



16 August 2019

Russell Pendlebury
Australian Energy Markets Commission
PO Box A2449
Sydney South NSW 1235
(lodged online at www.aemc.gov.au)

Dear Russell,

Market making arrangements in the NEM – draft determination

The Australian Financial Markets Association (AFMA) welcomes the opportunity to provide comment on the Market making arrangements in the NEM – draft determination.

AFMA is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets. AFMA represents the common interests of its members in dealing with issues relevant to the good reputation and efficiency and competitiveness of wholesale banking and financial markets in Australia. AFMA has more than 120 members reflecting the broad range of participants in financial markets, including Australian and international banks, leading brokers, securities companies, fund managers, energy companies and industry service providers.

AFMA is supportive of the AEMC's draft determination not to make a draft rule to introduce additional market making schemes in the national electricity market. We agree that the initiatives that are currently underway, such as the ASX's voluntary market making scheme and the market liquidity obligation (MLO) should serve the objective of increasing market liquidity in electricity derivatives.

We note also that the Commission is looking to work with relevant market bodies (including AFMA) to firstly, improve the transparency of the over-the-counter (OTC) market, and secondly, enhance the AER's powers to monitor market liquidity.

As noted in the draft determination, the ACCC's Retail Electricity Pricing Inquiry report recommended the establishment of an OTC trade repository, whereas the ESB, after consultation with industry in 2018, considers that the preferable path is for the AEMC, AER and AFMA to work with market participants to improve the transparency of the OTC market. We agree that this is the preferable path.

Australian Financial Markets Association

ABN 69 793 968 987

Level 25, Angel Place, 123 Pitt Street GPO Box 3655 Sydney NSW 2001

Tel: +612 9776 7907 Email: secretariat@afma.com.au Web: www.afma.com.au

AFMA has long supported market transparency in the electricity OTC markets. Since 2001, AFMA has delivered annual aggregated turnover information on electricity derivatives via what is currently known as the AFMA Electricity Derivative Turnover Report. Data is compiled from a survey of the principal participants in the OTC electricity derivatives market and ASX Limited. This data is publicly available on our website and is current up until the 2017-2018 financial year. AFMA is committed to ensuring that this data is updated in a timely fashion, and we will be producing 2018-2019 by the end of this quarter. In addition, from 2001 to 2014, AFMA provided regular price information on standard OTC electricity derivatives.

The AEMC notes that they consider there are “material” information gaps in the contract market which have the following two effects:

- 1) Undermine price discovery for participants
- 2) Undermine the assessment of market conduct and performance by regulators

Whilst some of our members might question that the information gaps are indeed “material”, AFMA and our members are nevertheless keen to work with the AEMC on solutions to these two issues.

Price discovery for market participants

As noted above, AFMA previously provided price information on electricity derivatives (on a subscription based basis) until December 2014, when it was discontinued following a review of the utility of the data available at that time. AFMA no longer provides price data services on financial market products and does not intend to do so in the foreseeable future. This is because there are now significant regulatory and compliance issues associated with collating reference rate data, which requires specialist organisational capacity to provide. Consequently, the current AFMA turnover survey could not be extended to include price data.

However having said that, AFMA and its members would be keen to work with the AEMC and AER as suggested to explore alternative solutions to improve price transparency in the market. In this regard, a number of issues would need to be addressed in order to come up with a satisfactory solution.

Firstly, we would need to determine exactly the breadth of products to be covered and what information would be needed to assist with price discovery, as well as the source of the information. For standardised products (like swaps and caps) traded via a market broker, price information would likely be more accessible and the information provided would be easy for recipients to understand. However, more bespoke and specialised derivative products, which contain specific terms and conditions (for example weather derivatives and load following hedges), by their nature do not contribute useful content to the broader market price formation process; indeed, the price information could be meaningless, or worse, misleading to the recipient in some circumstances. Also, transactions in non-standard products are more likely to be traded directly between market participants, rather than through a broker, and hence price information on these transactions would be less accessible and more likely to contain commercially sensitive information.

