

# Chapter 3

## Views on the bill

3.1 This chapter summarises submitters' views on the provisions of the bill and proposes recommendations to ensure that stakeholders' concerns are adequately addressed. There are three areas of concern:

- the exercise of delegated power by the Minister;
- the safeguards to ensure the proper exercise of delegated authority; and
- arguments put by the electricity sector that they should be exempted from the OTC regulatory framework.

3.2 Submitters generally approved of the objectives of the G20 OTC derivatives reforms. d-cyphaTrade commended the introduction of legislation to implement the G20 reforms in the Australian market.<sup>1</sup> The Australian Financial Markets Association (AFMA) submitted that industry supports international regulatory coordination, and endorsed the passage of the bill.<sup>2</sup> While not supporting the proposed application of the OTC reforms to the National Electricity Market (NEM), representatives of the electricity sector acknowledged that the bill provides the framework for Australia to honour the G20 commitment to improve the operation of the derivatives market.<sup>3</sup>

3.3 Submitters did not challenge the proposed timeframe for the commencement of the legislative reforms. Rather, it was acknowledged that the end of 2012 commencement date is necessary to ensure that Australia fulfils its G20 obligations.<sup>4</sup> Further, AFMA submitted that the draft legislation is required to promote parity between Australian markets and international markets and, therefore, a level playing field for Australian-based businesses.<sup>5</sup>

3.4 However, concerns were raised with aspects of the legislative framework proposed by the bill.

### Exercise of delegated power

3.5 Submitters to the inquiry recognised that, if passed, the proposed legislation would not impose new requirements on Australia's financial markets. Rather,

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1 d-cyphaTrade, *Submission 8*, p. 1.

2 Australian Financial Markets Association, *Submission 9*, pp 1–2.

3 See, for example, Origin, *Submission 1*, Attachment A, p. 1; TRUenergy, *Submission 11*, Attachment A, p. 1.

4 See, for example, Finance and Treasury Association, *Submission 7*, p. 1.

5 Australian Financial Markets Association, *Submission 9*, p. 3.

submitters acknowledged that the bill would provide a mechanism by which additional requirements may be imposed.<sup>6</sup> However, views differed as to the appropriate exercise of delegated authority by the responsible Minister and the Australian Securities and Investments Commission (ASIC).

3.6 AFMA endorsed the proposed framework under which the scope and content of the OTC derivatives reforms would be determined under delegated legislation. Noting that 'Australian authorities have been responsive and understanding of the issues facing industry', AFMA supported the delegation of power.<sup>7</sup> It argued that the contemplated framework provides the necessary flexibility to appropriately respond to changing market conditions:

The framework provides an open competitive environment for market infrastructure while giving the regulators the tools to manage systemic risk. The framework recognises the need for a flexible regime that can cope with the rapid evolution that is occurring around the globe that enables market participants to adopt appropriate risk management and business decisions based on cost and liquidity.<sup>8</sup>

3.7 However, AFMA questioned whether the extent of the proposed delegation to ASIC is appropriate. Arguing that the scope and content of regulatory obligations are matters to be determined by Parliament or the responsible Minister, AFMA submitted that ASIC's authority should be limited to the administrative and procedural aspects of the regulatory regime. Accordingly, AFMA recommended that the bill be amended to allow regulations to determine the broad parameters for derivative transaction rules such as clearing requirements, reporting requirements and execution requirements.<sup>9</sup>

3.8 The Australian Bankers' Association (the ABA) recognised that 'flexibility in the regulatory regime is necessary to allow Australia to accommodate ongoing international developments'.<sup>10</sup> However, the ABA also questioned the extent of the delegated authority, submitting that 'the primary legislation should set out the scope of the regime'.<sup>11</sup>

3.9 Treasury explained that the framework is necessary to allow Australia's financial markets to evolve in response to changes to the international market:

This flexibility is necessary to ensure the regime can be implemented in a proportional and targeted way in Australia, and can be readily adapted overseas to regulatory developments so as to ensure a coordinated approach

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6 See, for example, Australian Bankers' Association, *Submission 12*, p. 2; National Generators Forum, *Submission 10*, p. 2.

