OTC TRANSPARENCY IN THE NEM

Response to ESB consultation paper

October 2018

stanwell

1. Executive summary

Thank you for the opportunity to provide feedback on the OTC Transparency in the NEM Consultation Paper (Consultation Paper).

This submission contains the views of Stanwell in relation to OTC Transparency and should not be construed as being indicative of Queensland Government Policy.

Stanwell does not support the introduction of an obligation to report over-the-counter (**OTC**) trades in a trade repository.

Market participants considering hedging their exposure to wholesale electricity price risk are able to weigh the features of OTC trades (ie the ability to enter into bespoke arrangements) against the features of centrally cleared trades (ie pricing transparency but standardised products and conditions) and develop their trade book accordingly (including entering into both types of trades).

Stanwell considers that the features of these products are well understood by electricity market participants and are relevant to whether trades from different data sets can or should be compared. As standardised, centrally cleared trades comprise the majority of electricity derivatives and are already transparently reported, Stanwell considers that the addition of non-standard, non-cleared trade data may not achieve the intended outcome.

Stanwell welcomes the opportunity to further discuss this submission. Please contact Jennifer Tarr on (07) 3228 4546.

2. Market making requirement means costs will not overcome proposed benefits

In the Final Detailed Design of the National Energy Guarantee (**NEG**), the Energy Security Board (**ESB**) considered that with the Market Liquidity Obligation in place, the costs of establishing a trade repository were not warranted to satisfy the objectives of the NEG.

Similarly, Stanwell submits that with the market making obligations in place as proposed in the ESB's Market Making Requirements in the NEM Consultation Paper, the costs of establishing a trade repository are not warranted to overcome the alleged transparency issues that may otherwise support its introduction. Stanwell supports the introduction of a market liquidity obligation, as set out in our response to the Market Making Requirements in the NEM Consultation Paper.

3. Data is already largely available

Stanwell notes that a large portion of the data that an OTC trade repository would record and publish is already available through avenues such as the Australian Financial Markets Report (published by the Australian Financial Markets Association) and broker subscriptions. Centrally cleared trades available through the ASX also provide a significant source of information to participants.

Stanwell submits that introducing an obligation to report OTC trades would therefore result in ongoing compliance costs to trading parties in exchange for comparatively few, ill-defined benefits.

4. Published data could be misleading if it does not capture unique elements

A trade repository is only as useful as the data that it collects and reports.

Data that is published by a trade repository could be misleading to parties viewing the data if unique elements of the OTC contract are not also reported into, and published by, the repository. This would be impractical given the complexity of OTC contracting in the NEM.

For instance, Stanwell considers that the OTC contract data published in the "Hedge Disclosure" system maintained by NZX Limited and the NZ Electricity Authority (see https://www.electricitycontract.co.nz) is not particularly useful because the information it contains is generic (and is ill-suited to reporting bespoke OTC trades).

For example, although the system indicates whether a reported contract includes a force majeure clause, it does not allow users to determine the agreed force majeure liability position, in order to determine standard market practice (which is often a benchmark for commercial negotiations of OTC contracts). It also gives no indication of the special terms and conditions of load following hedges including customer number caps, load shapes etc.

Further, any data that is reported could result in commercially adverse behaviour if the identity of the parties to the reported trade were able to be identified (eg if load-following hedge positions were able to be identified by vertically integrated retailers, who could approach the targeted retail customers with a better price, thereby undermining a new entrant's competitive position).

Stanwell submits that neither of these outcomes (presenting misleading information or reporting confidential information leading to commercially adverse behaviour) would be in the best interests of market participants or consumers.

5. Costs of a trade repository will increase costs to consumers

Trade repositories add costs which must be considered against their benefits. The usual fee structure is an administration fee plus an ongoing fee based on the size of the open position. Data in the trade repository must be updated daily to account for the mark-to-market position of every open transaction (plus the entry of new trades).

Market participants will need to introduce or augment both their electronic and manual systems and processes to:

- capture the characteristics of OTC trades that must be reported to the trade repository;
- verify this data and transfer it to the trade repository on a daily basis; and
- access and analyse the data published by the trade repository for use in the business.

The lead times (and costs) required to implement these changes can be significant.

Please see the further confidential submissions in Attachment A on this issue.

Stanwell submits that all of the above costs will ultimately be borne by consumers for comparatively few, ill-defined benefits.

6. If a trade repository is introduced despite Stanwell's submission above

Despite Stanwell's submissions above, if the ESB proceeds considering introducing a trade repository, then please see Attachment B in relation to implementation issues.

Appendix A – Confidential – Costs to implement trade repository - submitted separately

Appendix B – Implementation issues

Stanwell submissions on the design of a trade repository

This Attachment B sets out Stanwell's submissions if, despite Stanwell's other submissions, the ESB proceeds with considering introducing a trade repository.

Alignment with ASIC trade repositories should be sought

If a trade repository were introduced, Stanwell would prefer that it be designed so that participants are able to meet the requirements of the scheme by participating in existing ASIC-licenced trade repositories for green, foreign exchange and oil market exposures. This would reduce implementation costs.

Stanwell would prefer the trade repository to be overseen by ASIC (given its significant prior experience in overseeing trade repository requirements) and would not support it being administered by the AER (which does not have that experience).

Access to underlying contract information

If a trade repository were introduced, Stanwell would prefer that access to the underlying contract information be limited to ASIC (as overseer) and the AER.

In particular, Stanwell does not see a compelling reason for the AEMC to be provided with access to underlying contract information as the hedging market has been designed to be separate to the wholesale electricity market created under the National Electricity Rules. The AEMC would have access to the reported data like any other user of the repository.

Stanwell also does not see a compelling reason for AEMO to be provided with access to underlying contract information given that financial contracts such as OTC contracts do not typically affect AEMO's management of the national grid or spot market. Where a financial contract imposes obligations to maximise or minimise generation, that is translated into bid and outage information provided to AEMO during the dispatch and PASA processes respectively.

Further, Stanwell submits that the AER should only be able to use the underlying contract information for the purposes of assessing and enforcing compliance with the trade repository obligations, but not for any other purpose related to the AER's functions or powers. This broader use would be inconsistent with the purposes for which the underlying contract information was provided to the trade repository and to which the AER was given access (and opens the door to potential regulatory overreach by the AER with the effectively unlimited use of that information).

Aggregated Standardised Trade Reporting should be preferred

If a trade repository were introduced, Stanwell would prefer that the AER provide reporting of aggregated summary positions for standardised products at set intervals, rather than individual contract trade reporting.

This approach would minimise the likelihood that the identities of the parties to the trade are able to be determined by the reported characteristics of their trade (including any bespoke characteristics).

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