MDAG Meeting, October 2021

# RISK MANAGEMENT: ADAPTABILITY TO 100% RENEWABLES

MDAG

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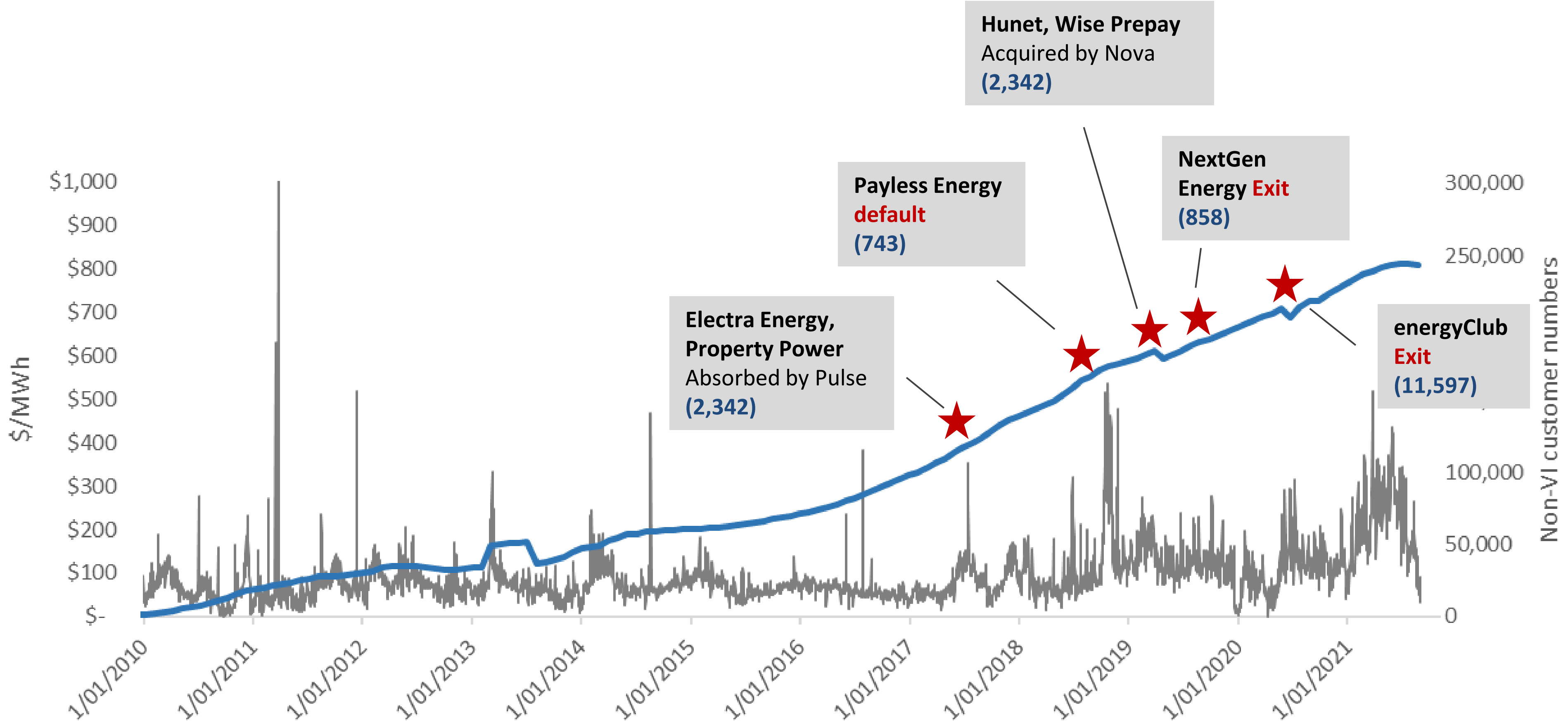
# Question & Context

- Will market participants' risk management adapt to (volatile) 100% renewables (and transition)?
  - Confidence in the market to deliver affordability, security, environmental
  - E.g., competition, efficient investment in resources (revenue adequacy)
- Confidence in future adaptation could be improved through evidence that positive adaptation is occurring, and has occurred (without undue failure):
  - Quantitative evidence (hedge market data, retailer growth/exit, stress test)
  - Qualitative evidence – survey/interview
  - Period of focus – 2010 onwards: post ASX/retail growth

