

28 November 2019

Director
Murray-Darling Basin Inquiry
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

RE: Murray-Darling Basin water markets inquiry

Waterfind is grateful for the opportunity to provide input into the Australian Competition and Consumer Commission's (ACCC) Murray-Darling Basin water markets inquiry (Inquiry).

The Australian water market functionality we benefit from today is the result of National and state water reform. Most significantly, the Council of Australian Governments (COAG) Water Reform Framework initiated in 1994 aimed to clarify water property rights and facilitate and promote water trading. The next wave of large reform came in 2004 with National Water Initiative (NWI). This agreement aimed to facilitate the efficient functioning of water markets.

While reform has been significant, some aspects have not kept up with the dynamic pace and shape of the water market. As pointed out by the Productivity Commission in its May 2018 report, many of the NWI objectives have/are being met, but there is more work needed to ensure fully efficient water markets. This includes removing barriers to trade, improving water market information, and reducing administrative costs and times. Waterfind supports the Productivity Commission's recommendations and is pleased the Australian Government has also shown its support for a renewed NWI. Waterfind proposes that further water reform opportunities are possible and has identified six areas of focus for the next round of water market reform. These are discussed further as an attachment to this cover letter.

Please contact me if you would like to discuss any of these matters further.

Yours sincerely



Stuart Peevor

Director – Market Regulation, Government and Conveyance

Further Water Reform Opportunities

1. A nationally consistent, agreed upon, framework that covers rules and standards for the role and interaction of government in the marketplace

Government acquisition and ownership are significant considerations in the water market. The method for entitlement acquisition continues to attract concern and criticism (for example, refer to the 'Watergate' event and opinions on the government's irrigation infrastructure efficiency upgrades). The setting of allocations is also an area that causes concern and confusion with water market participants. With any marketplace there should be clear separation of functions between rule makers, regulators, market operators, intermediaries, and buyers and sellers. A framework that covers the rules and standards for the role and interaction of government in the marketplace is urgently needed. This framework should cover at a minimum:

- The setting of allocations in a way that is transparent and consistent
- Regulatory involvement in the market

a) The setting of allocations in a way that is transparent and consistent

Temporary water markets are critical for Australian irrigators to manage short term water supply changes and challenges. This market has much higher price fluctuation than the permanent market (where demand and supply conditions often work naturally against each other in the long term). Rapidly changing demand and supply conditions can see the same Australian irrigators paying between \$20 to \$700 per ML for temporary water across irrigation seasons.

Waterfind has examined pricing data and has found the highest short-term contribution to price changes is water allocation announcements. These announcements are mainly the responsibilities of state agencies responsible for sharing finite resources between competing interests. Most state bodies now understand the importance of those announcements to the market, and have created structures and processes to protect leakage of those announcements to the market ahead of time. They have also made improvements to the transparency of how allocation decisions are made.

However, some state agencies put their Water Ministers as the key allocation announcers or refer to non-public models which they use to establish the announced allocation. This process, unfortunately creates the potential perception of market participants with in a qualitative process of setting allocations, rather than the quantitative process that they actually are. To address this, Waterfind recommends that all models and calculations used to determine allocations are publicly accessible. Ideally, these would show real time changes to underlying water conditions, sharing arrangements between competing users, water security measures, and changes to allocations under different future water supply scenarios. This additional transparency would minimise inefficiencies and distortions from information asymmetry and market announcements, and promote an overall greater level of confidence in the water market.

b) Regulatory involvement in the market

Currently, the largest holders of tradable Australian water rights are government or public entities responsible to regulate the market. While this is not dissimilar to other major national assets such as land, stocks and shares, unlike these assets there is a lack of Nationally consistent rules in which water regulators engage with the market.

Waterfind recognises that some regulators go to significant lengths to create transparent and consistent rules for market engagement (such as publishing trading intentions), which are designed to remove adverse market impacts from their engagement. However, these rules are imperfect and are not consistent. They also lack suitable coinciding measures, with which to monitor if they are successful in their intentions.

Market regulators also create their own short-term marketplaces (such as tenders) rather than utilising a transparent and independent market platform. Each time this occurs, important and disturbing signals are sent to the market, which are not consistent with the overall national objective of building market confidence in managing and sharing our water resources through market-based measures.

Proper market function and design would create barriers of responsibilities from regulators, rule enforcers, intermediaries and participants. While this may not be immediately achievable, market regulators could take some important short-term steps towards proper market function in the ways in which they utilise the Australian water market.

