

Dr Kerry Schott AO
Independent Chair
COAG Energy Council
Energy Security Board

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Submitted via email: info@esb.org.au

Dear Dr Schott

ENERGY SECURITY BOARD – OTC TRANSPARENCY IN THE NEM – CONSULTATION PAPER

Origin Energy Limited (Origin) welcomes the opportunity to comment on the ESB's consultation paper for over-the-counter (OTC) transparency in the NEM. Overall Origin supports greater transparency in the market that will enable the most efficient hedging outcomes to be achieved for each participant. Our submission highlights that there may be implementation issues with the proposals presented and that these issues, and any subsequent information requirement on participants, should be developed in close consultation with industry.

Purpose of the OTC Reforms

In deciding whether to introduce mandatory trade reporting on OTC electricity derivatives, the ESB should examine the intended purpose of the proposed reform. One of the main underlying assertions is that a lack of transparency in the OTC market inhibits price discovery which could serve as a barrier to entry, particularly for smaller participants. However, as discussed below, this reasoning is unlikely to hold true in practice, which calls into question the purpose and likely effectiveness of the proposed measure.

Mandatory trade reporting of OTC contracts is limited as a means of providing price discovery.

OTC contracts are made up of both bespoke and standardised products. A participant's portfolio has varying levels of bespoke and standardised products which they use to cover their loads in the NEM. Bespoke OTC products are difficult to compare because they are tailored for the specific portfolio requirements of their respective counterparties.

When entering a bespoke OTC contract each party assesses the value of the contract, the risk levels they are willing to tolerate and the price premiums for the product. Bespoke products will differ in size and duration and prices can vary substantially because the value that a retailer places onto an OTC contract is dictated by their level of risk to maintain their portfolio. Thus, bespoke products will likely be of limited usefulness as a means of price discovery to the market. For example, two counterparties may enter a unit outage product which allows coverage for a short period with the terms of the contract only allowing an exchange of MW if the unit has a forced outage. Attempting to draw meaningful conclusions, by comparing pricing outcomes against other OTC contracts or even ASX futures contracts is impractical and not particularly useful.

An additional argument put forth is that it allows smaller retailers to view generalised OTC price trends and this may affect the negotiated prices they are able to achieve when entering into OTC contracts. As a result, any overall price trend that would be published cannot be directly transferrable to all deals in the NEM as some OTC contracts are not standardised trades and differing credit and guarantee requirements will dictate differing pricing outcomes.

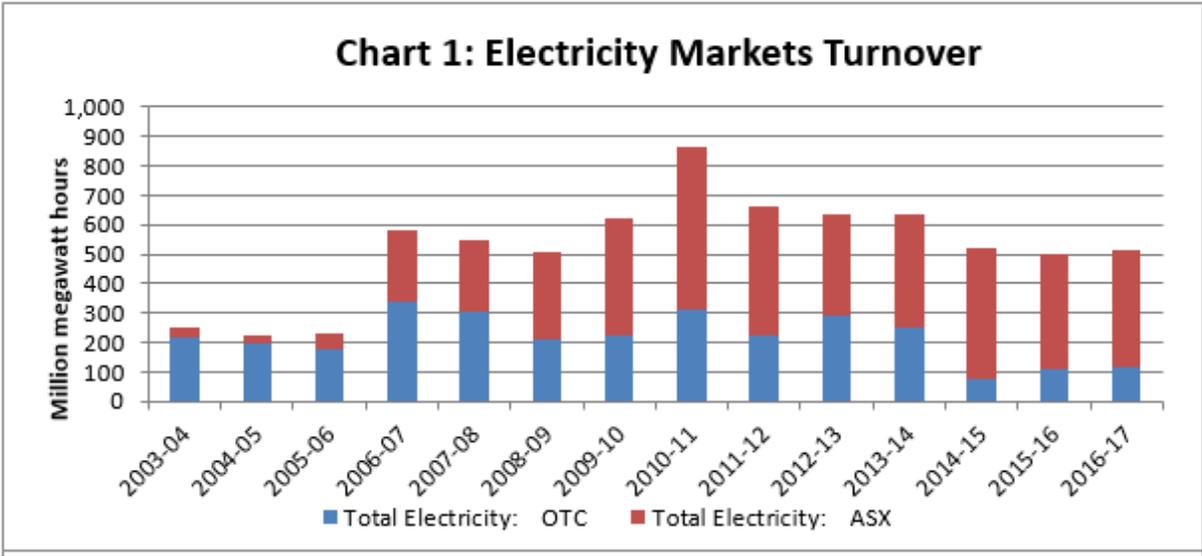
Visibility of the OTC market can help provide a clearer view of market liquidity.

