Credit Limit Procedures - Reassessing MCL in Extreme Market Conditions

Draft Report – Standard consultation for the National Electricity Market

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Executive summary and consultation notice

The publication of this draft report commences the second stage of the standard consultation procedure conducted by AEMO to consider proposed amendments to the Credit Limit Procedures (**Procedures** or **CLP**), to add a process to reassess market participant prudential settings during extreme market conditions (the **proposal**) under the National Electricity Rules (**NER**).

This consultation is undertaken as required by NER 3.3.8(g), following the procedure in NER 8.9.2.

The original proposal

AEMO is proposing to amend the Procedures to assist in re-establishing the prudential standard for the National Electricity Market (**NEM**). The proposed amendments would allow AEMO to reassess a market participant's maximum credit limit (**MCL**), which sets its minimum level of credit support, to better align with actual accrued liabilities. The key elements of the proposal are:

- AEMO may reassess a market participant's MCL when its average current accrued liabilities over the prior 21 days exceeds the amount of credit support held by AEMO for the market participant.
- In these circumstances, the MCL can be increased in line with the average current accrued liabilities.
- A market participant can ask AEMO to review their revised MCL if their current accrued liabilities are on a downward trend and below their outstandings limit.

The conditions for MCL reassessment will not be triggered for any short periods of high prices or participant liabilities, thus the proposed amendments will not remove the ability for market participants to provide security deposits to manage changes in their prudential position on a short term basis.

The proposal will address a gap in the current Procedures, which allow AEMO to revise credit support requirements for load and reallocation changes, but not for significant market price changes. This gap was highlighted during a sustained period of very high NEM prices across the middle of 2022, resulting in the probability of a shortfall following a market participant default exceeding the prudential standard of 2%.

Key issues raised in first stage of consultation

AEMO published its consultation paper on the proposal in November 2022 and received one written submission after the closing date. The submission supported a backwards-looking trigger using average accrued liabilities over 21 days, but raised some concerns, including:

- The cost to market participants of having to source additional credit support (bank guarantees).

  AEMO notes that, under the proposal, MCL would only be reassessed under extreme market conditions, and only for market participants who do not take proactive steps to manage their prudential obligations. Having considered alternative options, as outlined in the consultation paper, AEMO considers this is an efficient way to meet the prudential standard while ensuring that credit support requirements (and hence market participant costs) are not increased under normal market conditions.

- The time needed to put additional credit support in place, suggesting that a longer notice period or lead time should be provided.

Revising the MCL under extreme market conditions would follow the same principles in relation to the review process and timing for the provision of credit support as an MCL revision for any other reason under the existing framework. This is necessary because the elevated prudential risk is immediate and ongoing when average current accrued liabilities over an extended period have already exceeded the amount of credit support. AEMO will, however, investigate whether it could provide a simple indicative forecast to market participants of their 21 day average current accrued liabilities and an estimate of the timing of when an MCL reassessment could be triggered.

AEMO also received a number of questions from stakeholders at an information session held in December 2022. Most of these related to the utility and practicality of bank guarantees as a form of credit support. The requirements for acceptable credit support are prescribed in the NER and are beyond the scope of this consultation or the Procedures themselves.

After considering the feedback received, AEMO's proposes to implement all elements of the proposal as originally set out in the consultation paper, by amending the **Credit Limit Procedures** in the form published with this draft report, with a proposed effective date of **12 May 2023.**

Consultation notice

AEMO invites written submissions from interested persons on the draft proposal and issues identified in this draft report to **prudentials@aemo.com.au** by 5:00pm (Melbourne time) on **14 April 2023**.

Submissions may make alternative or additional proposals you consider may better meet the objectives of this consultation and the national electricity objective in section 7 of the National Electricity Law. Please include supporting reasons.

Please note the following important information about submissions:

- All submissions will be published on AEMO's website, other than confidential content.
- Please identify any parts of your submission that you wish to remain confidential, and explain why. AEMO may still publish that information if it does not consider it to be confidential, but will consult with you before doing so. Material identified as confidential may be given less weight in the decision-making process than material that is published.
- Submissions received after the closing date and time will not be valid, and AEMO is not obliged to consider them. Any late submissions should explain the reason for lateness and the detriment to you if AEMO does not consider your submission.

