-the-counter (OTC) transparency in the National Electricity Market (NEM).

About ERM Power

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load[1], with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. The Company operates 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. www.ermpower.com.au

General Comments

ERM Power is a strong supporter of deep, liquid and transparent financial markets. These features are critical to supporting competition and delivering efficient prices. Exchange-traded markets are well understood, yet OTC markets can at times appear to be opaque to many observers.

Much of the information about OTC and ASX-traded products can already be found in the wider market. Several services such as wholesale brokers publish observations of forward OTC and ASX electricity market curves to subscribers. Small market participants and even regulators are able to subscribe to these services in order to gain insights into the OTC and ASX markets. This occurs now without the need for a central trade repository.

Nonetheless, we accept that recommendations from bodies such as the Energy Security Board (ESB) and the Australian Competition and Consumer Commission (ACCC) to enhance the level of transparency in over-the-counter (OTC) electricity markets indicates that there is a perceived problem. ERM Power understands the desire to rectify this situation. Indeed, we provided cautious and qualified support to such a proposal in our submission to the ESB detailed design of the National Energy Guarantee arguing that it could support greater levels of transparency in the market subject to the specific nature of the design of such a repository, the associated costs and the obligations it would impose on market participants.

1 Based on ERM Power analysis of latest published financial information.

ERM Power considers that a trade repository can be implemented quickly, and the benefits realised through a low-risk, low-cost and pragmatic approach based on the Australian Financial Markets Association's (AFMA) recently reinstated electricity market survey.

In summary, we believe that electricity market participants should report the same aggregated data to the Australian Energy Regulator (AER) as they do as part of the AFMA survey, but on a quarterly basis. This will provide market bodies and regulators with a greater degree of transparency of OTC contract markets. At a far lower cost and lower risk than developing a new trade repository from scratch.

This approach should be given at least two years to operate initially, at which point the repository's performance can be tested to determine if there are data gaps and whether more complex, detailed arrangements would bring benefits.

The submission that follows provides ERM Power's responses to the questions set out in the consultation paper. Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

Ben Pryor
Regulatory Affairs Policy Adviser
03 9214 9316 - bpryor@ermpower.com.au

What costs and/or other risks need to be considered in the establishment of a new, industry-specific trade repository? How would these compare with leveraging an existing, generic trade repository? How might costs best be managed?

Are there any timing issues with establishment of a new, industry-specific trade repository? If so, what transitional arrangements could be put in place to deliver targeted benefits in as timely a manner as possible?

ERM Power believes that the costs and time associated with developing a specific trade repository for the electricity market, alongside the risks of revealing commercial-in-confidence data need to be weighed against the desire to increase transparency in the contract market.

As mentioned already, we believe that leveraging the newly-restarted AFMA survey of OTC electricity derivative trading provides a low-cost and timely way to increase the transparency of OTC markets in a fit-for-purpose manner. Given the likely low costs, this could be funded out of the Australian Energy Regulator's existing budget.

Is the AER the most appropriate body to perform the role of administrator of the Trade Repository?

Are there any specific issues or concerns with the AEMC and AEMO being provided access to information reported to a Trade Repository? If so, what limitations should be placed on their use and dissemination of data?

ERM Power agrees that the Australian Energy Regulator (AER) is the appropriate body to oversee and administer a trade repository. The AER has extensive experience handling confidential data. This will be crucial given the kind of information that may be relayed through the trade repository. The AER should be able to collect data and have the right to audit this data.

We have concerns with the potential for detailed information provided to a trade repository being shared with the AEMC and AEMO. Our understanding is that the AEMC and AEMO do not have the same level of obligations in dealing with confidential market data as the AER does. As we outline later on, there is a distinct risk that certain trades could be back-solved to determine the parties involved and this would reveal confidential commercial data. We are therefore not convinced that there are benefits in providing granular data to AEMO and the AEMC; it is unclear what problem this would solve.

We do accept that there is a case to make aggregated data available to these bodies, as well as the Australian Securities and Investment Commission (ASIC) in order to provide them with data to enhance their understanding of dynamics in the market.

What level of disclosure of OTC-traded products is appropriate? What information would be most useful to market participants, regulators and policy makers?

To what extent will the level of disclosure impact on the choice of trade repository (i.e. new, industry-specific versus leveraging existing trade repositories, on a transitional basis or otherwise)?

How frequently should the information be updated and publicly reported?

Does AFMA restarting its voluntary survey of OTC electricity derivative trading have any implications for the need for a trade repository? If so what are the implications?

To what extent, if any, would trade-to-trade reporting and publication compromise confidentiality of OTC transactions? How could any risks be mitigated?

ERM Power considers that aggregated data, equivalent to that reported in the AFMA survey but reported on a quarterly basis, is sufficient to provide the kind of data that would be useful to the market and regulators about the OTC market.

ERM Power does not believe that a trade-by-trade repository is warranted at this stage. There is no evidence that trade-by-trade reporting would reduce risks to the wider market or bring a useful degree of transparency. Individual trade reporting would create a large imposition on market participants in terms of cost and the risk of exposing their contract positions to other market participants. Furthermore, bespoke trades can be complicated and nuanced and therefore do not necessarily provide the kind of replicable data that is useful to determine what the underlying trends in the market are. In fact, we believe there are significant risks that come with trade by trade reporting which we detail below.

The National Electricity Market (NEM) has a relatively small number of participants, most of whom have very sophisticated analytical capabilities. It is highly likely that the more granular the data available, the more likely it is for trades to be back-solved to identify the buyers and sellers. This is extremely likely when there is a change of ownership or a new generation facility opens, and in certain smaller NEM regions where only one or two participants are capable of making some volumes of trade available.

Furthermore, new generators may seek to sign a limited number of 'foundational' contracts with counterparties in order to shore up financing of a project. These kinds of trades are not indicative of the wider market. If these were reported it could distort impressions of what is occurring in the OTC market. As discussed above, it may also be possible to back-solve these trades to determine who has made the trades, thereby exposing commercial-in-confidence data.

The fact that AFMA has restarted its annual electricity market survey makes a compelling case that an additional process to establish a trade repository is not needed. Though, ERM Power accepts the wider perception among regulators and market bodes that there is a lack of transparency in OTC markets. For this reason, we believe that an enhancement to AFMA's survey can be used as a model for a low-cost and fit-for-purpose trade repository. We consider that a quarterly, auditable version of the AFMA survey reported to the AER will provide a sufficient level of data to enhance regulators' understanding of OTC contract markets.

If recommendation 6 were implemented should it occur through changes to the NEL? If it was implemented using the NEL, how could it be designed to minimise the volume of non-reported trades?

Could obligations and reporting arrangements established for an industry-specific trade repository be streamlined with other regulatory processes?

Alternatively, are there specific approaches which could be adopted to minimise the compliance burden on market participants? For example, should trading intermediaries be allowed to report on behalf of liable entities?

As AFMA's existing survey is voluntary, it does not cover the whole market. Currently, there are some market participants who do participate. There is also the risk that existing participants may choose to drop out in the future. Consequently, some degree of change to the National Electricity Law (NEL) or National Electricity Rules (NER) would be needed to compel market participants to provide this information.

We recognise that if market participants alone were required to participate then this would not capture the entire market; some market intermediaries would not be covered by AER's reach. However, we believe that voluntary participation should be encouraged and that in the interests of a well-functioning and ongoing liquid market, as well as consideration of social licence, voluntary disclosure of trades from those participants is likely to arise.