Origin agrees that visibility of the OTC market will provide a more complete view of contract market liquidity. Both the ACCC report into Retail Electricity Pricing Inquiry and the AEMC Retail Energy

Competition Review expressed concerns about the lack of visibility in the OTC market. Those reviews discussed the lack of information available in the market, in particular the cancellation of the AFMA survey.

Recently the AFMA survey was voluntarily restarted by industry after a two-year absence and the 13 largest NEM participants who responded to the survey provided additional figures to cover the years where the survey did not take place. Generally, the AFMA survey covers standardised OTC products such as swaps, caps, swaptions and collars. Some of these products are directly comparable to ASX futures markets as they can cover a similar timeframe and conditions of a contract. For example, two parties may enter a 20MW swap deal for a calendar year.

These standardised products, as opposed to the bespoke products mentioned above, can be compared against ASX futures because they have the same conditions and the AFMA survey provides historical comparisons as shown in Chart 1 below¹.



Origin believes that the AFMA survey provides a view of liquidity in the OTC market which can go some way toward satisfying liquidity concerns around OTC trading in the NEM. In our view this can be used to form the basis of an OTC reporting requirement.

Any potential reporting requirement should be low cost and un-intrusive.

Origin recognises that the issues paper seeks input into a preferred solution for an OTC repository. Thus, if a reporting framework were to be put in place Origin prefers an approach that balances the benefits of greater transparency and the cost of compliance for obligated parties. It is important to note that the ACCC, through its new responsibility for monitoring the wholesale market, will have visibility of contracting information which can help further inform a view on market liquidity. This information should be utilised by the AER to minimise duplication of reporting requirements on participants and form a more comprehensive view of OTC liquidity in the NEM.

If a formalised reporting requirement is still deemed necessary, Origin believes the scheme should incorporate the following features.

- The current AFMA survey should be used as the starting point. The survey provides information on standardised OTC products and aggregates the trades at a regional level. We note that prior to its discontinuation, the AFMA survey was useful in providing visibility of OTC

¹ AFMA Electricity Derivative Turnover Report 2017
<https://afma.com.au/data/electricity/2017%20Electricity%20Derivative%20Turnover%20Survey.xlsx>

activity and contract market liquidity overall, as evidenced by its use in many market reports including those produced by regulatory bodies such as the AER.

- The survey, and its variables, should be used a basis for the information gathering framework. If additional variables are required, these should be developed in consultation with industry and only added where they benefit participants and meet the objective of the OTC reporting regime.
- The survey could be undertaken at 6-month intervals which will align with the ACCC reporting requirements.
- To ESB could explore options to ensure additional rigor, such as a requirement for retailers to participate in the survey.
- Confidentiality of information must be maintained and protections afforded to participants when providing data.

Unintended Consequences of OTC Disclosure in Reports

Retailers look to manage their portfolio in the most cost effective and efficient way possible using derivatives (ASX futures/OTC) and/or physical generation assets. If OTC reporting becomes mandatory and anonymity is not assured, there is a risk that participants move towards products where anonymity is assured (such as the ASX futures market) even where this does not necessarily align with their optimal contracting strategy. Participants may elect to purchase a more expensive product to maintain their competitive position. This represents an overall inefficient outcome.

As stated above, many OTC contracts are bespoke in nature and thus are hard to standardise. Without knowing and understanding the confidential contractual obligations underlying the contract there is a real risk that contracts are misrepresented when de-identified and aggregated. This could potentially misinform the market as to actual levels of liquidity that are available in the OTC market.

Dissemination of Information

In our view the sharing of OTC trade information with the AEMC and AEMO is not necessary given it is not needed in carrying out their respective functions. It also increases the risk of commercially confidential information being compromised.

The ESB's reasons for allowing these organisations to have access to this information is to better inform NEM decision making. The AEMC could request information relevant to particular rule changes on an as needs basis.

Origin does not believe that AEMO's access to OTC trade information will enable them to better carry out their role as market operator.

Should you have any questions or wish to discuss this information further, please contact James Googan in the first instance via email james.googan@originenergy.com.au or phone, on (07) 3512 4138.

Yours sincerely,



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