

## **APCWG Meeting 21 May 2020 - Summary of proposed changes to the Market Procedure: Prudential Requirements and the Market Procedure: Capacity Credit Allocation**

### **Background**

In July 2018, AEMO commenced the Reduction of Prudential Exposure (RoPE) project to address known issues with Prudential Requirements in the Wholesale Electricity Market (WEM). Phase 1 of the project ran from July 2018 to May 2019 and implemented the changes required under rule change RC\_2017\_06: Reduction of the Prudential Exposure in the Reserve Capacity Mechanism, including amendments to the Individual Reserve Capacity requirement (IRCR), Capacity Credit Allocations and associated Settlement and Prudential processes.

AEMO is now progressing proposed amendments to its Market Procedures to implement phase 2 of the project which will improve the accuracy of Outstanding Amount calculation.

Currently, a Market Participant's Outstanding Amount is calculated based on settlement outcomes that are up to 70 days out of date. This means the calculation does not accommodate real-time changes to a Market Participant's trading behaviour. This lack of real-time responsiveness increases the risk of default levies if the Outstanding Amount calculation underestimates actual prudential exposure, and/or requires Market Participants to provide excess prudential security in the event that the Outstanding Amount overestimates actual exposure.

The Outstanding Amount was fit-for-purpose when the market and therefore prudential requirements were less dynamic. However more recently, we have seen continual changes in trading behaviour by Market Participants across the WEM, meaning the current method will not accurately reflect exposure in the market in real time.

AEMO estimates the current Outstanding Amount calculation may overestimate or underestimate actual exposure by as much as \$25 million across all Market Participants. Overestimation may tie up Market Participants' security unnecessarily whereas underestimation increases the magnitude of default levies in the event of a Market Participant default event.

AEMO considers it prudent to minimise the likelihood of this occurring. It therefore proposes to amend the Outstanding Amount calculation to deliver a dynamic, daily Outstanding Amount calculation based on the settlement calculation specified in the WEM Rules, the latest operational data (e.g. Balancing Price, STEM Price, SCADA data, outages) or estimates of operational data when not available (e.g. meter data).

AEMO considers this Procedure Change Proposal to be a priority as it will deliver efficiencies in the administration and management of prudential requirements by:

- reducing the risk of significant default levies;
- ensuring any additional prudential security is only required when needed;
- providing a foundation to amend the Credit Limit methodology in the future; and
- providing Market Participants with more accurate forecast settlement estimates.

An overview of the changes to each of the Market Procedures is provided in the following sections.

## **Market Procedure: Prudential Requirements**

Amendments are proposed to section 5 of the Market Procedure to:

- amend the variables used in the calculation of the Outstanding Amount so that the estimated exposure for a Market Participant is calculated using known settlement data available at the time of the calculation (section 5.1); and
- specify the methodology for undertaking estimates in circumstances where AEMO is required to estimate input data that was unavailable at the time of the calculation, (section 5.2).

The draft calculation formulation document that is referred to in proposed steps 5.1.2 and 5.1.3 of the Market Procedure is available on AEMO's [website](#) under the title 'WEM Metering Settlement and Prudential Calculation Formulation – May 2020'.

## **Market Procedure: Capacity Credit Allocation**

Amendments are proposed to section 8 of the Market Procedure. These amendments require AEMO to use the latest Capacity Credit Allocation information to update the Outstanding Amount calculation when considering whether a Market Participant's Trading Margin is likely to be negative after a Capacity Credit Allocation is established or reversed.

Minor updates are also proposed to reflect amendments to the WEM Rules made by the Minister for Energy in February 2020 in relation to Reserve Capacity Price arrangements. These changes reflect the need for the Monthly Reserve Capacity Price to be determined for each Facility on the basis that the new arrangements result in various Reserve Capacity Prices in any one Capacity Year.