2012 A CONSULTANT'S OUTLOOK

What do you see as the biggest challenges for energy risk managers in 2012?

Baris Ertan, Partner, ETRM Practice Lead, The Structure Group: Liquidity risk management remains a top priority. The perilous way in which some organisations scraped through the financial crisis drove home the importance of maintaining sufficient liquidity to continue ongoing operations. Upcoming Dodd-Frank regulations and any MF Global-inspired rules will stipulate greater liquidity-support requirements for over-the-counter (OTC) derivatives and requirements for better managing funds by organisations to which they are provided. To manage this risk effectively, an organisation must build a proactive view of margin requirements that factors in anticipated shifts in exposure and/or creditworthiness. It also must plan for how it will meet these existing and anticipated margin obligations. Finally, companies should develop contingency plans to meet funding requirements if liquidity becomes a problem.

What is your view on regulatory uncertainty and the best way to tackle it in 2012?

Baris Ertan: The lack of final rules and implementation timelines presents challenges for energy trading organisations. While strategies, alternatives and potential issues are being discussed at a high level, and feedback on proposed rules has been provided, many companies have been slow to tackle more detailed planning. This 'wait and see' approach could lead to the predicament of being caught without a workable solution or the time to implement it.

Organisations should identify gaps in their ability to comply with pending regulations now, especially Dodd-Frank, and continue to make updates as additional information becomes available. Identifying gaps and the costs to remedy them will help evaluate alternatives and begin to budget for required changes. Some plan updates will be required as rules are finalised, but they will likely involve the revision of existing assessments, not a complete rework.

Once final rules are available, organisations that have performed such assessments can more efficiently determine their desired strategic approach and readiness to execute it. This enables the organisation to focus on the implementation of the specific strategic solutions.

Are you concerned about the outlook for international co-operation when it comes to regulation? What needs to be done to ensure against regulatory loopholes in this respect?

Baris Ertan: Regulations developed by G-20 countries will not be mirror images, nor will comparatively lawless markets offer significant regulatory arbitrage opportunities. Repeated delays have caused concerns about disparate timelines to diminish. Collaboration on in-progress rule-makings and statements issued by market regulators give some hope that material differences across markets can be addressed. A recent speech by Commodity Futures Trading Commission commissioner Scott O'Malia at the Futures Industry Association's *Asia Derivatives Conference* outlined the challenges of international co-ordination. Though it will put significant additional pressure on existing timelines, material issues are avoidable if some level of harmony is reached on key areas such as clearing and margining requirements.

What are the implications for energy trading and risk management (ETRM) systems that will be needed by energy companies as a result of new regulatory requirements? Do you think there will be a major boost in spending in 2012 and what areas are likely to require most attention?

Baris Ertan: Dodd-Frank's system implications are significant. Proposed regulations necessitate new or revised data, calculations, business logic, reports, integration and controls. Key system functions that will be affected

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include deal capture, confirmations, position management, risk reporting, limit monitoring and credit / collateral management – along with the integration to exchanges, clearing houses and various data repositories. The greatest effort will come with the introduction of business logic to store, process and report information. In addition, while the ETRM system will be the most heavily affected, it's unlikely to be the only one. Separate contract, credit, hedge accounting and reporting systems, as well as data warehouses, are just some of the other systems/tools where updates will be needed.

How do you see the move towards greater clearing playing out in the energy markets during 2012?

Baris Ertan: At present, costs associated with increased clearing are more tangible and immediate than any purported Dodd-Frank benefits stemming from increased market transparency. This may push some organisations towards greater use of strategic alternatives like increased physical trading or to leave risks unhedged. Significant increases in trading activity for and market reliance on large physical players could increase the systemic risks those organisations pose to the market.

Organisations that continue to trade OTC derivatives will see significant impacts on their day-to-day operations as a result of the clearing requirement, including additional demands on liquidity that will force even greater focus on its timely and accurate management. There will also be new processes and a significant additional workload arising from margin management and/or exemption processing.

Arguably, the most significant implication of central clearing is at a macroeconomic level. The potential importance of central clearing parties (CCPs) suggests that we may be creating a different type of too-big-to-fail entity. These organisations are not risk free, so trading organisations will need to manage exposures to these CCPs.