Benefits of addressing the above include:

- minimising adverse and unintended consequences of governments in the marketplace, including inefficiencies and distortions from information asymmetry and market announcements
- providing overall greater confidence in the water market (and avoiding such events as 'Watergate')
- increasing economic efficiency
- protecting regulators and their staff from potential insider trading accusations and or challenges.

2. Improvements to the way water assets are valued under state and federal legislation

Growing hardship in some parts of Australia from current drought conditions, compounded by well-intended recent financial reform, has made an urgent case for a review of the way water assets are valued under financial legislation. This must be nationally consistent to ensure a level playing field across states. Trading water is essential to our economy, directing scarce water resources to best economic use. The lack of efficient financing to purchase permanent water rights is hindering economic efficiency. Banks, generally, have limited understanding of water markets and trading. They use outdated valuations of water

entitlements, and limited flexibility such as tenor and repayment profile further compound this lack of understanding. Adhering to global accounting standards, banks treat water licenses as intangible. This puts them in the same class as derivatives and, as a result, they are required to 100 percent risk-weight them by the Australian Prudential Regulation Authority (APRA) for capital purposes. This compares to a risk weighting of as little as 25 percent for mortgages on residential property. The risk weighting results in significantly increasing a bank's cost of funds for permanent water rights in Australia.

Waterfind believes Australian water rights have many of the same characteristics of real property; rights that are registerable, tangible, transferable, enforceable and able to be objectively valued.

Improving the way water assets are valued would:

- increase the resilience of irrigation communities to deal with drought conditions through improved access to finance
- minimise the transition costs from business transfers and closures
- maximise the competitiveness of Australian owned family farming entities, to compete against foreign and domestic investors who may have access to different sources of financing, beyond the traditional Australian based banks.

3. Improvements to the access and robustness of water titles, including the ability to mortgage and online search and lodge changes

In some parts of Australia, water titles are not fully robust or fully accessible. For example, many customers of water infrastructure operators are unable to access permanent water rights, and some state governments have yet to achieve the requirements of the NWI, in that water titles adopt similar characteristics of land-based titles. Benefits of improving the access and robustness of water titles include:

- increasing economic efficiency from potentially more trading opportunities
- increasing the resilience of irrigation communities to deal with drought conditions through improved access to finance
- minimising the transition costs from business transfers and closures.

4. A single national exchange that is a centralised water market platform, providing a licencing and regulatory framework for market participants

Like the stock market, a centralised exchange would include a licencing and regulatory framework which could be accessed by water market participants. Waterfind considers it important from a market confidence, and national security perspective, that this centralised exchange be mandated by government to be Australian-owned and operated. In the absence of that mandate, this would be jointly owned by State and Federal Governments. Benefits of this reform include:

- lower costs for market participants
- evidence to APRA of a “marketplace”, which is essential to it shifting its current view of water rights property status and coinciding impacts to financing those rights
- greater consistency and transparency in market information than is currently provided by state-based registers
- overall market protection from appropriate regulation
- greater overall confidence in the marketplace.

5. A review into the requirement for regulation of water market intermediaries

Waterfind has long supported proportionate regulation of water market intermediaries. In the absence of industry regulation, some statutory and government owned authorities have developed well intended, but misguided criteria for dealing with water market intermediaries. At a minimum, a review needs to be conducted to determine agreed upon behaviour and operational criteria for market intermediaries.

Without market regulation, Waterfind suggests the following core criteria for government entities, and that the service provider:

- has clear, written terms of use which are agreed to by its customers. These would set out terms in which they conduct and manage water transactions, and clearly articulate the relationship the intermediary has with their customer
- does not create, or purport to create, any sort of agency relationship with their customer
- utilises trust accounts for all transactions that is free from any creditor action of that service provider
- does not trade water in their own right
- provides comprehensive information through an online system that is accessible, and in real time, to its customers (at a minimum, this would provide transaction history and key market driving events)
- has a quality endorsed business operation system that secures these core provisions into the way they do business.

Benefits of this reform include:

- reduced costs for water market intermediaries that arise from differing criteria
- greater protection of water market participants
- greater overall confidence in the marketplace.

6. A comprehensive public review into water asset investment and foreign water asset ownership

Waterfind notes the growing concern regarding the impact investors and speculators are having on the marketplace, including concern from water market participants regarding levels and intentions of foreign ownership of water assets. Without robust information and debate, this concern will continue to grow. The Register of Foreign Ownership of Water Entitlements report provided some good information into the debate surrounding foreign ownership. However, a comprehensive public review should be carried out to ensure practices and concerns are not having a detrimental impact to the effectiveness and efficiency of water markets. It is hoped the ACCC Inquiry will significantly assist in the provision of information.