Interested persons can request a meeting with AEMO to discuss any particularly complex, sensitive or confidential matters relating to the proposal. Please refer to NER 8.9.1(k). Meeting requests must be received by the end of the submission period and include reasons for the request. AEMO will try to accommodate reasonable meeting requests but, where appropriate, we may hold joint meetings with other stakeholders or convene a meeting with a broader industry group. Subject to confidentiality restrictions, AEMO will publish a summary of matters discussed at stakeholder meetings.

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1. Stakeholder consultation process

As required by the National Electricity Rules (NER) clause 3.3.8(g), AEMO is consulting on proposed amendments to the Credit Limit Procedures (Procedures or CLP) in accordance with the standard rules consultation procedure in NER 8.9.2 (proposal).

Note that this document uses terms defined in the NER, which are intended to have the same meanings. There is a glossary of additional terms and abbreviations in Appendix A.

AEMO's process and expected timeline for this consultation are outlined below. Future dates may be adjusted and additional steps may be included as needed, as the consultation progresses.

Table 1 Consultation process and timeline

Consultation steps	Dates
Initial stakeholder presentation and opportunity for feedback	11 October 2022
Consultation paper published	18 November 2022
Follow-up stakeholder presentation and opportunity for feedback	12 December 2022
Submissions closed on consultation paper	27 January 2023
Draft report published	10 March 2023
Submissions due on draft report	14 April 2023
Final report published	12 May 2023

AEMO's consultation webpage for the proposal is at: https://aemo.com.au/consultations/current-and-closed-consultations/credit-limit-procedures-reassessing-mcl-in-extreme-market-conditions

It contains all previous published papers and reports, written submissions, and other consultation documents or reference material.

In response to its consultation paper on the proposal, AEMO received one late submission, from ZEN Energy (ZEN), which AEMO has considered in preparing this draft report.

AEMO also held two information sessions, one before and one after the consultation paper was published, on 11 October 2022[1] and 12 December 2022. A number of questions were raised at the second session, to which AEMO has responded in this draft report.

AEMO thanks all stakeholders for their feedback on the proposal to date, which has been considered in preparing this draft report, and looks forward to further constructive engagement.

[1] At a meeting of the AEMO-convened Settlement Managers Working Group. Presentation available at: https://aemo.com.au/en/consultations/industry-forums-andworking-groups/list-of-industry-forums-and-working-groups/settlement-managers-working-group

2. Background

2.1. Context for this consultation

The Procedures establish the methodology by which AEMO determines the credit support requirements for each market participant – represented by the maximum credit limit (MCL) - so that the 2% prudential standard is met for the NEM. The prudential standard represents the probability of a market participant's credit support being insufficient to cover its outstanding liabilities by the time of suspension, following a payment default.

The Procedures use forecast regional market prices and associated volatilities in the calculations to determine market participant MCL. The methodology for determining forecast regional prices and volatilities relies on a complex statistical calculation based on past NEM data, which aims to smooth changes in MCLs resulting from one-off changes to price and volatility, while responding to longer-term trend changes. The methodology cannot accurately incorporate sustained very high market prices under extreme market conditions, into the forecasts, and under certain circumstance can result in forecast prices and volatilities being significantly below actual market conditions. The MCL methodology is described in more detail in section 3.

Market conditions in the NEM from May 2022 onwards resulted in a mismatch of market participant prudential settings and market participant accrued liabilities, as actual spot prices were significantly higher (for an extended period of time) than the forecast regional prices (and volatilities) used in the MCL calculations for the same period.

This meant the MCL for a significant number of market participants (and hence their minimum credit support requirement) was below their outstandings for extended periods. In these cases there was a 100% probability of the market participant's outstandings exceeding its MCL if it failed to rectify a breach of its OSL.

This highlighted a gap in the Procedures, which allow AEMO to reassess MCLs for any load and reallocation changes, but not for significant price changes, increasing the probability of a shortfall beyond the prudential standard.

The proposed changes aim to reduce the risk of loss given default to a level commensurate with the prudential standard going forward.

2.2. NER requirements

Under NER 3.3.8, AEMO is responsible for developing, publishing and maintaining the Procedures. The Procedures may be made or amended in accordance with the Rules consultation procedures set out in NER 8.9.

