9 August 2019

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

Dear Ms Boddington

COGATI Access Reform – Directions Paper

The Australian Financial Markets Association (AFMA) welcomes the opportunity to provide comment on the COGATI Access Reform – Directions 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 wholesale banking and financial markets in Australia. AFMA has more than 120 members reflecting the broad range of participants in financial markets, including Australian and international banks, leading brokers, securities companies, fund managers, energy companies and industry service providers.

Whilst acknowledging the overall objectives of the consultation paper, AFMA's focus is on the efficiency and competitiveness of electricity financial markets. Accordingly, our comments are limited to those areas that relate to this focus.

As you would be aware, in late April AFMA commented on your earlier consultation paper (COGATI Implementation – Access and Charging). Our key concern, echoed in several other submissions, related to the potential detrimental effects of the implementation of dynamic regional pricing on financial market liquidity. Given the content of the Directions Paper, we continue to hold that concern.

We note that section 4.6.2 of the Directions Paper notes that there "may be a risk of splitting liquidity in the contract market", and that the AEMC is "investigating this issue as part of its broader analysis on the implications of dynamic regional pricing for contract market liquidity." We consider the financial market liquidity risk to be very significant and we suggest that the AEMC ensures that this is given considerable consideration in its broader analysis.

We would like to reiterate our key comments in response to the consultation paper, as they remain relevant:

1) The introduction of dynamic regional pricing would be a significant reform and it has been presented as a solution without due consideration of the costs and benefits of its implementation or, indeed, of alternative solutions. A more detailed analysis of the costs and benefits involved is desirable before major implementation decisions are made.
2) The introduction of dynamic regional pricing introduces basis risk for generators who enter into hedging contracts based on the regional reference price but may receive a different dynamic regional price. The difference between the two prices can change considerably over time as well. The inability to hedge against the future difference between the two prices (regional vs dynamic) is of significant concern to participants, and may limit their interest in using hedge contracts going forward if dynamic pricing is introduced. This could have a significant detrimental effect on market liquidity and efficiency.
3) The AEMC in its review process will need to be mindful to ensure that the measures within the COGATI review are consistent with other programs being delivered by multiple regulatory bodies, such as:
    - Introduction of 5 minute settlement
    - The Integrated System Plan
    - The ESB NEM post 2025 Market Design
    - Various AEMC Rule Change requests under consideration
    - The Retailer Reliability Obligation, including the market liquidity obligation

Additional comments from our members in relation to the Directions Paper include the following:

- Further to point (2) above, the Paper appears to suggest that the existence of transmission hedges will sufficiently offset the basis risk that is introduced by dynamic pricing to ensure there is no detrimental effect on contract market liquidity. Our members remain concerned that contract market liquidity is still materially at risk despite this.
- Further to the third point above, our members note that most of the other regulatory initiatives [and in particular the Market Liquidity Obligation and the Treasury Laws Amendment (Prohibiting Energy Market Misconduct) Bill 2018] have been designed to promote greater liquidity in the financial contract market. The COGATI paper appears at odds with this as it introduces a significant downside risk to contract market liquidity.

Thank you again for the opportunity to provide comment on the Directions Paper. We would 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