7 Australian Financial Markets Association, *Submission 9*, p. 3.

8 Australian Financial Markets Association, *Submission 9*, p. 3.

9 Australian Financial Markets Association, *Submission 9*, p. 4.

10 Australian Bankers' Association, *Submission 12*, p. 3.

11 Australian Bankers' Association, *Submission 12*, p. 4.

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to regulation of global OTC derivatives markets between Australia's financial regulators and international counterparts.<sup>12</sup>

3.10 Treasury reiterated the view that the adaptability and flexibility that subordinate legislation provides is necessary to ensure that Australian businesses can effectively compete in international markets:

Consistent implementation by all major economies is important to reduce systemic risk and the risk of regulatory arbitrage that could arise if there are significant gaps in implementation. International cooperation and flexibility will also help to avoid unintended consequences of national laws such as the burden on businesses of duplicated or conflicting rules and the cost of reduced access to international markets.<sup>13</sup>

### ***Checks and balances—industry consultation processes***

3.11 Some submitters questioned whether the bill contains appropriate safeguards to ensure the proper exercise of delegated authority. Representatives of the energy sector strongly questioned whether the bill would facilitate appropriate industry consultation on regulatory requirements. The National Generators Forum (NFG), notably, challenged the appropriateness of not specifying in the legislation detailed consultation processes that would require the views of all stakeholders to be properly canvassed.<sup>14</sup> Origin submitted that the bill 'lacks appropriate checks and balances around the Minister's and ASIC's discretionary decision-making powers'.<sup>15</sup> It argued that the bill would 'leave open the very real possibility that decisions impacting on the energy sector could be made without adequate consultation with industry or energy market institutions'.<sup>16</sup> It was put to the committee that the bill would not ensure that the responsible Minister and ASIC would give due regard to the circumstances unique to the NEM.<sup>17</sup>

3.12 Representatives of the energy sector argued that the absence of a requirement to consult properly would create an uncertain market environment.<sup>18</sup> The extent of concern is evident in ESAA's assertion that the sector would be 'facing the prospect that it could be brought within the scope of the mandatory obligations on the Minister's whim at any time'.<sup>19</sup>

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12 Treasury, *Submission 6*, p. 3.

13 Treasury, *Submission 6*, p. 3.

14 National Generators Forum, *Submission 10*, p. 2.

15 Origin, *Submission 1*, p. 1.

16 Origin, *Submission 1*, Attachment A, p.7.

17 See, for example, National Generators Forum, *Submission 10*, pp 56.

18 See, for example, International Power-GDF SUEZ, *Submission 4*, p. 3.

19 Energy Supply Association of Australia, *Submission 3*, p. 2.

3.13 Accordingly, representatives of the energy sector recommended that the bill be amended to require industry consultation. The NFG recommended that scoping studies be undertaken before determinations are made.<sup>20</sup> Origin went further, calling for the bill to be amended to give joint authority to the Minister for Resources and Energy for derivative decisions affecting the NEM.<sup>21</sup>

3.14 More broadly, several measures were recommended to expand the consultation requirements. Norton Rose recommended that proposed section 901J be amended to require ASIC to undertake public consultations prior to adopting OTC derivatives rules.<sup>22</sup> The importance of consultation to gauge the regulatory and financial impact of proposed regulations and rules was also noted, with the Finance and Treasury Association (the FTA) and TRUenergy recommending that a cost benefit analysis be undertaken prior to the enactment of new regulatory requirements.<sup>23</sup> The FTA strongly advocated for industry consultation on the basis that successful registry development and implementation 'must involve experts of the industry and representative bodies rather than regulators operating in isolation'.<sup>24</sup> Similarly, the ABA submitted that the minister should be required to undertake public consultation before prescribing classes of derivatives.<sup>25</sup>

3.15 Clearly, it is important that the proposed consultation process entails appropriate industry consultations. Treasury advised that the bill, and the Minister's and ASIC's intended administration of the OTC derivatives framework, would provide for proper consideration of market risks and stakeholders' views. The committee's attention was drawn to Part 3 of the *Legislative Instruments Act 2003*,<sup>26</sup> which requires all appropriate and reasonably practicable consultation to occur prior to enacting regulations or rules that will affect business or restrict competition.<sup>27</sup> Treasury also advised that, as disallowable instruments, the regulations would be subject to Parliamentary scrutiny. Further, as the bill requires regulatory impact analysis to be undertaken, the financial impact of the proposed regulations and rules will be assessed prior to their enactment.<sup>28</sup>

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20 National Generators Forum, *Submission 10*, p. 5.