The Procedures establish the methodology by which the AEMO determines the prudential settings for each market participant so that the 2% prudential standard is met for the NEM. The prudential settings for a market participant are its maximum credit limit (MCL), outstandings limit (OSL) and prudential margin (PM). The MCL is the sum of the OSL and the PM (under NER 3.3.8(k)), and each market participant is required to procure credit support (typically bank guarantees) equal to or greater than its MCL. AEMO may draw down on the credit support and apply it against the market participant's liabilities in the event of a default.

The prudential standard of 2% is set in NER 3.3.4A, and refers to the 'prudential probability of exceedance'. That is, the probability of a market participant's MCL being exceeded by its outstandings within 7 days after a payment default (being the 'reaction period' within which the market participant is likely to be suspended).

NER 3.3.8(d) sets out the factors that AEMO must take into account when determining the prudential settings methodology, which are:

- Regional reference prices.
- Time of year.
- Volatility of load and regional reference price for a region.
- AEMO's estimate of a market participant's generation and load.
- The relationship between average load and peak load for a market participant.
- Prospective reallocations for the assessment period.
- Correlations between energy, reallocations and the regional reference price,
- Statistical distribution of any accrued amounts owing to AEMO.
- The time period for which the prudential settings are being calculated.
- Any other factors AEMO considers relevant having regard to the objective of the Procedures to meet the prudential standard for the NEM.

2.3. The national electricity objective

Within the specific requirements of the NER applicable to this proposal, AEMO will seek to make a determination that is consistent with the national electricity objective (NEO) and, where considering options, to select the one best aligned with the NEO.

The NEO is expressed in section 7 of the National Electricity Law as:

> to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

3. List of material issues

The key material issues arising from the proposal or raised in submissions or consultation meetings are listed in the following table:

Table 2 List of material issues

No.	Issue	Raised by
1.	Decline in the prudential standard	AEMO
2.	How to trigger an MCL reassessment	AEMO
3.	Calculating the revised MCL	AEMO
4.	Cost of MCL increases	ZEN
5.	Guaranteeing sufficient notice of MCL reviews	ZEN
6.	Reviewing the settlement period	ZEN

A detailed table of issues raised in written submissions to the consultation paper, together with AEMO's responses, is contained in Appendix B. Questions and responses from the information session held by AEMO in December 2022 are also included in Appendix B.

Each of the material issues in Table 2 is discussed in Section 4.

4. Discussion of material issues

4.1. Decline in the prudential standard

4.1.1. Issue summary and submissions

Over the 2022 winter season, with very high wholesale market prices, the credit support held by AEMO to protect the market against shortfall was significantly below aggregate market participant accrued liabilities and the level needed to meet the rules prescribed 2% prudential standard.

In their submission, ZEN acknowledged the mismatch between market participant credit support and accrued liabilities as the key driver for the proposed amendments, and understood AEMO's desire to ensure that the prudential standard remained below 2%.

4.1.2. AEMO's assessment

The purpose of the 2% prudential standard is to provide a target within which AEMO seeks to maintain the risk of loss in the event of market participant default. In 2022, there were a number of default events, including two resulting in a shortfall, despite AEMO's highly responsive operational processes. This confirmed the very real risk to the market and AEMO considered it appropriate to take steps to improve the correlation between the credit support held and actual outstandings, during extreme market conditions through the proposed changes. This is aligned to and consistent with the NEO.

4.1.3. AEMO's conclusion

In order to be consistent with the NEO, and keep prudential risk within the 2% prudential standard, the CLP should be amended to allow AEMO, during extreme market conditions, to review market participant MCLs so that the credit support held for market participants remains generally aligned with actual accrued liabilities.

4.2. How to trigger an MCL reassessment

4.2.1. Issue summary and submissions

An MCL reassessment should not be triggered during short periods of high prices/high volatility. At the same time, AEMO needs to deal with extreme events where MCLs are inadequate in a timely manner to avoid eroding the prudential standard. AEMO therefore proposed that an appropriate trigger for MCL review would arise where a market participant's average current accrued liabilities over the prior 21 days exceeds the amount of credit support provided for that market participant.

In their submission, ZEN supported the choice of a backward-looking trigger (the 21-day average of accrued liabilities).

