6 October 2017

Peter Geers
Executive General Manager, Markets
Australian Energy Market Operator
GPO Box 2008
Melbourne VIC 3001

Submitted via email: Prudentials@aemo.com.au

Dear Mr Geers

CREDIT LIMIT PROCEDURES – MODELLING PARAMETER AND MNSP PRUDENTIAL REQUIREMENTS – ISSUES PAPER

Origin Energy Limited (Origin) welcomes the opportunity to comment on potential changes to AEMO's credit limit procedures which calculates appropriate levels of credit support that market participants must provide to trade in the NEM. Overall, Origin does not support the suggested 'low scenario' increase in the weighting and capping factors from 10% to 20% because it will significantly increase prudential borrowing costs on all participants but especially smaller market participants.

Origin has undertaken an analysis of the expected borrowing costs to meet AEMO's proposed 'low scenario' and found an 8% increase would occur if additional prudential levels were required. We believe that costs for smaller participants, who do not have access to similar funding arrangements would be higher again. This may have the unintended effect of lessening competition in the marketplace as smaller participants withdraw from the NEM due to increased funding requirements.

Figure 3 of the consultation paper graphs the potential effect that different weighting and capping factors would have had on the total MCL for the 2017 Summer season. AEMO has proposed that an increase from 10% to 20% is the preferred outcome. When assessing the impact of this change, this would require market participants to increase their prudential requirements by ~37.5% for the credit limit calculation period to ensure that the 'Total Outstandings' do not breach the 'Total MCL'. In this scenario, the MCL is not breached when the weighting and capping is increased to 20%. This appears to place an excessive prudential cost on participants to ensure that the prudential standard is never breached, rather than allow for fluctuations to occur based on market events, as currently allowed under the Rules.

Origin believes there should be consideration of an alternative approach that will allow the current prudential standard to continue, account for increased wholesale market prices including fluctuations in a participant's prudential requirements and ensure that the 2% prudential standard is not breached. AEMO could apply a prudential margin over any additional credit support that is provided to meet market exposures. The advantage of this approach is that it will allow participants to manage any excess exposure proactively, without increasing the minimum credit support required for the entire period.

For example, when a participant goes above their MCL and provides extra credit support, AEMO could apply a portion of the funding to the participant's prudential margin and allow for an extension of the 7-day reaction period in line with the actual risk being applied. Origin believes that this outcome would allow the 2% Loss Given Default methodology to be met and lead to lower overall costs for market participants.

As stated above Origin is comfortable with the current smoothing regime and weighting values. Increasing the weighting and capping factors accentuates the previous seasons volatility. While high prices have been forecast to continue in the short to medium term by the AER, the change in average prices year on year is likely to lessen as higher prices stabilise. There may also be a case where a previous year's volatility is higher than the current year. If weighting and capping factors are increased, this would result in a 'higher high' scenario where participants would be required to fund excessive prudential requirements.

Should you have any questions or wish to discuss this information further, please contact James Googan in the first instance via email james.googan@originenergy.com.au or phone, on (02) 9503 5061.

Yours sincerely,

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Origin Energy