



# CREDIT LIMIT PROCEDURES – MODELLING PARAMETER AND MNSP PRUDENTIAL REQUIREMENT CHANGES

FINAL REPORT AND DETERMINATION

Published: **29 January 2018**





## EXECUTIVE SUMMARY

The publication of this Final Report and Determination (Final Report) concludes the consultation process considering amendments to Credit Limit Procedures (CLP) – Modelling Parameter and MNSP Prudential Requirement Changes.

### **Part A – Modelling parameter changes**

AEMO will make amendments to the CLP in relation to the modelling parameter changes in the form published with this Final Report. The CLP will be amended by:

- Changing the weighting factor for average regional price ( $W_{P,R}$ ) from 10% to 20%.
- Changing the weighting factor for volatility factors ( $W_{VF,R}$ ) from 10% to 20%.
- Changing the capping factor (for price and volatility factors) from +/-10% to +/-20%.

### **Part B – Market Network Service Providers (MNSP) prudential requirements**

AEMO will make amendments to the CLP in relation to the prudential requirements for Market Network Service Providers (MNSPs) in the form published with this Final Report. The CLP will be amended by amending clause 10.3 of the CLP to allow MNSPs to use reallocations, giving MNSPs greater flexibility in meeting their prudential requirements.

All changes for Part A and Part B will be implemented in AEMO's systems and be effective for the 2018 Winter season (from 1 May 2018).

### **Second stage Rules consultation**

AEMO received three submissions to the second stage consultation, from Alinta Energy, EnergyAustralia, and Flow Power. While the submissions made a variety of suggestions on improving or changing the CLP, these were outside of the scope of the current consultation. No new and/or substantive issues were raised on the subject matter for this consultation. Therefore, AEMO has made no changes to the CLP from the draft published with the Draft Report and Determination.

AEMO's final decision is to amend the CLP in the form published with this Final Report, effective from 1 May 2018.



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# 1. STAKEHOLDER CONSULTATION PROCESS

As required by clause 3.3.8 of the National Electricity Rules (NER), AEMO has been consulting on proposed amendments to the Credit Limit Procedures (CLP) in accordance with the Rules consultation procedures in rule 8.9 of the NER.

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

**Table 1 Consultation timeline**

<b>Deliverable</b>	<b>Indicative date</b>
Notice of first stage consultation and Issues Paper published	28 August 2017
First stage submissions closed	6 October 2017
Draft Report and Notice of second stage consultation published	29 November 2017
Submissions due on Draft Report	22 December 2017
Final Report published	29 January 2018

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 New Prudential Standard and Framework was implemented in 2012, and sits under clause 3.3 of the NER. Its key features are outlined in the CLP<sup>1</sup>, which has two main functions:

- To define the market’s prudential risk appetite through the prudential standard.
- To determine the prudential settings for market participants with reference to the prudential standard. The prudential settings for a market participant comprise its maximum credit limit (MCL), outstandings limit (OSL), and prudential margin (PM). The MCL is the sum of the OSL and the PM. Market participants must provide AEMO with credit support for an amount greater than or equal to their MCL.

This consultation examined two separate issues relating to the CLP. The most substantive topic, which has been the main focus of this consultation, is modelling parameter changes in the CLP.

The second issue relates to changes to MNSP prudential requirements.

### 2.3 First stage consultation

AEMO issued a Notice of First Stage Consultation and Issues Paper on **28 August 2017**. The proposal was to amend the CLP by:

- Changing the weighting factor for average regional price ( $W_{P,R}$ ) from 10% to 20%, to give more weight to actual average regional prices than is currently the case.
- Changing the weighting factor for volatility factors ( $W_{VF,R}$ ) from 10% to 20%, to give more weight to actual volatility than is currently the case.
- Changing the capping factor (for price and volatility factors) from +/-10% to +/-20%, to allow the weighting factor changes to take full effect in the model.
- Updating clause 10.3 to allow the use of reallocations in calculating MNSP prudential requirements.