4.2.2. AEMO's assessment

The key variables to consider when triggering an MCL reassessment are the amount owed by a market participant and the amount of credit support held for that market participant. Thus, to trigger an MCL reassessment, AEMO proposes using a comparison between:

(i) the credit support (i.e. guarantee amount) held by AEMO for the market participant, and

(ii) the average current accrued liabilities of the market participant over 21 days.

Using the amount of credit support held by AEMO as part of the trigger, ensures that market participant MCL will only be reassessed if the market participant has not already taken proactive steps to manage their prudential obligations.

Using a 21 day average of market participant current accrued liabilities as part of the trigger avoids any short periods of high prices/high participant liabilities, while ensuring that AEMO deals with extreme events where MCLs are inadequate in a timely manner to avoid eroding the prudential standard (and hence increasing the potential for a shortfall).

4.2.3. AEMO's conclusion

The CLP should be amended to include the proposed trigger for MCL reassessment when a market participant's average current accrued liabilities (i.e. the average dollar amount owed to AEMO) over the prior 21 days, exceeds the amount of credit support held by AEMO for that market participant.

4.3. Calculating the revised MCL

4.3.1. Issue summary and submissions

If AEMO decides to reassess a market participant's MCL when the extreme market conditions trigger has been reached, AEMO proposed that the MCL be increased in line with the average current accrued liabilities. No submissions commented on this issue.

4.3.2. AEMO's assessment

Under AEMO's proposal, a market participant's reassessed outstandings limit (OSL), would be equal to the market participant's average current liabilities over the prior 21 days, The prudential margin would remain unchanged.

The proposed methodology will ensure that the additional credit support amount needed to meet the revised MCL will be adequate, and not result in a trading limit breach at that point in time.

4.3.3. AEMO's conclusion

The CLP should be amended to include a new clause, which if certain trigger conditions are met, gives AEMO the option to reassess a market participant's MCL so that it is more closely aligned with current accrued liabilities.

4.4. Cost of MCL increases

4.4.1. Issue summary and submissions

The proposed changes will increase some market participants' MCL (and therefore the amount of credit support they must provide) during extreme market conditions.

Zen indicated that they anticipated that the MCL will increase significantly under the proposed amendments, and this would impose a greater cost of capital, particularly on non-vertically integrated retailers.

4.4.2. AEMO's assessment

Under the proposed changes, MCL will **only** increase under extreme market conditions and only for those market participants who do not take proactive steps to manage their prudential obligations. Any additional credit support required as a result of an MCL increase will take the place of security deposits that would otherwise have to be provided under the Rules in such circumstances to manage trading margin breaches. That is, in total (considering guarantees and security deposits), market participants will not have to provide more collateral to AEMO under the proposal than would be the case under the current arrangements. Rather, the proposal shifts the balance of that collateral from security deposit amounts towards the more secure guarantee format. AEMO acknowledges that there are costs associated with procuring guarantees versus the provision of security deposits, but believes the proposed solution is an efficient way to meet the prudential standard by ensuring the MCL calculation remains representative of market participant exposure, as envisaged by the NER.

An alternative option to ensure that credit risk is managed to meet the prudential standard would be to increase seasonal MCL for all market participants to be more in line with more recent prices/volatility (as opposed to using a long term averages). Such a change would increase costs for all market participants and would result in consumers paying more, irrespective of whether extreme market conditions materialised.

The proposal, with MCL reassessment happening only if extreme market conditions have occurred, should achieve the same prudential outcome while keeping MCL increases and associated costs to market participants as low as practicable. Such an outcome would best meet the NEO compared with any feasible alternative AEMO has identified.

4.4.3. AEMO's conclusion

AEMO considers that the proposal represents an effective way to meet the prudential standard while ensuring that credit support requirements (and hence market participant costs) are not increased under normal market conditions, and are minimised even in extreme conditions by applying a 21 day averaging calculation. AEMO notes that market participants may be able to take other steps to proactively manage their prudential position, which would avoid the potential for an MCL review in these circumstances,

4.5. Prior notice of MCL reviews

4.5.1. Issue summary and submissions

Currently AEMO may revise a market participant's MCL if certain parameters (e.g. load, generation or reallocations) change, with a minimum of one business day's notice to the participant. This is explicitly provided for in NER 3.3.8(m): .