21 Origin, *Submission 1*, Attachment A, p. 8.

22 Norton Roads, *Submission 5*, p. 3.

23 TRUenergy, *Submission 11*, Attachment A, p. 1; Finance and Treasury Association, *Submission 7*, pp 2-3.

24 Finance and Treasury Association, *Submission 7*, p. 4.

25 Australian Bankers' Association, *Submission 12*, p. 5.

26 Treasury, *Submission 6*, p. 14.

27 *Legislative Instruments Act 2003*, s. 17.

28 Treasury, *Submission 6*, p. 14.

3.16 In response to industry concerns, in evidence before the committee an undertaking was given to ensure that the Minister for Resources and Energy is consulted regarding decisions affecting the energy sector:

The Government will further ensure that should any future decision be taken by the Minister for Financial Services in relation to either the making of regulation, the mandating of a derivative or the consent to an ASIC rule, this will require the written approval of the Minister for Resources and Energy, where that decision relates to the energy sector.<sup>29</sup>

### ***Checks and balances – confidentiality of registry data***

3.17 Submitters also questioned whether the bill would impose sufficiently robust processes to ensure the confidentiality of data held on trade repositories. Origin argued that the trade reporting requirements 'could expose the commercial decisions of individual companies'.<sup>30</sup> Similarly, International Power–GDF Suez Australia expressed 'serious concerns' that the reporting requirements would result in the release of commercially sensitive information and, thereby, undermine market competition.<sup>31</sup> The FTA commented that licenses to operate trade repositories should not confer on licensees property rights over trade data.<sup>32</sup> Origin called for the bill to be amended to expressly require strict data handling procedures.<sup>33</sup>

3.18 Proposed section 904B would limit the disclosure of registry data. As noted in the Explanatory Memorandum (EM) to the bill, the use and disclosure of information would generally be permitted for the purpose of providing trade repositories services.<sup>34</sup> Accordingly, as stated in the EM, the bill would not absolutely prohibit the commercialisation of trade data.<sup>35</sup> However, as explained in the EM, it is anticipated that the regulations may impose additional limits on the use and handling, including the disclosure, of data.<sup>36</sup> Further, as indicated in the note to proposed subsection 904B(5), unauthorised disclosure would be an offence. Under section 1131 of the Corporations Act, the offence would be subject to a maximum penalty of 1000 penalty

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29 Treasury, *Submission 6*, pp 89.

30 Origin, *Submission 1*, Attachment A, p. 6.

31 International Power-GDF SUEZ, *Submission 4*, Attachment A, p. 4.

32 Finance and Treasury Association, *Submission 7*, p. 4.

33 Origin, *Submission 1*, Attachment A, p 9.

34 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.170.

35 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.174.

36 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.173.

units, or 5000 penalty units in the case of a body corporate. The EM advises that this is a 'significant penalty'.<sup>37</sup>

### *Committee view*

3.19 The bill implements the G20 commitment that responds to clear evidence that financial markets were exposed to systemic risk at the international level by inappropriate domestic regulation of OTC derivative transactions. The G20 view is clear: international stability requires international coordination. The committee is satisfied that the delegated legislative framework proposed is the appropriate mechanism to ensure continued international coordination and ultimately promote market security.

