



Rule Change Notice

Prudential Requirements (RC_2012_23)

This notice is given under clause 2.5.7 of the Market Rules.

Submitter: Allan Dawson, IMO

Date Submitted: 14 August 2013

The Proposal

The IMO manages the prudential requirements of Market Participants as set out in Chapter 2 of the Market Rules and the related *Market Procedure: Prudential Requirements*.

Prudential security for each Market Participant is held by the IMO to reduce the credit risk and consequential financial impact of default by a Market Participant on the Wholesale Electricity Market (WEM). The prudential process is principally designed to ensure that, if a Market Participant defaults by failing to settle its Short Term Electricity Market (STEM) or Non-STEM invoice amounts on a due date, the IMO will hold sufficient prudential security from that Market Participant so as to cover that Market Participant's exposure without short paying the market.

In accordance with the Market Rules, the IMO must determine each Market Participant's Credit Limit and Trading Margin. The IMO must also monitor these values to ensure that a Market Participant's exposure risk is not greater than the Credit Support provided. If at any time, the Market Participant's market exposure becomes greater than its Trading Limit as determined by the Credit Support provided by the Market Participant, the IMO may make a Margin Call or increase a Market Participant's Credit Limit, and therefore the required level of Credit Support to reduce the credit risk to the market.

The IMO has identified a number of areas in the Market Rules where clarification is required to ensure that there is no ambiguity around the prudential obligations of either Market Participants or the IMO. These areas include:

- (a) Credit Limit determination: The IMO seeks to amend relevant clauses to contain the principles that form the basis of determining a Market Participant's Credit Limit and move the prescriptive detail to the Market Procedure. The IMO also proposes to clarify the clauses to better align with current practice.
- (b) Determining the expected value of transactions: The IMO proposes to amend clause 2.37.9 to specify that instead of a guideline, a list of factors is provided in the Market Procedure to



assess the expected value of transactions.

- (c) Inclusion of voluntary prepayments in the calculation of Outstanding Amount: The IMO seeks to amend clause 2.40.1 to account for prepayments that a Market Participant may make to increase its Trading Margin to be able to securely transact in the market. Cleared funds submitted as prepayments would be reflected in the forthcoming Invoice for that Market Participant.
- (d) Typical Accrual and the amount of the Margin Call: The IMO proposes to remove the concept of Typical Accrual and link the determination of the Margin Call amount to the Trading Margin at the time the Margin Call is made.
- (e) Credit Support arrangements: The IMO seeks to amend the clauses related to the provision of Credit Support to improve the integrity of the drafting and provide additional clarity to Market Participants around their obligations. These issues will also be addressed for clauses related to the provision of Reserve Capacity Security under clause 4.13 and the Market Procedure: Reserve Capacity Security.

Appendix 1 contains the Rule Change Proposal and gives complete information about:

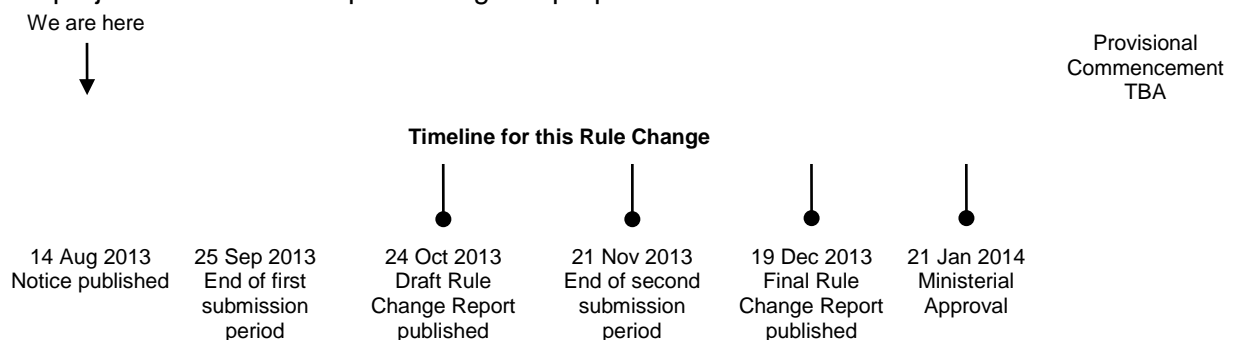
- x the proposed amendments to the Market Rules;
- x relevant references to clauses of the Market Rules and any proposed specific amendments to those clauses; and
- x the submitter's description of how the proposed amendments would allow the Market Rules to better address the Wholesale Market Objectives.