> At any time, and for any reason that is consistent with objective of the credit limit procedures under paragraph (b), *AEMO* may change the prudential settings that apply to a *Market Participant*, provided that any change to the *Market Participant's* prudential settings applies no earlier than one *business day* after the date *AEMO* notifies the *Market Participant* of changes to its prudential settings.

It is a NER requirement (under clause 3.3.5) for a participant to maintain sufficient credit support to cover its MCL at all times. In its submission, ZEN flagged potential operational risks of this proposal for non-vertically integrated retailers and proposed AEMO provide 15 business days' notice prior to an MCL review, or prior to it becoming effective.

4.5.2. AEMO's assessment

AEMO considers there is no basis to justify separate notice timing requirements for credit support provision, depending on why an MCL review was triggered. The key consideration in all cases of MCL revision is that the potential exposure a participant represents to the market has increased beyond the credit support provided. The review itself identifies the exposure risk, and the provision of additional credit support to maintain prudential risks within the boundaries stipulated in the NER is therefore time-critical.

AEMO works with participants where possible ahead of and after any MCL review, irrespective of the reason, to ensure that the possible need to provide additional bank guarantees is understood in advance and the process occurs as smoothly as possible.

Ultimately, each market participant should be aware of their prudential position and obligations, and how those may change based on market conditions. This awareness allows participants to manage the timing constraints of procuring bank guarantees. The option of providing additional guarantees above the minimum requirement of the MCL amount exists at all times, and is a prudential risk management strategy employed by a significant number of market participants.

4.5.3. AEMO's conclusion

AEMO does not consider that prescribing any extended notice period for increased MCL is workable once an assessment has been made, within the context of prudential risk mitigation and AEMO's obligations to meet the Rules prescribed 2% prudential standard.

AEMO will investigate whether it could provide a simple indicative forecast to market participants of their 21 day average current accrued liabilities and an estimate of the timing of when an MCL reassessment could be triggered.

4.6. Reviewing the settlement period

4.6.1. Issue summary and submissions

Under the Procedures, market participant prudential cover (i.e. MCL) is calculated for the average 35 day settlement period, with an additional 7 days of prudential cover for the default/suspension process.

ZEN raised concerns that prudential requirements will increase over the coming decade of renewable transformation, and proposed that AEMO investigate reducing the settlement period to two weeks to lessen system wide credit risk.

4.6.2. AEMO's assessment

The implementation of a reduced settlement period would require changes to the NER and have wide ranging implications for processes, procedures and systems across AEMO (not limited to prudential management) and for all market participants. As such, this issue is outside of this consultation's ability to consider.

4.6.3. AEMO's conclusion

AEMO is unable to reduce the NEM settlement period through changes to any procedures. AEMO encourages market participants to consider referring reform ideas of this nature or scale to AEMO's NEM2025 Electricity Wholesale Consultative Forum for consideration and stakeholder discussion, or proposing a Rule change for consideration by the AEMC.

5. Other matters

Both ZEN and some attendees at AEMO's December 2022 information session made additional observations and suggestions concerning the practicality of bank guarantees as credit support. These have been noted in Appendix B, but are not matters that can be addressed by the Procedures.

In addition to the amendments necessary to reflect the proposal, the draft Procedures have been updated to reflect AEMO's newest procedures template format, with a small number of non-substantive correction of errors. Changes in the published draft are tracked, with the exception of formatting and template updates.

6. Draft determination on proposal

Having considered the matters raised in submissions to the consultation paper and at consultation meetings, AEMO's draft determination is to amend the **Credit Limit Procedures** in the form published with this draft report, in accordance with NER **3.3.8**.

The draft proposal to amend the CLP to allow AEMO, during extreme market conditions, to review market participant MCL so that the credit support held for market participants is in line with actual accrued liabilities will assist in keeping prudential risk within the rules prescribed 2% prudential standard. Once the MCL reassessment is triggered, all other aspects relating to credit support provision of the NER and the Procedures will apply.

Under the draft proposal, market participant MCL reassessment will only occur under extreme market conditions, allowing for better prudential risk management outcomes while keeping MCL increases and costs to market participants as low as possible. AEMO considers this outcome is consistent with the NEO.

Effective date

AEMO's proposed effective date for the determination is **12 May 2023**. This will allow the procedure to be effective for the 2023 winter season, when extreme market conditions are more likely to eventuate increasing prudential risks.

