Energy Retailers Association of Australia
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19 December 2013

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Sir/Madam,

RE: NEM Financial Market Resilience Stage Two Options Paper

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide feedback in response to the Australian Energy Market Commission's (AEMC) *NEM Financial Market Resilience Stage Two Options Paper* (the Stage Two Options Paper). This input compliments the ERAA's previous submission to the *NEM Financial Market Resilience Options Paper*.

The ERAA represents the organisations providing electricity and gas to almost 10 million Australian households and businesses. Our member organisations are mostly privately owned, vary in size and operate in all areas within the National Electricity Market (NEM) and are the first point of contact for end use customers of both electricity and gas. ERAA members AGL Energy, Alinta Energy, EnergyAustralia and Origin Energy are represented on the AEMC's industry working group.

The ERAA welcomes the analysis provided by the AEMC in the Stage Two Options Paper. A resilient financial framework is necessary to ensure the financial relationships that underpin the NEM are efficient and robust.

Market participants currently utilise sophisticated strategies to manage their risk in a variety of ways. Over the Counter (OTC) markets provide an efficient and low cost method for market participants to manage risk. These activities are already highly regulated, with the Australian Securities and Investments Commission (ASIC) afforded the powers to monitor and investigate any concerns with electricity financial market participants. As noted in the Stage Two Options Paper, these hedges are based on physical commodities, meaning they have a lower associated risk than strategies employed for speculation in other financial markets. Regardless of risks in the OTC market, the physical market for electricity will continue to flow and retail customers will continue to be served.

The ERAA welcomes the AEMC's decision to:

> "only recommend the implementation of any of the measures and options discussed in this paper if we consider that:
>
> - the existing market and regulatory risk management mechanisms are inadequate or could be enhanced, strengthened or supplemented;
> - a deficiency has been identified that results in material risk of contagion; and
> - implementation of the measure would be likely to promote efficient investment in, and efficient operation of electricity services for the long term interests of consumers of electricity."[1]

[1] AEMC (2013), *NEM Financial Market Resilience Stage Two Options Paper*, p.44

The ERAA supports this approach, as the cost of unnecessary regulations can be high. In the case of the market for OTC electricity derivative markets, there is no case for new obligations or restrictions. The existing market and regulatory frameworks are robust and suitably transparent, and risk management practices have shown to be adequate. The ERAA does not believe that consumers would benefit from new regulations to address systemic financial risk in the NEM. Further regulation of OTC electricity derivative contracts in the ways suggested may result in reduced use of this market, decreasing liquidity and thus increasing costs. Structured OTCs are important for new entrant retailers, and these costs will increase barriers to entry and stifle competition. The ERAA believes that Option 1 will best serve the long term interests of consumers in the NEM, meaning we do not support Options 2 - 6.

In regards to stress testing (Options 3 and 6), this approach may seem desirable on first glance, although it will actually create significant risk for both the industry and the relevant regulator. Achieving consensus on credible stress test scenarios is likely to be particularly challenging. Of greater concern is the implication that a regulator will be in a better position to judge the effectiveness of complementary risk measures developed by professional risk experts in the businesses, which would seem improbable. The ERAA would also strongly oppose the introduction of additional margin requirements (Option 5). Any such mandated increases to capital requirements would be inefficient and poorly targeted.

Should you wish to discuss the details of this submission, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely,

Cameron O'Reilly
CEO
Energy Retailers Association of Australia

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