



15 February 2012

Mr Percy Bell
Manager, Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email – financialmarkets@treasury.gov.au

Dear Mr Bell,

Implementation of Australia's G-20 over-the-counter derivatives commitments

Alinta Energy welcomes the opportunity to make a submission in response to the *Implementation of Australia's G-20 over-the-counter derivatives commitments* proposals paper, released by Treasury in December 2012.

Alinta Energy is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta Energy has over 2500MW of generation facilities in Australia (and New Zealand), with retail energy customers in Western Australia, Queensland, New South Wales, South Australia and Victoria.

Entities within the Alinta Energy corporate structure hold an Australian Financial Services License and are active participants in Australian electricity derivatives markets trading over-the-counter and Australian Stock Exchange electricity products. Alinta Energy has some exposure to non-energy related derivative markets.

The purpose of this submission is to outline Alinta Energy's perspective on the implementation proposal.

In broad terms, Alinta Energy remains concerned with the direction of these reforms and unconvinced that any proposal that leads to increased costs on business would provide commensurate value to end users and customers, generally and for energy specifically. As such a phase in of trade reporting, in relation to the noted classes, is an acceptable threshold from which calls for further regulation should be resisted.

Use of trade reporting

As an end user of non-energy derivatives, Alinta Energy is concerned by increased reporting obligations and the potential financial imposts that would result if any of the more heavy handed proposals that have been aired in recent times were to be advanced.

Like many energy sector entities, Alinta Energy is exposed to currency and interest rate risk. For example, given the purchase costs and servicing obligations associated with specialised generation and mining equipment sourced from foreign based entities. As a general rule the bulk of generation equipment providers and maintenance contractors are not based in Australia.

Alinta Energy appreciates the rationale behind trade reporting but remains doubtful this information, especially as it pertains to end user corporate entities, will be of significant value. Nevertheless, given the proposed timeframe of late 2014 and the high propensity to use vanilla products for these classes of derivatives, trade reporting is an appropriate threshold at which costs are unlikely to be as significant as to distort purchasing and risk management incentives.

If trade reporting were to be extended beyond the noted classes this cost-benefit threshold is likely to be breached. Alinta Energy's expects there will be notable costs associated with centralised trade reporting if the proposed reporting derivatives framework is fully implemented across all classes including energy. The costs will have to be recouped and hence any decreased risk needs to be justified against increased costs.

Further, Alinta Energy notes that in markets where reporting has developed in the absence of the current legislation, that costs are likely to be less significant. In this regard, forcing reporting in the absence of industry support would be less than ideal.

Implementation timetable and potential extension to energy

As implied above, Alinta Energy believes the proposed approach for non-energy derivatives is acceptable, including the phasing in of obligations for end user corporate entities from late 2014.

In relation to the energy sector, the current review process has illustrated that financial relationships and markets are robust. Hence, given the low probability of financial contagion, the underlying physical nature of the market, and the highly developed energy risk practices of individual businesses, there is little justification in mandating trade reporting.

On this basis, and given the absence of evidence of systemic failure, there is little justification or basis for regulators to agitate or openly canvas further regulation. This is particularly the case given the Australian Energy Market Commission review processes underway.

It is important to fully appreciate the benefits of the existing arrangements for the energy sector and consumers. These issues should be drawn out and assessed in detail prior to the recommendation of any imprudent regulatory proposals.

For example, the underlying value of bespoke over-the-counter derivatives is the flexibility they provide counter-parties across the supply chain and large end users. This is both in regions with high liquidity and those without.

Additionally, there is little commercial enticement for the energy sector to move away from bespoke bilateral agreements as they are specifically tailored towards participants' individual risk exposures. Hence, a move away from these products as a consequence of increased regulation may increase not decrease risk.

Further, the energy sector uses letters of credit or parent guarantees in credit support risk management as a means of reducing cost where it is risk appropriate. The use of cash as collateral is not required between established counterparties with good credit and any new collateral obligations would significantly raise the cost of trade. However, it should be noted the amount of collateral and the use of cash does vary depending upon the creditworthiness of the parties and other relevant factors.

Alinta Energy notes that in its analysis, the Reserve Bank of Australia outlined that regulators are still interested in increasing regulatory obligations in the energy sector.

The main tools proposed by the Reserve Bank of Australia are:

- due diligence and counter party approvals;
- agreement of robust legal documentation; and
- collateralisation of exposures.

Alinta Energy understands that these tools are intended to strengthen safe guards; however, as outlined in previous submissions, Alinta Energy is of the view that these conditions are all already met by energy market participants who achieve an appropriate balance between credit risk and market risk exposure. Therefore, mandatory obligations are not warranted in this area.

Privacy concerns

In regards to trade reporting, Alinta Energy is concerned that there is an imbalance between Australian privacy laws, as set out in the *Privacy Act 1988*, and reporting to a centralised trading scheme.

Specifically, Alinta Energy would not be able to support statutory overrides of client's confidentiality and privacy agreements in favour of reporting obligations.

Furthermore, as various countries have differing privacy laws, there is some confusion as to how this section of the proposed scheme will be implemented.

Next steps

Whilst appreciative of Australia's commitment to an international regulatory over-the-counter framework, these products currently meet the needs of market participants across a range of sectors and any proposal which reduces the value of trade in any or all sectors should be questioned.

Alinta Energy is very supportive of mitigating risk; however, it is highly likely that by imposing new obligations that the costs of regulation may outweigh any potential benefits. Alinta Energy is particularly concerned about the impact of any new obligations on energy consumers in what is already a highly regulated market.

The proposed obligations, if imposed on the energy sector, would likely discourage new investment and entrants due to the need to hold large cash reserves. The result of this policy would be a less competitive market as well as higher energy prices.

As it pertains to the current implementation plan, Alinta Energy suggests this establishes an appropriate threshold from which calls for additional regulation should be resisted.

Should you have any queries in relation to this submission, please do not hesitate to contact me on, telephone, 02 9372 2633.

Yours sincerely,



Jamie Lowe
Manager, Market Regulation