Appendix A. Glossary

Term or acronym	Meaning
AEMO	Australian Energy Market Operator
CLP	Credit Limit Procedures
MCL	Maximum credit limit
NEM	National electricity market
NEO	National electricity objective
NER	National Electricity Rules
OSL	Outstandings limit
PM	Prudential margin

Appendix B. Consultation feedback and AEMO responses

No.	Stakeholder	Issue	AEMO response
		Written submission	
1	ZEN	ZEN believes 10 business days is representative of the time required to procure a bank guarantee. Without advanced notice there is a risk that solvent retailers will fail to meet their obligations under the NER.	• Currently AEMO revises the MCL if participant load/generation or reallocations change, with a minimum of one business day's notice to the participant (NER 3.3.8(m)). It is a NER requirement (3.3.5) for a participant to maintain sufficient credit support to cover its MCL at all times. • Separate timing requirements for credit support provision on the basis of the reason for an MCL review are not justified. The key consideration in all cases of MCL revision is that the potential exposure a participant represents to the market has increased beyond the credit support provided. The review itself identifies the exposure risk, and the provision of additional credit support to maintain prudential risks within the boundaries stipulated in the NER is therefore time-critical. • AEMO works with participants where possible ahead of and after any MCL review to ensure that the possible need to provide additional bank guarantees is understood in advance and the process occurs as smoothly as possible. • Ultimately, each market participant should be aware of their prudential position and obligations, and how those may change based on market conditions. This awareness allows participants to manage the timing constraints of procuring bank guarantees. • The option of providing additional guarantees above the minimum requirement of the MCL amount exists at all times, and is a prudential risk management strategy employed by a significant number of market participants.
2	ZEN	ZEN supports the choice of a backward-looking trigger (the 21-day average of accrued liabilities).	• AEMO notes ZEN's support of the 21 day backward looking trigger for MCL review.
3	ZEN	During a market failure, liabilities are difficult to forecast and can accrue quickly. As such, ZEN is not confident that it will always be possible to forecast a trigger with 10 or more business days' notice. This is especially a concern if multiple reviews are called in quick succession as section 3.5 of the consultation paper suggests could be the case.	• From the market's perspective, the conditions in which liabilities are accruing quickly are exactly those in which it is important for the prudential framework to respond equally quickly to mitigate shortfall risk. The proposed changes are to mitigate those risks by ensuring that prudential cover is sufficient at all times. • While AEMO acknowledges exact liabilities may be difficult to forecast, realistically all market participants can be expected to have a reasonable internal estimation of their liabilities going forward.
4	ZEN	To mitigate the risk that a solvent retailer may fail to procure a bank guarantee in the time required by section 3.3.6 of the NER,	• Given the conditions that will trigger an MCL review under the proposed CLP amendments, 15 business days prior notice of a review is not workable. As explained

No.	Stakeholder	Issue	AEMO response
		ZEN proposes AEMO guarantee 15 business days' notice of a review. Potential ways of achieving this include: • After a trigger, AEMO provides retailers with an indicative new MCL and a 15-business day period to procure it. The hard figure for the new MCL could be revised during the notice period. • AEMO provides a forecast of trigger events and guarantees not to call a review until 15-business days after a forecast warning.	above, a significant delay will exacerbate the risk and fail to meet the prescribed 2% prudential standard. • AEMO will investigate whether it would be possible to provide an indicative forecast to market participants of when MCLs could potentially be reviewed. AEMO would encourage participants to create their own forecast of their likely prudential position into the future. • Please refer to AEMO's responses above.
5	ZEN	Anticipate that the MCL will increase significantly under the proposed amendments. This will impose a greater cost of capital, particularly on non-vertically integrated retailers. Increased costs will result in consumers paying more. Such an outcome would be inconsistent with the National Electricity Objective.	• Under the proposed changes, the potential for MCLs to increase based on current accrued liabilities will only arise when extreme market conditions have continued for an extended period. The draft trigger conditions have been designed to achieve the prudential standard while keeping MCL reviews and costs to participants as low as reasonably practical. • An alternative option to manage credit risk to the 2% prudential standard would be to increase seasonal MCL for all market participants to be more in line with more recent prices/volatility (as opposed to using long term averages). Such a change would increase costs for all participants and would result in consumers paying more, irrespective of whether extreme market conditions materialised. • It is worth noting that any additional credit support that may be required under these provisions will take the place of security deposits that otherwise have been required under the NER in such circumstances to manage the trading margin breaches that would have occurred. • As regards the NEO, the prudential standard is set in the NER. AEMO must proceed on the basis that this standard represents a level of risk associated with retailer failure and its potential impacts that was considered consistent with the NEO.
6	ZEN	Concerned that, in some instances, the proposed amendments impose further solvency risks on smaller retailers and thereby lead to a less competitive market for consumers. While ZEN survived the winter of 2022 through our strong cash and credit management principles, we saw several of our peers become insolvent or encourage their customers to leave for another retailer. In this context, an unintended/adverse consequence of the proposal is that it puts smaller retailers at risk and further entrenches incumbency.	• Extreme market conditions are the circumstances that impose risks to all market participants and necessitate the increase in MCL for some market participants to manage prudential risks within the bounds outlined in the Rules. • Market participant confidence in the financial settlement of spot electricity transactions is critical to the operation of the NEM. The proposed changes are seeking to ensure this confidence is maintained even under extreme market conditions. AEMO considers this is consistent with the NEO.
7	ZEN	In the long run, with fossil-based generation retiring and the challenges of securing ex-ante reallocations from new renewable	• AEMO notes this concern. AEMO reviews the CLP annually (CLP effectiveness report)[2] and as a result updates the procedures and/or prudential processes as required to

