7 May 2010

Dr John Tamblyn
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235
Emailed: submissions@aemc.gov.au

Dear John,

In response to previous submissions, this submission provides a non-exhaustive list of explanations as to why SFE Clearing Participants and other banks are likely to avoid registering or actively participating as Reallocators to AEMO under current energy reallocations and proposed swap and options reallocations. The credit default risk and non-firmness of reallocation are the primary deterrents to bank involvement.

1. AEMO (the bank's counterparty to a reallocation) is not a AAA-rated credit counterparty;

2. Under Basel II, registered reallocations involve credit default risk (the risk that AEMO does not honour or terminates the reallocation commitment to the bank) that necessitates a heavy credit default charge (i.e. funding cost) against the bank's balance sheet. In comparison, the daily mark-to-market margining process and reduced risk of futures positions attract a zero credit risk weighting under Basel II for futures positions;

3. In accordance with the potential reallocation-termination triggers defined in the NER s3.15.11(f) which are beyond the control of the bank, AEMO can unilaterally terminate the reallocation, creating potentially large financial cost (i.e. forfeited mark-to-market contract value) across the future term of the registered swap and options reallocation. This non-firmness risk is increased if the swap and option reallocation is in-the-money (for the bank Reallocator) at the time AEMO terminates – e.g. if the forward curve sold off after the reallocation was registered. AEMO does not pay any forward mark-to-market compensation to the bank Reallocator. This lack of mark-to-market compensation means that registered swap and option reallocations are even more risky than normal OTC swap contracts that at least include "contract replacement cost" compensation provisions for the event of default.

4. Whereas futures contracts actually reduce credit risk through the process of daily mark-to-market margining, a reallocation merely transfers credit risk from AEMO (see PWC Report p.16) to the bank Reallocator. i.e. under existing energy reallocations, the commercially imperative transfer of default risk (equal to the full face value of the swap) into the opposing off-market OTC swap (between the retailer and the Reallocator) is a key inefficiency and deterrent to bank involvement.

5. Being bound by an additional regulatory framework (the NER) in order to be a Reallocator, creates an administrative hurdle for banks and SFE Clearing Participants which would further prohibit their involvement as Reallocators.

d-cyphaTrade remains available to assist the AEMC wherever appropriate to ensure efficient implementation of FOAs.

Yours Sincerely,

Dean Price
General Manager