





### **Proposed changes**

The prudentials regime that currently applies in the WEM has not been changed since market start in 2006. Since that time the IMO has encountered a number of issues with the application of the relevant rule requirements that it considers require clarification in order to ensure that there is no ambiguity around the prudential obligations of either Market Participants or the IMO. Alinta understands that some of these ambiguities under the current Market Rules have resulted in compliance issues for the IMO.

The IMO subsequently proposed a suite of changes to the rules around prudentials to bring the rules in line with its current practices and remove any ambiguity. Additionally the IMO proposed to remove any prescriptive details in the Market Procedure for Prudential Requirements consistent with its broader move towards principles based drafting.

An overview of the changes is provided below:

- **Credit Limit determination (Issue 1):** The IMO proposes to clarify that a participant's Credit Limit will be set at a value that will not be exceeded over a 70 day period (*over the last 24 months*). This is intended to reflect a participant's maximum exposure to the market as reflected by historical data, though there is an ability for the IMO to use its discretion to consider other factors such as default of payments. This amended to the methodology will reflect the IMO's current practice.

The IMO also proposes to outline the principles taken into account in determining a participant's Credit Limit in the rules, with the p



- **Typical Accrual and the amount of the Margin Call (Issue 5):** The IMO proposes to remove the concept of Typical Accrual and directly link the IMO's determination of whether a Margin Call should be issued to the amount of Trading Margin at the time when the Margin Call is made. The IMO also proposes to require the IMO to re-determine a Credit Limit following a Margin Call being made and to ensure that any responses from a Market Participant (as required under the clause 2.42.2) are completed within 24 hours of the Margin Call being issued.
- **Credit support arrangements (Issue 6 and 8):** The IMO proposes clarifications to a number of the obligations for Market Participants relating to the provision of a Credit Support and Reserve Capacity Security including clarifying that:
  - All participants must provide a Credit Support, regardless of whether they meet the Acceptable Credit Criteria;
  - Move the obligations to provide updated Credit Support within a defined timeframe into the Market Procedure;
  - Specify the situations where a replacement Credit Support must be provided in the Market Procedure; and
  - Make similar amendments to the obligations around Reserve Capacity Security (where relevant).
- **List of entities meeting Acceptable Credit Criteria (Issue 7):** The IMO proposes to amend this clause to state that only Market Participants can provide the IMO with evidence that a Credit Support provider continues to meet the Acceptable Credit Criteria.

#### **Alinta's views during the first round of consultation**

While generally supportive of the intention of the majority of the IMO's proposed amendments, Alinta did not support the amendments to:

- use the highest value of transactions owed to determine a Market Participant's Credit Limit (*Issue 1*);
- expressly require notifications to the IMO where a Market Participants market exposure decreases under clause 2.37.8 (*Issue 2*); and
- amend the timing for providing updated Credit Support where a Margin Call is issued to 24 hours(*Issue 5*).



Those changes to clause 2.37.8 address the concerns raised by Alinta with respect to Issue 2. In particular the IMO has further amended the proposed Amending Rules to ensure inappropriate civil penalties would not be potentially accrued by participants where they failed to inform the IMO of a change in circumstances that would decrease its Credit Limit.



Trade-off between protecting market and holding excessive monies

Alinta remains particularly concerned that there has been no consideration of whether the proposed amendments appropriately account for the important trade-off between protecting the market and holding excessive amounts of participants' capital in the form of Credit Support. Alinta reiterates that nowhere else in the Market Rules, including for the purposes of procuring sufficient capacity to cover the Reserve Capacity Target (which is acknowledged to be a conservative approach) is a level of 100% coverage prescribed.

The IMO's position that the settlements regime is designed on the fundamental principle that all Market Participants will always be fully paid on time appears at odds with the views of CRA International, the expert engaged at market start by the IMO to develop the methodology for setting Prudential Credit Limits<sup>3</sup>. CRA International specifically noted that in setting the initial credit limits they required:

*"a balance between the cost of maintaining the credit support required for the credit limit and the number of margin calls which might be required. If the credit limits are too low, there will be an excessive number of margin calls which are costly; if the credit limits are too high, then the cost of maintaining the support is excessive."*

This important trade-off between the amount of risk the market takes on and the amount of credit support to be provided has been at the heart of the recent consideration of the prudentials regime in the National Electricity Market (NEM). Given that the prudentials regime adopted in the WEM essentially mimicked that originally implemented in the NEM it's unclear why a similar consideration of the trade-off would not be relevant in the WEM.

As requested above, we consider a cost-benefit assessment of the proposed changes should be prepared by the IMO and presented to industry to enable consideration of whether an appropriate I p-off-0.1159771(m)10.4119(b)-0.115971(i)1.871tweed208N-0.115972()-0.115971(e)-0.11597115(l)







fact that financial institutions are unable to provide necessary funds outside of business hours.

Alinta requests that, based on the NEM regime for responding to Call Notices (Rule 3.3.13<sup>7</sup>), the IMO:

- considers whether similar flexibility to that contained within the NEM Rules with respect to late calls (clause 3.3.13(b)) could be reflected in the WEM Rules; and
- considers whether there should be an express ability for the IMO to extend the timeframes for providing additional credit support where a margin call is issued to avoid a participant unnecessarily going into default.

***Issue 6: Credit Support arrangements***

Alinta disagrees with the IMO's views that clause 2.38.1 is currently ambiguous – the drafting makes it clear that if at any time a Market Participant doesn't meet the Acceptable Credit Criteria it must provide a Credit Support<sup>8</sup>.

The current requirement appears to have been developed taking into account the important trade-off between protecting the market and holding





provide Credit Support to ensure an even playing field exists. Rationale for this approach should be further explored and presented to industry.

Additionally, Alinta continues to consider that the IMO's proposed drafting of clauses 2.38.1, 2.38.2 and 2.38.3 adds unnecessary additional prescription to the rules by repeatedly clarifying that a Credit Support has to be in the form specified in clause 2.38.4. Given that any single clause needs to be read in the context o



**Appendix 1: Drafting issues between proposed Amending Rules and proposed redrafted Market Procedure**

Procedure Step	Issue	Suggestion
1.2.1(c)	The procedure refers to “how the IMO will assess <u>entities</u> against the Acceptable Credit Criteria” however clause 2.43.1 refers to “assessing <u>persons</u> against the Acceptable Credit Criteria”.	While Alinta acknowledges that clause 1.4.1 of the Market Rules clarifies that a person includes an individual, a firm a body corporate etc. it would improve the integrity of the rules and procedure if the same language was used.
2.2.3(b) and 2.3.2(b)(ii)	Clause 2.37.6 provides the IMO discretion, to the extent it considers relevant, to take into account a minimum amount that the IMO considers would adequately protect the WEM. Steps 2.2.3(b) and 2.3.2(b)(ii) paraphrase the requirements of clause 2.37.6 but appear to incorporate a different test to that contained within the rules, i.e. rather than the IMO applying its discretion “to the extent it considers <u>relevant</u> ” the procedure refers to a “minimum amount it <u>reasonably</u> considers...” Alinta considers it would be better regulatory practice to ensure that the same test was referred to in both the rules and procedure.	Alinta recommends that the IMO considers what test is appropriate (either a relevance test or reasonableness test) for the purposes of applying clause 2.37.6 and reflects the test in both regulatory instruments.