



CREDIT LIMIT PROCEDURES: APPLICATION OF OFFSETS IN THE PRUDENTIAL MARGIN CALCULATION CONSULTATION

FINAL REPORT AND DETERMINATION

Published: **30 June 2017**





EXECUTIVE SUMMARY

The publication of this Final Report and Determination (Final Report) concludes the Rules consultation process conducted by AEMO to consider proposed amendments to Credit Limit Procedures: Application of offsets in the Prudential Margin (PM) calculation under the National Electricity Rules (NER). AEMO will commence operation of the Prudential Margin (PM) offsets facility under the revised Credit Limit Procedures (CLP) for the 2018 summer season (effective from 30 November 2017). Other CLP changes resulting from this consultation are applicable from 1 July 2017.

On 22 September 2016, the Australian Energy Market Commission (AEMC) made the *National Electricity Amendment (Application of Offsets in the Prudential Margin Calculation)* Rule 2016 (PM Offsets Rule).

Effective from 20 October 2017, the PM Offsets Rule gives AEMO the ability to offset trading amounts against reallocation amounts when determining a Market Participant's prudential margin (PM), as part of its prudential settings in the National Electricity Market (NEM). This allows the PM for a Market Participant to be reduced if:

- The Market Participant has negative aggregate trading amounts (i.e. load) and positive aggregate reallocation amounts (i.e. credit reallocations). The PM will be based on the load offset by the credit reallocations.
- The Market Participant has negative aggregate reallocation amounts (i.e. debit reallocations) and positive aggregate trading amounts (i.e. generation). The PM will be based on the debit reallocations offset by the generation.

Second stage Rules consultation

During the second stage of consultation, the proposed amendments were provided to the Australian Financial Markets Association (AFMA) Reallocations Working Group and AEMO's Settlement Managers Working Group. No issues were raised by these groups.

AEMO received one written submission in response to the second stage consultation from Basslink. Basslink reiterated its concerns about introducing Maximum Credit Limits (MCLs) for Market Network Service Providers (MNSPs).

Basslink asked AEMO to treat its submission as confidential, and it has not been published on AEMO's website.

In finalising the proposed CLP amendments, AEMO has made one minor change to clause 7 to clarify that a Typical Accrual amount will not be calculated for MNSPs. AEMO's final decision is to amend the CLP in the form published with this Final Report, effective from 1 July 2017. The CLP as made by AEMO are otherwise in substantially the same form as published with the draft report.



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1. STAKEHOLDER CONSULTATION PROCESS

As required by clause 3.3.8 of the NER, AEMO has been consulting on proposed amendments to the CLP in accordance with the Rules consultation procedures in rule 8.9 of the NER. In addition, AEMO also sought feedback on its proposed changes to the reallocation timetable published under clause 3.15.11 of the NER.

AEMO's timeline for this consultation is outlined in Table 1:

Table 1 – Consultation timeline

Deliverable	Due date
Notice of first stage consultation and Issues Paper published	23 Feb 2017
First stage submissions closed	31 Mar 2017
Draft Report & Notice of second stage consultation published	3 May 2017
Submissions due on Draft Report	19 May 2017
Final Report published	30 Jun 2017

The publication of this Final Report marks the conclusion of this consultation.



2. BACKGROUND

2.1 NER requirements

Under NER clause 3.3.8, AEMO is responsible for developing and publishing the CLP, which may be amended or replaced from time to time. AEMO must comply with the 'Rules consultation procedures' set out in NER rule 8.9 when making or amending the CLP.

2.2 Context for this consultation

The initial CLP were implemented in November 2013, following a 2012 rule change to introduce the 'New Prudential Standard and Framework in the NEM' (the New Framework).

A key aspect of the New Framework was the concept of a 'prudential standard', defined as a 2% prudential probability of exceedance (POE). This effectively requires the prudential arrangements to ensure that no payment shortfall will arise in 98 out of 100 instances of a Market Participant default that is not remedied. In the remaining 2% of cases, Generators would face a potential shortfall. The maximum credit limit (MCL), which is the outstandings limit plus the prudential margin, is calculated to meet the prudential standard.

On 22 September 2016, the AEMC made the PM Offsets Rule following consultation on a rule change request from AEMO. From 20 October 2017, the PM Offsets Rule will give AEMO the ability to offset positive reallocation amounts against trading amounts in PM calculations. A reallocation is a process under which two Market Participants ask AEMO to match debits and credits to the financial position of those Market Participants with AEMO. Clause 3.3.8(e) of the NER currently precludes such offsets in the PM from being applied to reduce collateral required to cover trading amounts, and vice versa. The Rule is expected to allow for a more efficient use of Market Participant collateral, reduce barriers to entry and meet the prudential standard at a lower cost.

AEMO must amend the CLP, including the reallocation procedures and/or the reallocation timetable as required, to account for the PM Offsets Rule by 1 July 2017. AEMO also identified clarifications and improvements in other areas of the CLP, through the two stages of the consultation process, which were included in this consultation for clarity and efficiency.

2.3 First stage consultation

AEMO issued a Notice of First Stage Consultation on **23 February 2017**. The original proposal was to amend the CLP and amend the reallocation timetable, and an updated draft MCL calculator was provided to assist participants to estimate the PM with the new full offset calculation.

An issues paper was published containing details of the proposed amendments, and made available on the AEMO website <http://aemo.com.au/Stakeholder-Consultation/Consultations/Credit-Limit-Procedures--Application-of-offsets-in-the-Prudential-Margin-calculation>.

