

Australian Competition & Consumer Commission
Level 17,
2 Lonsdale St
Melbourne Vic 3000
By email: waterinquiry@accg.gov.au

Dear Mr. Mikkelsen,

30th October 2020

RE: H2OX Submission to the Murray Darling Basin Water Market Inquiry Interim Report

H2OX welcomes the Murry-Darling Basin water markets inquiry Interim Report and is pleased to make the following submission.

We support many of the findings of the ACCC's Interim Report and would encourage the ACCC to embrace some of the more ambitious reforms proposed in the report. We believe this inquiry provides a once in a generation opportunity to materially improve the water market and we would encourage the ACCC to be ambitious in its recommendations to ensure that all market participants benefit through the creation of a level playing field for all.

Please find our answers in response to questions posed in the Interim Report below.

Conflict of interest deceleration: H2OX operates a water exchange and could benefit from the establishment of a central water exchange platform if H2OX was chosen to build and operate the exchange.

Sincerely,



Lex Batters
CEO H2OX

Chapter 6:

- ***What is your experience of brokers holding client funds? Should a broker or brokerage firm have statutory obligations in respect of holding client funds?***

Brokers should have statutory obligations in respect to holding client funds. Brokers and other intermediaries often hold large sums of money for extended periods, for example H2OX has multi-year forward deposits that are held for as long as 5 years. At present there are no statutory obligations in how these funds are managed, nor are they protected from an insolvency event. Statutory trust accounts should be available, and their usage mandatory for water intermediaries.

- ***If statutory trust accounts were mandatory for brokers, should any interest on client funds be directed to an assurance or fidelity fund?***

Interest earned from client funds is currently either kept by the intermediary or kept by the deposit holding institution. It would be logical that, interest from client funds be directed towards an assurance or fidelity fund, or to a regulatory body to help cover the cost of regulation

- ***Should brokers be required to hold professional indemnity insurance?***

Yes. Intermediaries who use the Victorian Broker Portal are required to hold professional indemnity insurance. This should be mandatory for all intermediaries.

- ***If clear, reliable and timely information about the market was more easily available, would this prevent brokers from providing misinformation to clients?***

Clearer more reliable and timely information about the market will create a more efficient market ensuring everyone has access to equal market information. It would create a level playing field for all market participants and improve the level of service provided by intermediaries.

Chapter 7:

- ***Do you consider that there is a place for bona fide water options and futures in the water market?***

Water options and futures should play a role in the continuing maturation of the water market. These products, once a market is established, can provide water users better long-term water management

options at lower cost than existing products. Futures should also replace forwards as a lower risk option for water market participants to utilise, protecting both sides of the trade.

- ***Would you buy or sell water futures on-exchange or over-the-counter, if they were available?***

A future is defined as an exchange traded product. An exchange is required to set the contract, match the counterparties, and manage the counterparty risk of the contract.

The OTC equivalent is a forward which is already common in the water market.

- ***Do you think that brokers and intermediaries in MDB water market should be licensed?***

Yes, intermediaries should be licenced we believe an Australian Financial Services Licence should be required to act as a water intermediary. Intermediaries handle large sums of money on behalf of their clients and give advice on the sale of assets, the value of which can run into the millions of dollars. The lack of regulation and licencing of this industry is alarming.

- ***Should a licensing scheme be enforced at the Basin State or federal level?***

Ideally licencing should be enforced at a federal level to ensure uniformity across the Basin States, this will prevent brokers and intermediaries basing their operations in the jurisdictions with the lowest licencing requirements, whilst also lowering the cost of compliance for intermediaries who operate in multiple jurisdictions.

- ***Should the licensing scheme be entrusted to an already established body or an independent new body specific to the MDB water market?***

The licencing scheme should be entrusted to an already established body. Establishing a new body would likely be cost prohibitive given the small size of the market.

- ***Should the financial regulation framework be applied to basic tradeable water rights and arrangements to buy and sell them, noting that it is a ready-made market regulation framework?***

Yes the financial regulation framework should be applied. Many water products resemble financial products already. Treating water as a financial product would also enable the creation of more sophisticated water management tools, providing lower cost ways to secure insure against high water prices.

- ***Should an independent market focused regulator be established for the MDB water market?***

An independent market focused regulator for the MDB should be established, or an existing regulator should be given similar powers.

Chapter 8:

- ***Do you consider that automating the flow of information (price, struck date, product type) from an exchange to a register would greatly improve accuracy of data? Do you consider the benefits of improving price reporting would outweigh the cost of adopting this approach?***

An automated flow of information from an exchange to the register would greatly improve the accuracy of the data but also the timeliness of the data which is a major issue with water registry data. Yes the benefits would substantially outweigh the minor costs involved.