[2] https://aemo.com.au/en/energy-systems/electricity/national-electricity-market-nem/market-operations/settlements-and-payments/prudentials-and-payments/maximum-credit-limit

No.	Stakeholder	Issue	AEMO response
		projects, we are concerned that the prudential requirements will grow to an unmanageable level.	more effectively achieve the 2% prudential standard or address any other emerging issues in the prudential area. • AEMO encourages all market participants to approach AEMO with any specific concerns regarding the CLP and their application, and identify real world difficulties participants may experience that could be addressed within the current NER framework. Alternatively participants may wish to consider proposing changes to the NER.
9	ZEN	ZEN encourages AEMO to conduct an assessment of the amendments to the Credit Limit Procedures impact on the cash requirements of particularly the non-vertically integrated retailers and assure the market that these amendments will not impose significant solvency risks on the retail market participants. This is critical to continue to uphold the National Energy Objective which emphasises price, reliability, security, and safety equally.	• Under the NER and the CLP all market participants in the NEM are treated equally with regards to prudential obligations. • AEMO does not have the ability under the NER to consider the impact of cash requirements on non-vertically integrated retailers differently to those that are vertically integrated, when considering their prudential settings.
10	ZEN	ZEN proposes for AEMO to conduct a broader assessment on how the prudential system could be reviewed considering the ongoing renewable transition. ZEN recommends AEMO to consider reducing the settlement period to two weeks.	• AEMO agrees that prudential processes and settings in the NEM need to remain appropriate in a changing energy landscape going forward. As noted above, AEMO undertakes an annual review of the CLP. • In terms of considering a reduced settlement period, such a change would reach across many AEMO systems and processes (not just prudentials) and as such is outside of this consultation's ability to consider. • AEMO encourages market participants to consider referring reform ideas/suggestions of this nature and scale to AEMO's NEM2025 Electricity Wholesale Consultative Forum[3] for consideration.
11	ZEN	Non-vertically integrated retailers are effectively required to cover the credit risk associated with their supply obligations twice, providing cash to cover several weeks of the pool costs of customer supply as well as 14-30% of the face value of swaps and caps purchased from the ASX electricity board (a similar amount if the retailer is hedging on a rolling 12-month basis). These credit exposures naturally offset one another, which means that there would be lower credit exposure in the market and less cash security posted by retailers to cover any residual credit liability to the market if the AEMO and ASX electricity margin accounts were linked.	• Unless AEMO had the legal right to exercise the swaps and caps, such an arrangement would be of no prudential benefit to the market. The ASX is not a market participant. • Any possibility of linking ASX and AEMO accounts in relation to prudential management is outside of this consultation's ability to consider.