3.20 However, the committee acknowledges industry concerns regarding the consultation process for the development of subordinate regulations and rules. For regulatory requirements to provide necessary safeguards, the requirements must actually reflect the market. An accurate understanding of the market requires industry analysis and consultation. The committee commends the government's commitment, indicated in its evidence to the committee, to include industry in the regulatory development process. To ensure stakeholders can effectively engage with the process, Treasury and ASIC should publish guidance material that outlines the consultation process and provides contact details for the relevant officers. This material should be available by the commencement of the proposed amendments to the *Corporations Act 2001*.

### **Recommendation 1**

**3.21 The committee recommends that Treasury and the Australian Securities and Investments Commission publish guidance material outlining the consultation process for the development of OTC derivatives regulations and rules. The material should be released by the commencement of the Corporations Legislation Amendment (Derivative Transactions) Act.**

3.22 Stakeholder education is fundamental to ensuring the effective operation and administration of regulatory requirements. The effectiveness of the new regulatory framework will be dependent on industry understanding its new regulatory requirements. Accordingly, the committee emphasises the need for ASIC to release a regulatory guide detailing the new OTC derivative rules.

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37 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.175.

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## Recommendation 2

**3.23 The committee recommends that the Australian Securities and Investments Commission release a regulatory guide explaining the derivative transactions and trade repository rules.**

3.24 Under section 243 of the *Australian Securities and Investments Commission Act 2001* the committee is authorised to inquire into, and to report to both Houses of Parliament on, ASIC's activities. Accordingly, the committee regularly inquires into ASIC's activities and related matters. The committee will monitor the exercise of ASIC's delegated authority as part of the committee's ongoing ASIC oversight process.

## Recommendation 3

**3.25 The committee recommends that the Australia Securities and Investments Commission provide regular updates on the development of OTC derivatives rules and the market's response to the new regulatory requirements. Updates can be provided as part of the committee's ongoing ASIC oversight process.**

3.26 The committee notes the concerns expressed by some stakeholders regarding the confidentiality of data held on OTC derivative trade repositories. Unauthorised disclosure and misuse of data would undermine the principles of commercial certainty and security that the bill is seeking to uphold. On the basis of information provided to the committee, it does not appear that express amendments to the bill are warranted. However, the committee considers that it would be appropriate for ASIC to develop guidance material on the use of data by derivative trade repository licensees. Additionally, ASIC should closely monitor the licensees use of data. The committee notes the advice in EM that ASIC may revoke a derivative trade repository licence if ASIC has declared the individual to be unfit.<sup>38</sup> The committee is of the view that it would be appropriate for ongoing monitoring of licensees' use of data to be taken into account when determining whether a licensee continues to be fit to operate a trade repository.

## Recommendation 4

**3.27 The committee recommends that ASIC issue guidance material on the confidentiality of data and trade repositories, and the use to which data may be put. ASIC should closely monitor the activities of derivative trade repository licensees regarding the use and disclosure of repository data.**

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38 Explanatory Memorandum, Corporations Legislation Amendment (Derivative Transactions) Bill 2012, paragraph 1.82.

## **Exemptions from the OTC G20 derivatives requirements**

3.28 Both the non-financial and the energy sectors put to the committee that the bill should be amended to exempt their industry from the OTC derivatives regulatory requirements. In both instances, it was argued that the rationale underpinning the G20's recommendation and, therefore, the bill, is not applicable to its use of derivative transactions. Similarly, the ABA also sought to limit the kinds of derivatives that may be included within the OTC derivatives regulatory framework, arguing that the policy intent underlying the legislation may be achieved without all classes of derivatives being captured by the regulatory framework.

### ***Use of OTC derivatives by non-financials (particularly corporations)***

3.29 The FTA submitted that derivative transactions undertaken by non-financials, particularly corporations, should be excluded from the new OTC derivatives framework. It argued that as OTC derivatives by non-financials are 'a tiny part of the derivative market here and abroad', the industry does not present a systemic risk to market stability. Accordingly, it claimed that additional regulatory safeguards are not required.<sup>39</sup>

### ***Classes of derivatives other than AUD interest-rate swaps***

3.30 The ABA submitted that classes of derivatives, outside AUD interest-rate swaps, should be exempt from the proposed OTC derivatives regulatory regime. The ABA identified that the Council of Financial Regulators did not highlight any risks posed by classes of derivatives outside AUD interest-rate swaps. Accordingly, the ABA argued that the intent of ensuring market stability and transparency would be achieved were the OTC derivative rules to be limited to AUD interest-rate swaps.<sup>40</sup>

### ***Arguments to exempt the electricity derivatives market from the bill***

3.31 Representatives of the electricity sector strongly opposed the application of the new OTC derivatives regulatory requirements to participants in the NEM. They gave the following arguments.