- ***Do you consider that there would be benefits in aligning the states' water management roles (as much as hydrologically possible)?***

Any moves to standardise management roles across the states would be beneficial

- ***Do you consider, that apart from state-specific or water sharing plan specific rules that each allocation trade within the Basin should be subject to the same assessment framework? For example, that a standard and automatable checklist should be used for each state (including; is there enough water in account balance, check trading rules, check fee is paid, check correct form is used, check consent is given)? Do you consider that this checklist should be made available to water traders so that they understand what assessment process their application is subject to?***

Any moves to standardise the way trades are assessed across the states would be beneficial. The way trades are assessed should be publicly available

- ***Do you consider that entitlement trades should also be standardised across the states? Do you consider this will create more equal trading opportunities? Do you***

consider that fees should then also be standardised? Do you consider that the New South Wales framework provides a good starting point for separating out different transfer types?

Any moves to standardise the way trades are assessed across the states would be beneficial. The way trades are assessed should be publicly available. The way the New South Wales framework separates different transfers is a good starting point, however a more complete reasons for trade list would be more beneficial.

- ***Would you like to see one trade form with standardised language be used across the states?***

Yes, any moves to standardise the way trades are managed across the states would be beneficial.

- ***Would you like to see the trade type and party type (investor, irrigator, other) recorded publicly?***

We do not think this information would provide any benefit to the market. Defining an investor and irrigator can also be problematic, as they are often interchangeable terms.

- ***Would you like to see all state water register websites to provide the same information, presented consistently? If no, why not?***

Yes a consistent approach to water registers would be beneficial to the market, as it would make compiling and analysing water market information easier.

- ***Do you think that the consolidation of trading rules into one document per state/per Basin would assist users in undertaking trades?***

Yes, however we do not consider this to be a major impediment to trade in the major water markets.

- ***Do you think there would be benefit in standardising and making it clear that each state should have the following separate and distinct registers and information should be published on each:***
 - ***Ownership register (water entitlement)***
 - ***Water entitlement trade/transfer register***
 - ***Water allocation trade/transfer register—including identifying product type***

Standardising the water registers across the states would create substantial benefits to the market. We don't think it's necessary for each state to have separate and distinct registers for each of the above. A single state register could provide all of the above information.

Chapter 9:

- ***What information do you think is critical to your ability to make water trading and investment decisions?***

Price discovery and market depth are the two key pieces of information required for an efficient market. At present, determining price and depth is very difficult and time consuming. Large market participants have a material advantage over smaller participants.

- ***How do transparency and data quality issues impact your trading activity?***

Lack of transparency and poor data makes it difficult to make informed market decisions and creates inequality in the water market. Price discovery and market depth are the two biggest factors in making an informed trading decision. Poor quality historical data, and even worse quality live market data makes this very challenging.

Chapter 11

- ***Do you consider the publication of IIO trading data (internal and external) would be of benefit to all water traders?***

Yes, trading data with IIOs should be published as the larger IIO zones can be very active markets. In NSW Murray above choke for example, the majority of trades occur within MIL. Whilst MIL publish data from their own exchange, other transactions are not transparent. Within Murrumbidgee Irrigation there is very little transparency. The publication of trade data inside IIOs would materially improve the quality of water trading data.

- ***Do you consider that the Basin Plan Water Trading Rules (BPWTR) should be updated to include requirements on Trade Approval Authorities to collect more information on trades?***

Yes, all trade approval authorities should be required to collect, and publish more information on trades, including; date, time, price, volume, zone, transaction type

- ***Do you consider that price reporting obligations on sellers under section 12.48 of the BPWTR are well understood?***

We don't think 12.48 is well understood. By placing the obligation on the seller, it gives intermediaries the ability to not report accurate trade prices without consequence. We do not believe this is a widespread issue, but the very high percentage of \$0 trades indicates there may be an issue

- ***Do you consider that section 12.50 of the BPWTR, which applies to states to make water allocation announcement generally available is sufficient? Would you support extending this obligation to require consistency across the states' announcements?***

We believe 12.50 of the BPWTR are sufficient in making these announcements generally available. A greater benefit would be in making water allocation announcements more frequent and the methodology used to make the determinations more transparent.

- ***Do you consider that each state should make available, in one place, the following:***
 - ***how much has been allocated to entitlement holders***
 - ***what the current carryover limit is applying to each zone, with clearly explained reasoning if there are any differences***
 - ***historical trading information, with sufficient detail to understand what products are traded and for what price***
 - ***current buy and sell offers to understand market depth and current pricing trading and carryover policies and rules.***

Providing all of this information in a single place would be challenging under the current market infrastructure. Historical trade information and general water availability information should be provided in a single place. The Victorian Water Register provides a good starting point, with historical trading information available and current water availability information available through their unused water function. The unused water function however, could be improved by differentiating between trading zones within systems i.e. separating Zone 6 & 7.

Providing all current buy and sell offers in the same place, should be managed through a central exchange. Under the current system, collating bids and offers from multiple brokers and exchanges raises a host of issues, such as reporting the same buy/sell offer by multiple brokers which would impact market depth.

- ***What information should a single water market information portal cover?***

Improving the quality of the data would be of greater benefit than collating all of the information into a single portal. As an example, it would be more beneficial for the MDBA, GMW, BOM and State Water to agree a value for storage volume of Hume Dam at any one time, than for the four differing values those entities currently report to be provided in one place.