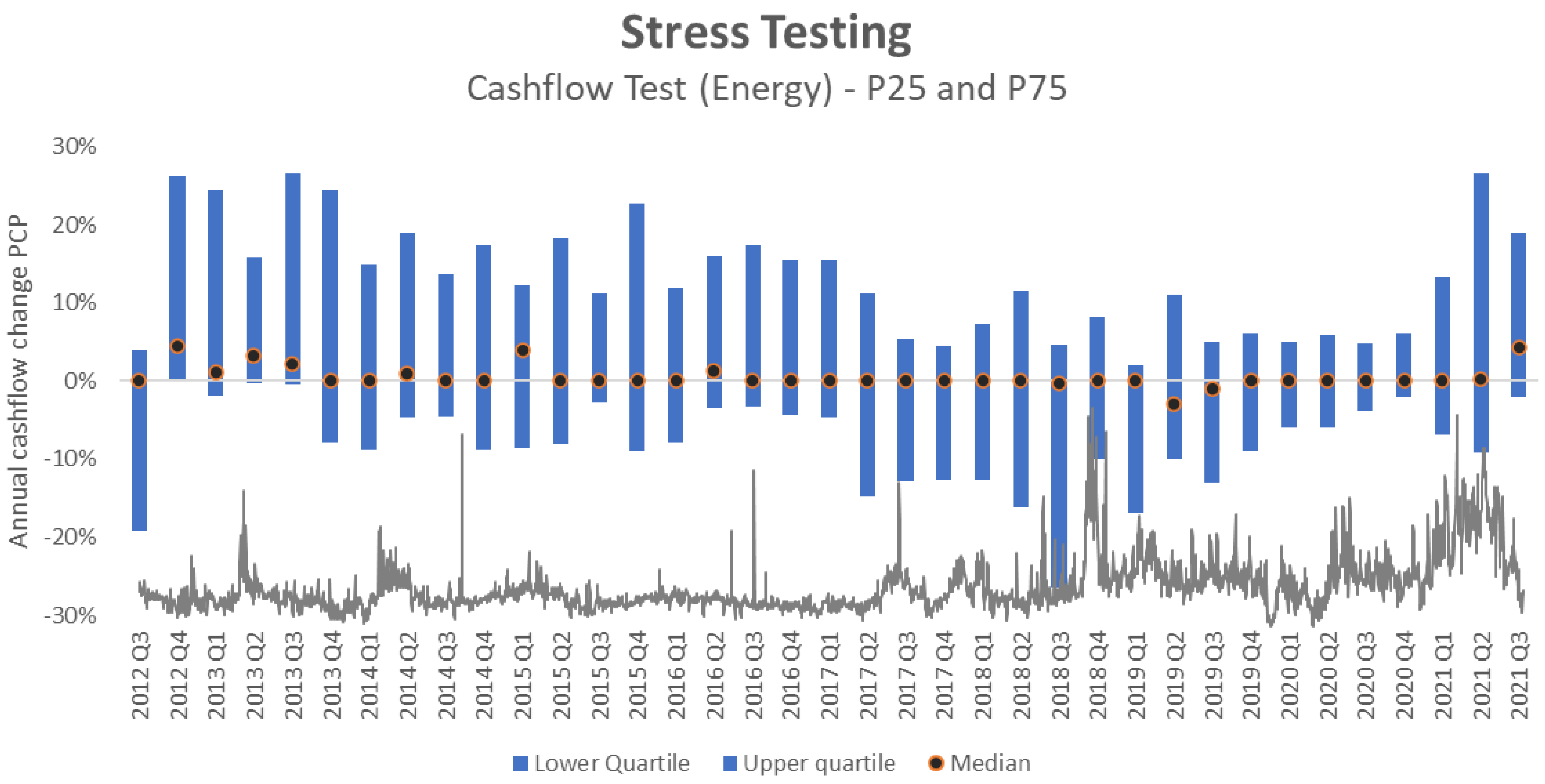
# Market Data

- Caveat
  - Each data snapshot is only part of the tapestry; problem of silent evidence.
  - Data quality is an issue; granularity (e.g., participant type)
- But:
  - Minimal retailer default through volatile period
  - No evidence that stress tests have materially deteriorated
  - Non-VI hedging has increased over 2010-2021 period (in baseload products)

# Retailer Exit



# Stress Testing



# Hedge Volumes

# Survey

- Method
  - ~ 1hour interviews with 12 participants across 3 cohorts:  gentailers, independent retailers, brokers/traders, industrials
  - All participants asked the same set of high-level questions
- Caveats
  - Timing of survey?
  - Significance of some cohorts (industrial, retailers)
- Impressions
  1. Some issues were common across (almost) all cohorts
  2. A number of issues were contentious (mainly between cohorts)
  3. Some cohorts were particularly focused on areas not mentioned by other cohorts

# 1. Common views

1. Unambiguous agreement across all 12 that risk management (models, analysis, policies, product use) **have improved since 2010**
2. Range of sophistication of RM approaches from position limits through to multi-product VaR+; general acceptance that **further improvement likely or inevitable**
3. Common agreement that **ASX has become an expensive channel for hedging** (initial margins)
4. Views on current and future impediments varied….

# 2. Areas of contention

| Issue | | |
|---|---|---|
| **Sufficiency of current product suite?** | Generally satisfactory, although EnergyLink flex-CfD; 7-day peak; solar/wind firming all mentioned as potential for development | |
| **Liquidity of current product suite?** | Insufficient in peak, caps | Generally, all pricing requests are responded to. |
| **How should future product innovation and liquidity be encouraged?** | Managed market-making on exchange | Through OTC market |
| **OTC credit conditions** | Credit requirements have increased | Little change in credit conditions; or fair reasons for increase? |
| **Increasingly active PPA market** | Ability to get access (term); managing intermittency | Developer pricing expectations; cost of managing intermittency |
| **Demand-side flexibility/response potential** | Caution vis reality of growth, volumes | Significant potential being explored |
| **Price of peak/swaptions/caps** | Too high relative to risk | Fair representation of asset value |
| **Dry year vs capacity risk?** | Little mention of dry year; main concern is short-term volatility | Short term vol will be solved by batteries; big issue is dry year risk |

# 3. Areas of cohort focus

- **Independent Retailers**: access to products:  shape, liquidity, credit
- **Industrials**:  Management/governance challenges; “explainability” of prices and price relativity (eg PPA vs ASX vs OTC)
- **Gentailers**:  Thermal needs a plan (of different varieties); concern re: intervention and desire to pursue market-driven approaches