3.32 First, it was claimed that the electricity market does not pose a systemic risk to market stability. The NGF highlighted that electricity derivatives 'were not identified as a concern warranting regulation through the Australian government's commitment to the G20'. Further, it noted that the consultation process did not raise concerns with the stability and integrity of the electricity derivatives market.<sup>41</sup>

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39 Finance and Treasury Association, *Submission 7*, p. 3.

40 Australian Bankers' Association, *Submission 12*, p. 5.

41 National Generators Forum, *Submission 10*, p. 5.



3.33 Second, it was argued that the NEM is a sophisticated market that operates well within existing regulatory safeguards. International Power GDF SUEZ stated that 'the sector has developed and applied sophisticated risk management practices to manage financial risk'.<sup>42</sup> The NGF claimed that there is recognition among Australia's regulators that existing arrangements 'are working'. It cited the view of the Australian Energy Market Commission which found that the financial relationships and markets that underpin the efficient operation of the NEM generally robust, and there is likely to be a low probability of financial contagion occurring in NEM.<sup>43</sup>

3.34 Third, it was argued that standardisation of the electricity OTC derivatives market would reduce the capacity for contracts to be tailored to minimise risk. ESAA commented that 'any attempt to standardise the electricity derivatives market would result in electricity market participants losing the ability to enter into bespoke contracts to manage the risk'.<sup>44</sup>

3.35 Fourth, the committee heard that Australia's energy market is different to that in most other G20 countries. ESAA argued that for an energy-only market, it is 'particularly important that prices are allowed to rise and fall with as little constraint as possible'. It noted that without occasional very high prices, there are not the signals for new investment and the possibility for generators to recover their long-term costs. ESAA surmised that in many other markets around the world, the impact of restrictions on the electricity derivatives market 'would not be on anywhere near the same scale as here in Australia'. Accordingly, it put to the committee that there 'is a case...to exempt the energy sector which would be a 'very defensible position for Australia to put to its G20 colleagues'.<sup>45</sup>

3.36 Fifth, it was argued that if the energy sector is subject to OTC derivative regulations, there would be a negative impact on competition in the NEM. The NGF claimed that when a new entrant enters the retail market, it may be able to get the support of a generator to cover the new entrant and leave the volume and the profile fairly flexible to encourage that new entrant.<sup>46</sup> It claimed that if this is not possible, it is less likely that there will be new entrants into the market, thereby affecting competition.<sup>47</sup>

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42 International Power-GDF SUEZ, *Submission 4*, p. 1.

43 National Generators Forum, *Submission 10*, p. 3.

44 Energy Supply Association of Australia, *Submission 3*, p. 4.

45 Mr Kieran Donoghue, General Manager, Policy, Energy Supply Association of Australia, *Proof Committee Hansard*, 5 October 2012, p. 8.

46 Mr Timothy Reardon, Executive Director, National Generators Forum, *Proof Committee Hansard*, 5 October 2012, p. 1.

47 Mr Gregory Everett, Director, Electricity, National Generators Forum, *Proof Committee Hansard*, 5 October 2012, p. 3.