We don't have a problem with disparate information sources, the problem is in the quality of the underlying data.

- ***Do you consider that the markets for permanent trade, derivatives and temporary transfers can all be dealt with under one technological solution? Do you consider permanent trades less reliant on real-time data and would be better suited to a different solution?***

Yes, all of these products could be dealt with under one technological solution. A central exchange for all of these products would make sense. Permanent trade is as affected by difficult price discovery and market depth as allocation products and should be dealt with under a single solution. Permanent trades could be handled under a different exchange, but it would increase costs of implementation and ongoing management, whilst providing no net benefit.

- ***Do you agree that it is important to preserve the ability for buyers and sellers to strike 'off-market' deals, provided that all approved trades are registered and captured in historical trade data? Why or why not?***

Yes, it is important that buyers and sellers be able to strike "off market trades" as there will always be related party trades and contractual lease transfers that need to be transferred. However off market trades can be handled through a central exchange as a "reported trade" that ensures the details of the trade are captured accurately and are visible to the market. A central exchange does not preclude off market trades.

- ***Do you support the short- and medium-terms options proposed? Why or why not? Do you consider alternative options should be considered for implementation in the short- to medium-term? Please provide details.***

Yes, we support the short- and medium-term options proposed. They are sensible, incremental improvements to the market, however we think more ambitious reforms should be undertaken. We consider this review to be a once in a generation opportunity to make meaningful reforms to the market and think more can and should be achieved in the short and medium term.

If only incremental improvements come from this process, we would consider it a missed opportunity for meaningful reform. We believe a central exchange is the only way to solve the majority of the issues in the water market, and create a level playing field for all participants.

- ***Which of the technological options presented in section 11.3 would you support? Please provide reasons supporting your preference. Are there additional technological or policy/governance solutions which should be considered for implementation over the longer term? Please provide details.***

We support the creation of a single exchange, similar to that described in option 11.3.4

A single exchange would solve the two biggest issues in the water market, price discovery and market depth the two issues that impact every single transaction. By collating all bids and offers into a single market place every market participant has equal access to the same information and can make an informed trading decision. A central exchange creates a level playing field for all market participants.

A central exchange would vastly improve the quality of historical trade data as all transactions would be automatically and accurately reported in real time. Counterparty risk would be almost eliminated as an exchange integrated with the registers would ensure sellers had the water they were selling, and buyers would be forced to complete trades as defaults could prevent market access going forward. Sell and buy orders could not be replicated across multiple markets ensuring accurate assessment of market depth.

A central exchange would enable easier regulation of the market, much like with the ASX, where the exchange could self-regulate broker behaviour. All transactions would be visible in one place, enabling a regulator total oversight of the market and all market participants trading activity. By simplifying price discovery and market depth discovery, the ability of brokers to provide inaccurate information would be greatly reduced, whilst increasing the level of service provided by brokers through increased competition based on fees and service as opposed to access to their client lists. A central exchange would create a level playing field for brokers as well as market participants.

A central exchange would likely lower the cost of transacting even if exchange access was limited to brokers (which it needn't be). Brokerage fees would likely reduce through increased competition given all brokers would have access to the same bids and offers.

A central exchange would provide the liquidity and price discovery to enable the trading of more sophisticated products that lowered the cost of irrigators managing their water risk. These products could improve the markets ability to manage water in dry times by potentially financially settling market products.

A central exchange would also improve the security of market participants by being able to more closely monitor trading activity, increase KYC and AMLCTF compliance, well beyond that completed by existing intermediaries and through integration with water registers instantaneously updating trade authorisations.

- ***Do you consider the identification of water right holder types (land-owner, brokers, agribusinesses, environmental water holders) in ownership, permanent and temporary trade registers would change your approach to engaging in water markets? How do you consider such a classification would be made—by account or by individual (for example, a farmer may own an ABA that is not connected to a use licence and then own another that is, in the first option that same farmer***

would have two classifications, in the second option he would be classified as a land-owner for both accounts).

We don't think identifying the water right holder by type would add any material value to the operation of the water market. Difficulty in classifying market participants could create misconceptions about who is buying and the reasoning behind the transaction.

- ***Do you support disclosing some ownership information for those who own more than a certain amount of entitlement in a system? If yes, what proportion should this be and how will this change your approach to engaging in the water market? If no, why?***

We do not believe publishing this information would provide any material benefit to the market, however we are not opposed to it if it is carefully managed.

Publishing large ownership information may go some way to addressing the concerns of farmers that large corporate investors or corporate agriculture businesses are hoarding water and influencing the price of water on the temporary market. However, with no way to interpret the data, we are concerned it would create misconceptions around the behaviour and intentions of large water holders. This has already happened with much speculation on water holdings published as part of public company reporting requirements.

- ***Do you support the mandatory collection of broker details in trade forms where the trade was facilitated by a broker? Do you consider that reporting (in an aggregate manner) on broker facilitated trades could increase transparency and reduce concerns about broker misconduct?***

Yes we support this measure. Collecting broker details on trade forms, will ensure accurate price reporting of transaction details at a minimum. It would also make detection of broker misconduct simpler.