An Issues Paper was published containing details of the proposed amendments and supporting analysis, and is available on the AEMO website at:

<https://aemo.com.au/Stakeholder-Consultation/Consultations/CLP-Modelling-Parameter-and-MNSP-Prudential-Requirement-Changes>

The first stage consultation closed on **6 October 2017**. AEMO received five written submissions, from Australian Energy Council, Origin Energy, Red Energy and Lumo Energy, Alinta Energy, and EnergyAustralia. Copies of all written submissions have been published on AEMO’s website at the above link.

<sup>1</sup> Available at: [https://aemo.com.au/-/media/Files/Stakeholder\\_Consultation/Consultations/Electricity\\_Consultations/2017/CLP2/Credit-Limit-Procedures-v3-FINAL--CLEAN.pdf](https://aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/Electricity_Consultations/2017/CLP2/Credit-Limit-Procedures-v3-FINAL--CLEAN.pdf)



## 2.4 Second stage consultation

AEMO issued its draft report and Notice of Second Stage Consultation on **29 November 2017**. The draft report noted and responded to the issues raised in submissions which AEMO considered relevant to the matters under consultation. The draft report is available on the AEMO website at:

<https://aemo.com.au/Stakeholder-Consultation/Consultations/CLP-Modelling-Parameter-and-MNSP-Prudential-Requirement-Changes>

The second stage consultation closed on **22 December 2017**. AEMO received three submissions, from Alinta Energy, EnergyAustralia, and Flow Power. A detailed summary of issues raised in the submissions, together with AEMO's responses, is in Appendix A. Copies of all written submissions have been published on AEMO's website at the above link.

While the submissions made a variety of suggestions on improving or changing the CLP, they did not raise any new or substantive issues directly relating to the proposed CLP amendments that were being consulted on. Therefore, AEMO is not making any further changes to the CLP in response to second stage submissions.

### Further changes to the CLP outside the scope of this consultation

Several submissions expressed an interest in AEMO undertaking a further review of the CLP and/or suggested various changes to the prudential process and methodology that were outside the scope of this consultation.

As part of AEMO's continuous monitoring of the effectiveness of the CLP, AEMO will undertake a standard annual review of the CLP and publish the findings as directed under clause 3.3.8(f) of the NER. The 2018 CLP effectiveness review will begin once all the relevant prudential data becomes available for the Summer 2018 season (at the end of April 2018). AEMO expects to publish the results of the review in the third quarter of 2018.

The outcomes of AEMO's annual review will determine what, if any, potential further changes to the CLP should be considered, with any additional areas for investigation outlined in the published review. If the review finds that further changes should be pursued, all suggestions made in submissions to this consultation will be considered. AEMO's standard consultation process will apply to any proposed CLP changes.



### 3. FINAL DETERMINATION

Having considered the matters raised in submissions, AEMO determined that no further changes should be made from the draft CLP published with the Draft Report and Determination.

The CLP will be amended to:

- Change the weighting factor for average regional price ( $W_{P,R}$ ) from 10% to 20%.
- Change the weighting factor for volatility factors ( $W_{VF,R}$ ) from 10% to 20%.
- Change the capping factor (for price and volatility factors) from +/-10% to +/-20%.
- Amend clause 10.3 to allow MNSPs to use reallocations to meet their prudential requirements.

Accordingly, AEMO's final determination is to amend the CLP in the form of **Attachment 1**, in accordance with clause 3.3.8 of the NER. The amended CLP will apply to prudential settings determined with effect from 1 May 2018.