3.37 Sixth, the energy sector argued that OTC derivative regulations would increase its costs and the costs for consumers. In terms of the costs to the industry, NGF identified the cost of increasing compliance complexity and collateral costs to the extent that good risk management decisions are impaired.<sup>48</sup> The NGF also told the committee of its concern that, in addition to the current and future upward cost pressures facing the industry, regulations may 'flow through to an additional price increase on top of that'.<sup>49</sup>

***The nature of the electricity sector's concern with the bill***

3.38 The committee asked the NGF the precise nature of its concerns given that the proposed legislation only establishes a framework for regulation, as opposed to actually applying any regulations. It responded:

The nature of the legislation provides the power to the minister to direct ASIC to inquire into the need for regulation of a particular type of derivative and see that as a fairly quick response to result in ASIC concluding that there may be a need for regulation of that particular derivative and see at this stage that legislation being drafted is far broader than the policy it was intended to achieve. So we would like to see that this legislation has minimal effective regulation for the policy principles it is seeking to achieve, without any concern having been raised around electricity derivatives specifically. It would not seem appropriate that legislation covering electricity derivatives would be introduced and passed by parliament.<sup>50</sup>

3.39 The same question was put to ESAA. It gave the following response:

...we are subject to a whole range of inquiries at the moment, some of which may lead to further regulations being imposed on the industry and our experience has often been that many such inquiries and many such subsequent regulations have been carried out possibly in response to political issues, rather than sound underlying policy drivers, and that from time to time they have been carried out with limited or insufficient consultation. So we are perhaps predisposed to be very wary of even the possibility of additional regulation on the sector. I would also observe that the matter could be equally well considered in reverse, and that if the government has no plans to regulate the sector there would seem to be little harm to be done by exempting the sector.<sup>51</sup>

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48 Mr Gregory Everett, Director, Electricity, National Generators Forum, *Proof Committee Hansard*, 5 October 2012, p. 3.

49 Mr Timothy Reardon, Executive Director, National Generators Forum, *Proof Committee Hansard*, 5 October 2012, p. 4.

50 Mr Timothy Reardon, Executive Director, National Generators Forum, *Proof Committee Hansard*, 5 October 2012, p. 5.

51 Mr Kieran Donoghue, General Manager, Policy, Energy Supply Association of Australia, *Proof Committee Hansard*, 5 October 2012, p. 8.

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## Support for including the electricity sector in the legislation

3.40 Not all submitters shared the view that the bill should expressly exempt the electricity sector. d-cyphaTrade argued that, as an essential service, it is necessary for the electricity derivatives market to come within the broader G20 OTC derivatives regulatory framework.<sup>52</sup> d-cyphaTrade did not share the view that the market is currently subject to adequate safeguards. It strongly argued that 'regulations are needed to prevent systemic default risk because the multimillion dollar OTC electricity derivatives market is dominated by non-bank, non-regulated OTC issuers'.<sup>53</sup>

3.41 It is clear in evidence before the committee that, as at the time of this report, the government does not intend to prescribe the electricity sector as a class of derivatives to which the new OTC derivatives framework would apply. Treasury advised that 'the government has no plans to make rules relating to the energy sector.' However, it is further evident that the government does not support amending the Bill to exempt the electricity sector. Treasury noted that '[n]o particular derivative market has been written out of the regime that will be supported by the proposed amendments'. Treasury noted in its submission that while the Government has no plans to make rules relating to the energy sector, it is important that electricity derivatives be included in the legislative framework:

Applying the legislative framework to all derivatives (including electricity derivatives) ensures that the ongoing market assessment being conducted by the financial regulators is on clear legislative footing.<sup>54</sup>

3.42 Treasury submitted that amending the bill to expressly exclude the energy sector from the OTC derivatives regulatory framework would not be best practice, and would restrict regulatory capacity to respond to changing market conditions:

The bill establishes the legislative underpinnings of what will be an ongoing process. Over time reassessments may occur in response to changing regulatory or marketing environment. The appropriateness of any regulatory approach that has been adopted may be reassessed and adjusted accordingly. The bill seeks to set up a regime that does not merely reflect industry practice or regulatory arrangements at one point in time.

Although the electricity derivative market, based on information currently available, is traded largely between electricity generation, transmission and retailing entities, this may change in the future...It will therefore be important to have the capacity to better understand and respond to any changes in the market for electricity derivatives.<sup>55</sup>

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52 d-cyphaTrade, *Submission 8*, p. 2.

53 d-cyphaTrade, *Supplementary submission 8*, p. 6.

