30 April 2024

Karen Krist
a/General Manager, Market Surveillance
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Submitted via email: ContractMarketMonitoring@aer.gov.au

Dear Karen,

Enhancements to wholesale market monitoring and reporting guideline – issues paper submission

FEX Global Pty Ltd (FEX) appreciates the opportunity to respond to the Australian Energy Regulator's (AER's) 'Enhancements to wholesale market monitoring and reporting guidelines – issues paper'.

FEX holds an Australian market licence (AML) granted under ss795B(1) of the Corporations Act 2001 (the Act). The licence allows FEX to operate a financial market for derivatives (including electricity derivatives). FEX is an approved MLO Exchange under 4A.G.23(a) of the National Electricity Rules (NER).

Chicago Mercantile Exchange Inc. (CME) provides clearing and settlement (CS) services to FEX Global. CME holds an overseas CS facility licence granted under ss824B(2) of the Act. The licence allows CME to operate a CS facility in Australia. CME is registered by the U.S. Commodity Futures Trading Commission (CFTC) as a derivatives clearing organization (DCO).

As noted in the issues paper, the AER is interested in understanding contract market behaviour – in particular, issues around access to markets and barriers to entry and participation. The AER notes that access to beneficial owner data, would improve the AERs understanding of electricity market participants' (customers) contract positions.

While improved monitoring and reporting of a customer's contract position is a desirable objective, in general, it will only confirm the extent to which the electricity derivatives market is concentrated. Monitoring and reporting will not address the underlying issues – that is, the lack of available clearing entities (CEs) that clear (or are incentivised to clear) exchange-traded electricity derivatives and the inconsistency of international financial regulation relating to customer margin requirements.

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Differences in the margin requirements applying to CEs of ASX 24 and FEX, likely impedes customer access to FEX. Under CCP Standards[1] (Appendix A) applying to CEs of ASX 24, net margining is permitted – a CE is permitted to collect gross margin from the customer and pass through net margin to the CCP. A net margin standard is preferred by the CE as the CE retains the customer's excess margin. Under CTFC Regulation[2] (Appendix B) applying to CEs of FEX, net margining is not permitted – a CE collects and passes through gross margin from the customer to the CCP (or equivalent). A gross margin standard is less preferred by the CE as the CE retains no excess margin.

If you wish to discuss this submission in further detail, please contact Craig Keenan at c.keenan@fex.com.au or on 0409 055 216.

Regards,

Craig Keenan

Head of Compliance

FEX Global Pty Ltd

[1] See: CCP Standards (pg. 6-7) https://www.rba.gov.au/payments-and-infrastructure/financial-market-infrastructure/clearing-and-settlement-facilities/standards/201212-new-fss-ris/pdf/attachment-2.pdf

[2] See: CFTC Regulation 39.13(g)(8)(i)(C) https://www.law.cornell.edu/cfr/text/17/39.13

Appendix A: CCP Standards extract

Standard 6: Margin

A central counterparty should cover its credit exposures to its participants for all products through an effective margin system that is risk based and regularly reviewed.

6.1 A central counterparty should have a margin system that establishes margin levels commensurate with the risks and particular attributes of each product, portfolio and market it serves.

6.2 A central counterparty should have a reliable source of timely price data for its margin system. A central counterparty should also have procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable.

6.3 A central counterparty should adopt initial margin models and parameters that are risk based and generate margin requirements sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. Initial margin should meet an established single-tailed confidence level of at least 99 per cent with respect to the estimated distribution of future exposure. For a central counterparty that calculates margin at the portfolio level, this requirement applies to each portfolio's distribution of future exposure. For a central counterparty that calculates margin at more granular levels, such as at the sub-portfolio level or by product, the requirement should be met for corresponding distributions of future exposure. The model should: use a conservative estimate of the time horizons for the effective hedging or close out of the particular types of products cleared by the central counterparty (including in stressed market conditions); have an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products; and to the extent practicable and prudent, limit the need for destabilising, procyclical changes.

6.4 A central counterparty should mark participant positions to market and collect variation margin at least daily to limit the build-up of current exposures. A central counterparty should have the authority and operational capacity to make intraday margin calls and payments, both scheduled and unscheduled, to participants.

6.5 In calculating margin requirements, a central counterparty may allow offsets or reductions in required margin across products that it clears or between products that it and another central counterparty clear, if the risk of one product is significantly and reliably correlated with the risk of the other product. Where a central counterparty enters into a cross-margining arrangement with one or more other central counterparties, appropriate safeguards should be put in place and steps should be taken to harmonise overall risk management systems. Prior to entering into such an arrangement, a central counterparty should consult with the Reserve Bank.

6.6 A central counterparty should analyse and monitor its model performance and overall margin coverage by conducting rigorous daily backtesting and at least monthly, and more frequent where appropriate, sensitivity analysis. A central counterparty should regularly conduct an assessment of the theoretical and empirical properties of its margin model for all products it clears. In conducting sensitivity analysis of the model's coverage, a central counterparty should take into account a wide range of parameters and assumptions that reflect possible market conditions, including the most volatile periods that have been experienced by the markets it serves and extreme changes in the correlations between prices.

6.7 A central counterparty should regularly review and validate its margin system.

6.8 In designing its margin system, a central counterparty should consider the operating hours of payment and settlement systems in the markets in which it operates.

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Appendix B: CFTC Regulation 39.13(g)(8)(i) extract

(8) ***Customer margin***—(i) *Gross margin.*

(A) During the end-of-day settlement cycle, a derivatives clearing organization shall collect initial margin on a gross basis for each clearing member's customer account(s) equal to the sum of the initial margin amounts that would be required by the derivatives clearing organization for each individual customer within that account if each individual customer were a clearing member.

(B) For purposes of calculating the gross initial margin requirement for each clearing member's customer account(s), a derivatives clearing organization shall have rules that require its clearing members to provide to the derivatives clearing organization reports each day setting forth end-of-day gross positions of each individual customer account within each customer origin of the clearing member.

(C) A derivatives clearing organization may not, and may not permit its clearing members to, net positions of different customers against one another.

(D) A derivatives clearing organization may collect initial margin for its clearing members' house accounts on a net basis.

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