Questions from stakeholder forum – 12 December 2022

[3] https://www.aemo.com.au/consultations/industry-forums-and-working-groups/list-of-industry-forums-and-working-groups/electricity-wholesale-consultative-forum

No.	Stakeholder	Issue	AEMO response
12	N/A	How is cash held not better than a guarantee? Guarantees cost more and are more difficult to put in place than cash for users.	• The NER requires market participants to provide credit support in the form of an unconditional guarantee to AEMO from an acceptable financial institution, at or above the pre-determined MCL value. • Cash held by AEMO is subject to clawback, should a participant fail. AEMO manages this risk with the use of credit support, in an effort to minimise the possibility of a shortfall event.
13	N/A	AEMO will need to reassess a couple of conditions within its standard form guarantee. It is a barrier to entry.	• AEMO would need more information on this from stakeholders to investigate.
14	N/A	During extreme market conditions banks become more risk adverse. The ability to get short term bank guarantees (in AEMO format) will become harder, and hence while cash is deliverable but bank guarantees almost impossible. Net result bank guarantees not delivered and more failures.	• From the market's perspective, the conditions in which liabilities are accruing quickly are exactly those in which it is important for the prudential framework to respond equally quickly to mitigate shortfall risk. The proposed changes are to mitigate those risks by ensuring that prudential cover is sufficient at all times. • Ultimately, each market participant must be aware of their prudential position and obligations, and how those may change based on market conditions. This awareness allows participants to manage the timing constraints of procuring bank guarantees. • The option of providing additional guarantees above the minimum requirement of the MCL amount exists at all times, and is a prudential risk management strategy employed by a significant number of market participants.
15	N/A	Will there be a limit to how frequent AEMO can reassess MCL within a period (i.e. 7 days)?	• There is no limit in the procedures on MCL reassessments if the trigger conditions are met.
16	N/A	It cost participants more to get a guarantee.	• The NER requires market participants to provide credit support in the form of an unconditional guarantee to AEMO from an acceptable financial institution, at or above the pre-determined MCL value.
17	N/A	Banks treat additional bank guarantees as a security application, even if it is backed with 100% cash. They need get their credit team to approve issuing, which could take a long time, even if we back it up cash. Banks do a complete company review prior to issues bank guarantees (new application). Their risk managers, are very risk adverse during high price events and will not issue.	• AEMO appreciates that financial institutions' processes and risk appetites can result in delays or difficulties, however the acceptable credit support criteria sit within the NER. Given these obligations, each market participant must be aware of their prudential position and manage the timing constraints of procuring bank guarantees. • The option of providing additional guarantees above the minimum requirement of the MCL amount exists at all times, and is a prudential risk management strategy employed by a significant number of market participants.
18	N/A	Is it possible to set up a new mechanism like the security deposit but eliminate the claw back risk to AEMO?	• The NER requires market participants to provide credit support in the form of an unconditional guarantee to AEMO from an acceptable financial institution, at or above the pre-determined MCL value. • Any changes to this current arrangement would necessitate a Rule change and is outside of this consultations ability to consider.

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19	N/A	Banks rotate staff as well and they find this particular bank guarantee, the proforma etc difficult. They don't seem to want to provide drafts either. It would be great to find an alternative which provided retailers flexibility to give you our money, as opposed to a BG at short notice	• The NER requires market participants to provide credit support in the form of an unconditional guarantee to AEMO from an acceptable financial institution, at or above the pre-determined MCL value. • Any changes to this current arrangement would necessitate a Rule change and is outside of this consultation's ability to consider.
20	N/A	Regarding participants being proactive in providing bank guarantees, what reports or resources does AEMO propose to provide to assist with participants assessing their own MCL?	• AEMO provides participants with a seasonal MCL calculator to assist in assessing their MCL.[4] • AEMO will investigate whether it would be possible to provide an indicative forecast to market participants of when MCLs could potentially be reviewed. AEMO would encourage participants to create their own forecast of their likely prudential position into the future.
21	N/A	What is the expected response time for participants to supply a bank guarantee?	• Currently AEMO revises the MCL if participant load/generation or reallocations change, with a minimum of one business day's notice to the participant (NER 3.3.8(m)). It is a NER requirement (3.3.5) for a participant to maintain sufficient credit support to cover its MCL at all times.

[4] https://aemo.com.au/en/energy-systems/electricity/national-electricity-market-nem/market-operations/settlements-and-payments/prudentials-and-payments/maximum-credit-limit/maximum-credit-limit-calculator