54 Treasury, *Submission 6*, p. 10.

55 Treasury, *Submission 6*, p. 10.

## Current inquiries into the electricity sector

3.43 The committee draws attention to several current inquiries into the electricity sector. The Senate Select Committee on Electricity Prices is due to report in November this year. In addition:

There are three processes currently underway that will further the understanding of the Australian OTC derivatives energy market.

The AEMC has been asked to provide advice to the Standing Council on Energy and Resources (SCER) on the resilience of the financial relationships and markets that underpin the operation of the National Electricity Market (NEM). The AEMC expects to consider OTC electricity derivatives markets as part of this assessment in the first half of 2013.

The AEMC released an issues paper on 8 June 2012. While the AEMC states that their initial view is that financial relationships in the NEM are generally robust, there may be risks to system security created through the financial interdependencies between market participants.

APRA, ASIC and the RBA initiated a targeted survey of derivatives markets participants on 6 July 2012, as part of a market assessment of Australia's derivative markets. This survey is expected to provide for increased understanding of the bilateral risk management practices and exposures of derivatives markets participants. This survey extends to electricity derivative markets.

On 4 May 2012 ASIC commenced consultation on revised financial requirements for market participants in wholesale electricity markets dealing in OTC derivatives, to ensure that they make adequate provision for expected expenses and carry sufficient financial resources to mitigate against operational risk that could lead to unexpected losses or expenses.

It is expected that each of these market assessments will be completed by the end of the first half of 2013 and together they should provide for a greater understanding of the bilateral risk management practices and exposures in the OTC electricity derivatives markets.<sup>56</sup>

3.44 The committee believes that it is important for these inquiries to reach their conclusions. These findings will be important to understand the exact nature of the pressures facing the energy sector, and in particular its cost structure, competitive tension, prudential needs and risk profile.

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56 Treasury, *Submission 6*, pp 9–10.

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## Committee view

3.45 The makes the following four observations about the electricity sector's claims to be exempted from the bill.

3.46 The first relates to the issue of extraterritoriality. Treasury has noted that the electricity market should be included in bill given the strong likelihood of international regulations applying to electricity derivatives. These regulations would have extraterritorial effect and require a further domestic legislative response.<sup>57</sup> The committee finds this argument convincing and does not support the NGF's position that if Australia is party to an international commitment to regulate electricity derivatives, this should be done through separate legislation.<sup>58</sup>

3.47 Second, the committee emphasises the point made by d-cypha that the electricity market is a central and essential service and as such, electricity derivatives should properly fall within the broader G20 OTC derivatives regulatory framework. It is appropriate that the electricity sector is subject to the provisions of the legislation.

3.48 Thirdly, the committee has confidence in the process established in the bill to delegate power to the Minister and ASIC. It agrees with AFMA's assessment that Australian authorities have been responsive and understanding of the issues facing industry. Further, the committee believes that in any future consideration of whether OTC derivative regulations should apply to the electricity market, there will be a careful assessment of the possible impact on the industry.

3.49 Finally, the committee notes the comments of ESAA that it would be 'useful' for the legislation to reference the integrated nature of the physical and derivatives market in the case of electricity. ESAA argued that one way to do this would be to specifically include the Energy Minister as chair of the Standing Council of Energy and Resources in the decision-making process.<sup>59</sup> The committee agrees that this approach would be prudent and recommends accordingly.

## Recommendation 5

**3.50 The committee recommends that for matters relating to the energy sector, the Minister for Resources and Energy be consulted prior to the making of regulations, the mandating of derivatives or the consent to an ASIC rule.**

## Recommendation 6

**3.51 The committee recommends that the bill be passed.**

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57 Treasury, *Submission 6*, p. 9.

58 Mr Timothy Reardon, Executive Director, National Generators Forum, *Proof Committee Hansard*, 5 October 2012, p. 5.

59 Mr Kieran Donoghue, General Manager, Policy, Energy Supply Association of Australia, *Proof Committee Hansard*, 5 October 2012, p. 10.

**Ms Deborah O'Neill**

**Chair**