Secondly, a company willing to act as a data provider for the price information would need to be found. There are a number of specialist data providers in the market who may be willing to provide such a service. Costs of the service would be dependent on such issues as establishment costs, frequency of information provided, and the depth of products covered, as well as regulatory compliance.

Assessment of market conduct and performance by regulators

Coverage of products

The draft determination suggests that the AFMA survey could be enhanced by the inclusion of further information on non-standard hedging instruments. The AEMC notes that the non-inclusion of these products in the AFMA survey means that the AFMA data understates the actual level of OTC contracting, as it does not include data on PPAs, demand response, weather derivatives or secondary SRA trading. On page 23 of the draft determination, the AEMC notes that “no data is available on the relative importance of these products as part of participants’ overall risk management.”

AFMA’s current survey attempts to capture all electricity derivative trading that can be measured in terms of megawatt hours. Many non-traditional hedging products, such as the ones described above, may not be measurable in simple megawatt hours, and hence to date have not been part of the accumulated data. Consequently, capturing and aggregating meaningful data on these non-traditional products is a more complex exercise.

In 2018, AFMA made enhancements to the survey to provide qualitative information on the types of non-traditional products being used, but we agree more can be done in this regard. We would be keen to work with the AEMC and AER as suggested to work on solutions to enhance the survey further to provide more information on these hedging products, notwithstanding the known issues of aggregating information on products that cannot be measured in simple megawatt hour terms.

Coverage of participants

The AEMC notes that there are currently fourteen participants in the AFMA turnover survey, but also notes that they represent the majority of market generation. There is an implied suggestion in this statement that total OTC turnover is understated due to the number of participants.

AFMA survey participants are the primary financial market participants in the OTC market. Participants report turnover done with other survey participants, as well as turnover transacted with non-survey-participants. To the extent that the survey participant is a counterparty to a transaction, it is captured by the survey. Only transactions between a non-survey-participant and a non-survey-participant are not captured. Given that the major financial market participants are all included in the survey and the nature of member feedback we have received, we believe that we are capturing a very significant proportion of the OTC market, however this is difficult to definitively prove or disprove.

AFMA would welcome suggestions from the AEMC and the AER on how to add more participants to the survey, but we note that almost all relevant AFMA members are already contributing, and that the AFMA survey is currently a voluntary process.

As with the price discovery solution, AFMA would be happy to look at a solution which could involve an alternative data administrator if necessary.

Timeliness

The AEMC notes that the AFMA turnover survey is conducted annually and released some months after the end of the financial year, limiting its usefulness. The AEMC also notes that at least monthly data would be necessary if the data is useful for price discovery.

AFMA agrees that for price discovery, more regular data would be useful. We have suggested that the solution for price discovery should be separately addressed outside of the AFMA turnover survey, and that this solution should be mindful of the need for regular price information.

However, we are not certain of the benefit of more regular turnover data, as this does not aid in the price discovery objective. Any change in the regularity of the AFMA data turnover survey would need careful consideration of the costs and burden placed on AFMA and its members.

Implementation and effectiveness

AFMA agrees with the AEMC and ESB that the effectiveness of any agreed solution should be reviewed after a suitable period. It will be important to determine at the outset clear objectives that are intended to be addressed by the solution(s), as well as metrics for the purpose of reviewing outcomes versus objectives.

AFMA notes that the AEMC is keen to agree some threshold issues in the near term. Such issues include whether the key dimensions of pricing data, coverage and timeliness can be addressed by improvements to the AFMA survey, or any other alternative solutions agreed. AFMA is in agreement with that approach, and the timetable of end 2019 for these threshold decisions to be made.

We recommend that representatives of AFMA, its members, and the AEMC and AER have a meeting in the near future in order to agree these threshold issues, and work collaboratively together towards a solution that benefits all parties.

Yours sincerely



Mike Chadwick
Head of Education and Director - Markets