AFMA

23 May 2019

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

Dear Prabpreet

National Electricity Amendment (Short Term Forward Market) Rule 2019

The Australian Financial Markets Association (AFMA) welcomes the opportunity to provide comment on the National Electricity Amendment (Short Term Forward Market) Rule 2019 (the 'consultation paper').

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 financial markets in Australia. AFMA has more than 120 members reflecting the broad range of participants in financial markets including traders, brokers, investors and market infrastructure providers.

AFMA's focus is on the efficiency and competitiveness of electricity financial markets. AFMA looks to support initiatives designed to foster deep, liquid and efficient financial markets. Hence, AFMA welcomes the consultation paper and the discussion of options to improve risk management and price transparency.

In the last quarter of 2018, AEMO undertook a consultation process which included conversations with AFMA members about the short term forward market (STFM) proposal. AFMA has subsequently facilitated member discussions about this proposal over the ensuing months and member firms have provided further feedback to AFMA in the last week. On the basis of these discussions and feedback, we believe that the majority of AFMA's energy market members are yet to be convinced that the benefits of an AEMO operated short term forward market as proposed would be outweighed by the costs that would necessarily need to be incurred.

The primary benefit suggested in the consultation paper is that the introduction of the STFM is expected to give certain participants (wind and other intermittent generators, gas powered generators and demand side response) more options to manage price risk. Whilst this could be true, a majority of our members have questioned the quantum of this benefit, and noted that the benefit needs to be weighed against the cost of implementation.

A large majority of management of electricity market risk is undertaken via longer-term ASX and over the counter (OTC) contracts, usually for quarterly or annual terms. This appears sufficient to satisfy the majority of our members' risk management needs. Our Electricity Markets Committee, whose members consist of the larger electricity derivative market participants, meets on a quarterly basis to discuss the effective functioning of electricity financial markets, and they have shown little interest in the development of a short term market in recent years.

Whilst we understand that there are some bespoke short-term hedge products available in the market (such as daily call options and swing options), our members have indicated that these contracts do not trade in significant quantities relative to the long-term products. In addition, as the AEMC notes in the consultation paper, the ASX has the ability to offer short term electricity derivatives, but is yet to do so, also indicating limited interest amongst market participants.

We also note that the implementation of the Retailer Reliability Obligation will force retailers to undertake additional hedging for longer terms, and this would likely lessen their short-term hedging requirements. These issues raise the important question of whether an AEMO operated STFM would generate enough interest and liquidity to be sufficiently viable or not.

We note that if the STFM were operated by the AEMO, there would be costs associated with the establishment and operation of a short-term forward market, and these would need to be shared by market participants. In addition, although we understand that this would be a voluntary market, in order to participate an energy market participant would incur additional system and other costs over and above the AEMO costs. A number of members have noted that it would be more appropriate for a short-term forward market, if necessary, should be operated by a derivatives exchange operator, such as the ASX or FEX, rather than the AEMO.

Given that the majority of our energy market members are questioning the liquidity benefits in the establishment of an AEMO-run STFM, but noting sufficient costs in its establishment and operation, our view is that AFMA is not convinced at present that the costs of this initiative are outweighed by the potential benefits suggested in the consultation paper. We expect that a number of AFMA members will be making their own submissions which support this viewpoint.

Thanks again for the opportunity to provide comment on this consultation paper, and we welcome any further opportunity for the AEMC to consult directly with our members in the future.

Yours sincerely

Mike Chadwick
Head of Education and Director - Markets