Box A

Developments in the Electricity Derivatives Market

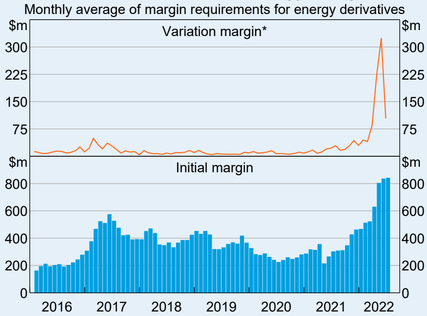
Between 15 and 24 June, the Australian Energy Market Operator (AEMO) suspended spot trading in the National Electricity Market (NEM). ASX Clear (Futures) does not clear the spot market but does clear electricity derivatives (futures and options) that reference spot market prices. Developments in the demand for and supply of electricity in the NEM earlier in the year had led to large increases in spot prices and large changes in the value of derivative contracts. This volatility drove an increase in initial margin collected by ASX Clear (Futures) from its participants and their clients, as well as large variation margin calls (Graph A1).

The spot market suspension did not directly affect electricity derivatives clearing at ASX Clear (Futures), but coincided with a decline in trading volumes, which have since recovered. Activity in the derivatives market is dominated by end users (generators and retailers) who hedge price risks associated with their operations. Generators typically hold short positions to hedge the risk that prices fall in the spot market, so large and rapid price increases can result in margin calls that put pressure on their liquidity buffers. Over recent months, some end users moved to the over-the-counter (OTC) electricity derivatives market to avoid the burden of daily margin calls at the CCP, although such transactions do not receive the risk and default management benefits of central clearing.

Graph A1

ASX Clear (Futures) Energy Margin

Monthly average of margin requirements for energy derivatives



* Value of one side of variation margin flow.

Sources: ASX; RBA

Generators and retailers access the derivatives market as clients of the participants of ASX Clear (Futures). Since their main assets are typically less liquid than those of the financial institutions that participate in CCPs, they can be more vulnerable than clearing participants to liquidity risks from large margin calls. ASX Clear (Futures) requires its participants to establish robust procedures to monitor, warehouse and manage risks deriving from the potential default of one of their clients.

Margin requirements are designed to respond to stressed market conditions in order to minimise the effect a potential default might have on other participants, the CCP and the financial system. The FSS requires CCPs to have an effective margin system that is risk based and regularly reviewed. ASX Clear (Futures) reviews initial margin parameters monthly. As part of this process, ASX Clear (Futures) increased initial margin for some electricity derivative contracts in recent months. In July 2022, ASX also introduced a range of new stress test scenarios intended to capture recent price volatility for energy derivatives. In some circumstances these could require participants to contribute additional initial margin, but this type of margin call is not typically passed on by participants to their clients.