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Dear Mr Lim

### **Treasury Proposals Paper – Implementation of Australia’s G-20 Over-the-Counter (OTC) Derivatives Commitments**

The privately owned electricity generation companies listed (PGG) welcome the opportunity to respond to Treasury’s Proposals Paper (the Paper). The PGG has been appreciative of Treasury’s approach to the G20 OTC proposals in general. Treasury has shown a keen interest in engaging with non financial entities to better understand the impact that these reforms may have on entities outside of the banking and financial institution sector.

The PGG represents a group of privately owned Australian electricity generation companies, many of whom are also electricity and gas retailers. These entities, like many non financial entities, enter into OTC derivatives to manage their commercial risks. The PGG emphasizes that a cost-benefit approach should be applied in the implementation of the G20 OTC proposals in Australia. The following are our views on mandating central clearing and other proposals raised in the Paper.

#### **Mandatory Central Clearing of ‘G4’ Denominated Interest Rate Derivatives**

The PGG agrees with Treasury’s proposal to restrict mandatory central clearing of US Dollar, Euro, British Pound and Yen denominated interest rate derivatives (G4-IRD) to large financial institutions with significant cross border activity (G4 dealers). There is little value in extending this proposal to other entities, especially those entities that enter into derivatives as an incidental part of their business to manage their commercial risk (End Users). The reason being, that the benefits identified with mandatory central clearing do not apply to End Users:

- **Benefit 1: Substitution Compliance**  
End Users do not have international central clearing obligations like G4 Dealers do. Hence they will not benefit from the ability to substitute their domestic obligations for their international obligations like G4 dealers will. Furthermore, a key objective of the G20 implementation is to achieve consistency of OTC regulation globally. As many jurisdictions have exempted End Users, there is a strong case for also exempting End Users from these obligations in Australia.
- **Benefit 2: Netting of Transactions**  
Netting will also not apply to End Users. Entities that have offsetting transactions are able to net these transactions to reduce their overall exposure. While banks

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and financial intermediaries have offsetting positions, End Users typically do not, as they enter into derivatives in the same direction. Hence End Users have relatively few trades to net off.

- **Benefit 3: Reduction of Counterparty Credit Risk**  
Some may consider that exposure to a single central clearing counterparty reduces counterparty credit risk. However, this argument may not be as strong in the case of End Users of interest rate derivatives. End Users typically trade with top rated banks. Concentrating the exposure to one central counterparty may open them up to more risk than spreading the risk across top rated banks.

Aside from End Users not benefitting from mandatory central clearing, it will also impose significant costs on them. There are considerable IT and legal costs required to implement mandatory central clearing. In addition, it will increase their cash flow risk which may have serious implications for End Users.

### **Mandatory Central Clearing in Other Markets**

In addition, the PGG considers that the proposal should not be extended beyond G4 IRD. Extending the scope of the proposal to Australian dollar interest rate derivatives may impose additional costs onto End Users.

Moreover, extending these reforms to other classes of derivative markets, in particular the commodities markets, may have adverse implications. Commodity market participants rely on bespoke products to hedge their commercial risks. However, mandatory central clearing only facilitates the trading of standard vanilla products. Therefore extending this proposal to commodity markets will make it harder for market participants to manage their risks, which may have serious impacts on these markets.

Furthermore, the additional cash flow pressures and capital requirements associated with mandatory central clearing may hinder the growth of emerging markets such as the gas derivative market.

### **Trading Platforms**

The PGG considers that it is more appropriate for trading platforms to be an optional tool (where available) rather than mandatory. This is because while there are benefits associated with trading platforms, there are also limitations with it such as the lack of product flexibility.

### **Trade Reporting**

The PGG supports Treasury's recommendation for a permanent exemption for End Users from trade reporting. The PGG agrees that this would provide certainty to End Users. In addition, trade reporting by End Users would deliver little benefit as reporting of their relatively small derivative activities would provide little insight into the systemic risk of the economy. On the same basis, the PGG considers that other classes of participants such as AFSL holders whose derivative market activity are of relatively low volumes, should also be exempted. The only outcome of applying it to these entities would be to impose additional compliance costs on them.

If you have any queries about the submission or require further information, please contact Josynta Singh at [jsingh@agl.com.au](mailto:jsingh@agl.com.au) or on 03 8633 6628.

Yours sincerely,



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On behalf of the listed companies