The first stage consultation closed on **31 March 2017**. AEMO received three written submissions as a result of the first stage of consultation. Submissions were received from the AEC, ERM, and Basslink. Other than Basslink's submission, which was made on a confidential basis, copies of the written submissions were published on AEMO's website at the above-mentioned location.

2.4 Second stage consultation

AEMO issued its draft report and Notice of Second Stage Consultation on **3 May 2017**. The draft report noted and responded to the issues raised in submissions, including the issues raised by Basslink that AEMO considered relevant to the matters under consultation. The draft report is available on the AEMO



website at <http://aemo.com.au/Stakeholder-Consultation/Consultations/Credit-Limit-Procedures--Application-of-offsets-in-the-Prudential-Margin-calculation>.

The second stage consultation closed on **19 May 2017**. AEMO received one confidential submission from Basslink. Basslink asked AEMO to treat its submission as confidential and it has not been published. No substantive new issues were raised in the second stage.

In the second stage of consultation AEMO made one further minor change to clause 7 of the CLP (typical accrual for MNSPs). This clarifies the application of NER clause 3.3.11(a)(2) in determining the appropriate call amount for MNSPs. The call amount is expressed in the NER as the higher of outstandings less typical accrual, and the outstandings less the trading limit. As it is not feasible to determine a typical accrual amount for an MNSP, the call amount will always be outstandings less the trading limit.

2.5 CLP amendments

AEMO has made the following amendments to the CLP.

1. Amendments to the CLP in line with the PM Offsets Rule:
 - Reflect the PM Offsets Rule by introducing an alternative PM calculation to include offset between trading amounts and reallocation amounts.
 - Clarify when and how AEMO can offset trading and reallocation amounts when determining a Market Participant's PM. To access this option, Market Participants will need to meet an extended prospective reallocations timetable requirement (14 days ahead) and opt in to the 'PM full offset' calculation. Market Participants will also need to maintain reallocations in accordance with the extended timetable for the purposes of their outstandings limit (OSL) calculation.
 - Confirm that Market Participants who do not meet the relevant criteria or do not opt in to the PM full offset calculation will have their PM calculated according to the current PM calculation (PM limited offset).
 - Clarify that the PM cannot be negative, in accordance with the PM Offsets Rule.
2. Amendments identified by AEMO to clarify and/or improve other areas of the CLP:
 - Determine an MCL for MNSPs, reflecting observed changes in the operation of MNSP services, resulting in prudential risks inconsistent with the prudential standard. Historically, the estimated load and estimated generation for a MNSP has been assigned as zero, resulting in zero credit support being required. However, recent experience confirms that MNSPs can frequently flow against price. This results in the NEM being exposed to a prudential risk inconsistent with the prudential standard. AEMO proposes the MCL for an MNSP be based on its highest level of accrued liability in the preceding 12 months.
 - For MNSPs, confirm that no typical accrual amount (TypA) is to be calculated (for the purposes of clause 3.3.11 – call notices).
 - Encourage Market Participants to pre-emptively manage prudential risks arising as a result of the transition between MCL seasons. AEMO recognises that the transition between seasons creates issues for prudential management, where large reductions in MCL can lead to an exposure which is not consistent with the prudential standard. AEMO has proposed provisions to recognise this issue and promote pre-emptive action by Market Participants to reduce the risk of prudential breaches.
 - Update the impact of the repealed *Clean Energy Act 2011* (Cth).
 - Update the process for generation estimation amounts where there is material variation in past levels. The process for estimating generation amounts has been reviewed and updated to protect the prudential standard. Where a generator exhibits significant differences in



generation levels between 35–day periods within the past 12 months, an assessment of daily generation for inclusion in the MCL calculation may consider the lowest average generation over an appropriate period (where no outage has occurred). Where a seasonal pattern is clearly evident, AEMO may take into account seasonal variation.

3. Consequential changes to the reallocation timetable: The ex-ante reallocations timetable is extended from the current seven business days to 14 business days for Market Participants who wish to opt in to full offsets in the PM calculation.
4. Updates to the MCL Calculator: The MCL calculator was updated to include the PM full offset calculation, and provided in the earlier stages of this consultation to assist participants to estimate the PM with the new full offset calculation. The finalised version of the calculator would be published prior to the Summer 2018 season.

The proposed changes for PM offsets will be implemented in AEMO's systems and be effective prior to the 2018 summer season (from 30 November 2017). A new menu item "Prudential Margin Offset" will be added in August 2017 to the AEMO Participant Web Portal under the Settlements Menu item for participants to opt in/opt out of PM Offsets. Other CLP changes resulting from this consultation are applicable from 1 July 2017.



3. FINAL DETERMINATION

Having considered the matters raised in submissions, AEMO's final determination is to amend the **CLP (Attachment 1)** and Reallocation timetable (**Attachment 2**), in accordance with clause **3.3.8** of the NER.



ATTACHMENT 1 – FINAL CREDIT LIMIT PROCEDURES

Published as a separate document at:

1. <http://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Settlements-and-payments/Prudentials-and-payments/Maximum-Credit-Limit>
2. <http://aemo.com.au/Stakeholder-Consultation/Consultations/Credit-Limit-Procedures--Application-of-offsets-in-the-Prudential-Margin-calculation>



ATTACHMENT 2 – FINAL REALLOCATION TIMETABLE

Published as a separate document at

1. <http://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Settlements-and-payments/Prudentials-and-payments/Procedures-and-guides>
2. <http://aemo.com.au/Stakeholder-Consultation/Consultations/Credit-Limit-Procedures--Application-of-offsets-in-the-Prudential-Margin-calculation>