## APPENDIX A. SUMMARY OF SECOND STAGE SUBMISSIONS AND AEMO RESPONSES

No.	Consulted person	Issue	AEMO response
1.	Alinta Energy	Believes parameter changes will increase MCL requirements and incur non-trivial costs to prudential management overheads, constraining working capital and act as a raised barrier of entry for new entrant retailers.	<ul style="list-style-type: none"> <li>The issue of increased prudential costs and raised barriers of entry to new entrants is addressed in Section 4.1 of the Draft Report and Determination.</li> </ul>
2.	Alinta Energy	Recognises the importance and benefit of the 2% prudential standard. Is cognisant of, and appreciates the obligations and responsibility AEMO has in meeting that 2% prudential standard.	<ul style="list-style-type: none"> <li>AEMO thanks Alinta Energy for its comment.</li> </ul>
3.	Alinta Energy	Notes that the additional analysis undertaken for the Draft Report and Determination improved the quality of the consultation overall which was appreciated.	<ul style="list-style-type: none"> <li>AEMO thanks Alinta Energy for its comment.</li> </ul>
4.	Alinta Energy	<p>Suggests reform options outside of the scope of this consultation for alternative and more dynamic prudential management including:</p> <ul style="list-style-type: none"> <li>Placing a greater reliance on short term MCL top-up mechanisms in response to peak summer periods.</li> <li>Shorter settlement cycles to reduce counterparty credit exposure and net cost of providing prudential services, increasing economic efficiency in the NEM.</li> </ul>	<ul style="list-style-type: none"> <li>AEMO thanks Alinta Energy for its suggestions for dealing with prudential risks.</li> <li>The next annual review of the CLP will be undertaken once all relevant prudential data is available for the Summer 2018 season.</li> <li>Any further changes to the CLP will be considered based on the results of the annual review, with the options suggested considered in any review of AEMO's prudential arrangements.</li> </ul>
5.	EnergyAustralia	Supports efforts to reduce credit risk in the market but consider that approach may not be the most cost-effective solution for managing default risk during extreme high prices.	<ul style="list-style-type: none"> <li>AEMO thanks Energy Australia for its comment.</li> <li>The balancing of prudential costs and risks is done through the 2% Prudential Standard.</li> </ul>
6.	EnergyAustralia	Believes proposed approach is likely to increase credit limits which ultimately increases the cost of providing customers with energy.	<ul style="list-style-type: none"> <li>The issue of increased prudential costs and increased costs to end users is addressed in Section 4.1 of the Draft Report and Determination.</li> </ul>
7.	EnergyAustralia	Believes that if credit support limits are set to cover extreme price peaks, the procurement of credit at this level throughout the year represents an over procurement of support requirements. This is inefficient and unnecessary and does not represent value for customers or the market.	<ul style="list-style-type: none"> <li>Credit support requirements are based on average seasonal price and volatility.</li> <li>While the proposed change is a response to recent price increases, AEMO believes generally higher prices are likely to continue for the short to medium term.</li> </ul>
8.	EnergyAustralia	Suggests that AEMO consider reviewing the current approach taken to credit support requirements to identify the most economic and efficient ways of managing peak pricing risk incidences.	<ul style="list-style-type: none"> <li>The next annual review of the CLP will be undertaken once all relevant prudential data is available for the Summer 2018 season.</li> <li>Any further changes to the CLP will be considered based on the results of the annual review.</li> </ul>



No.	Consulted person	Issue	AEMO response
9.	Flow Power	Believes that the regulatory system does not taken note of the innovative efforts that have been applied through business models to grow demand response. Suggests that any changes to the Credit Limit Procedures should take into account the rise and importance of demand response in the NEM.	<ul style="list-style-type: none"><li>• The next annual review of the CLP will be undertaken once all relevant prudential data is available for the Summer 2018 season.</li><li>• Any further changes to the CLP will be considered based on the results of the annual review, with the options suggested considered in any review of AEMO's prudential arrangements.</li></ul>
10.	Flow Power	Believes any increase in bank guarantee fees and interest costs to meet higher prudential obligations, is ultimately passed on to business customers, which in turn has a chain reaction causing widespread price increases to business and the economy generally.	<ul style="list-style-type: none"><li>• The issue of increased prudential costs and increased costs to end users is addressed in Section 4.1 of the Draft Report and Determination.</li></ul>
11.	Flow Power	Believes increasing Prudential Requirements and the MCL will penalise and discourage smaller innovative Retailers to continue making a significant and positive contribution to increasing competition in the power industry.	<ul style="list-style-type: none"><li>• The issue of increased prudential costs and raised barriers of entry to new entrants is addressed in Section 4.1 of the Draft Report and Determination.</li></ul>



# ATTACHMENT 1. FINAL CREDIT LIMIT PROCEDURES

Published as a separate document at:

<https://aemo.com.au/Stakeholder-Consultation/Consultations/CLP-Modelling-Parameter-and-MNSP-Prudential-Requirement-Changes>