Decision to Progress the Rule Change

The IMO has decided to progress the Rule Change Proposal on the basis that Rule Participants should be given an opportunity to provide submissions as part of the rule change process.

Timeline

The projected timelines for processing this proposal are:



Call for Submissions

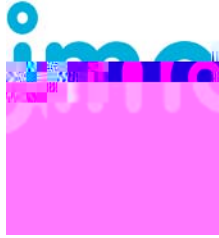
The IMO invites interested stakeholders to make submissions on this Rule Change Proposal. The submission period is 30 Business Days from the Rule Change Notice publication date. Submissions



must be delivered to the IMO by **5.00pm** on **Wednesday, 25 September 2013**.

The IMO prefers to receive submissions by email (using the submission form available on the Market Web Site: <http://www.imowa.com.au/rule-changes>) to:





Wholesale Electricity Market Rule Change Proposal Form

Change Proposal No: *RC_2012_23*

Received date: *14 Aug 2013*

Change requested by:

Name:	Allan Dawson
Phone:	9254 4333

In order for the proposal to be progressed, all fields below must be completed and the change proposal must explain how it will enable the Market Rules to better contribute to the achievement of the wholesale electricity market objectives. The objectives of the market are:

- (a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system;
- (b) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors;
- (c) to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions;
- (d) to minimise the long-term cost of electricity supplied to customers from the South West interconnected system; and
- (e) to encourage the taking of measures to manage the amount of electricity used

- x **Trading Margin** – The amount by which a Market Participant’s Trading Limit exceeds its Outstanding Amount (clause 2.41.1) which triggers a Margin Call.
- x **Margin Call** – The requirement for a Market Participant to provide a Security Deposit or additional Credit Support to cover possible losses in accordance with clause 2.42.4.

Prudential security for each Market Participant is held by the IMO to reduce the credit risk and consequential financial impact of default by a Market Participant on the Wholesale Electricity Market (WEM). The prudential process is principally designed to ensure that, if a Market Participant defaults by failing to settle its Short Term Electricity Market (STEM) or Non-STEM invoice amounts on a due date, the IMO will hold sufficient prudential security from that Market Participant so as to cover that Market Participant’s exposure without short paying the market.

In accordance with the Market Rules, the IMO must determine each Market Participant’s Credit Limit and Trading Margin. The IMO must also monitor these values to ensure that a Market Participant’s exposure risk is not greater than the Credit Support provided. If at any time, the Market Participant’s market exposure becomes greater than its Trading Limit as

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In practice, the IMO uses historical data to predict future behaviour for Credit Limit determinations. The IMO uses up to 48 months of historical Settlement data, or a reasonable estimate if data is unavailable, as an estimation of a Market Participant's future exposure in the market by calculating the anticipated maximum exposure over 70 days. This represents the highest 15-day STEM exposure and the highest 70-day Non-STEM exposure, and therefore represents the theoretical maximum amount that the Market Participant has already reached. The IMO then uses its discretion to consider other factors such as previous defaults in payments or other Suspension Events to increase the Credit Limit determination appropriately.

Using the anticipated maximum exposure to benchmark a Market Participant's Credit Limit as an amount that will not be exceeded over a 70-day period has proved to be a robust, predictable and repeatable tool for both Market Participants and the IMO. Therefore, the IMO proposes amendments to the expectation of owed amounts in this clause to clarify that the Credit Limit is the amount owed over any 70-day period and increase transparency of the IMO's calculation of a Market Participant's Credit Limit.

- (c) Currently, the IMO determines the Credit Limit for a Market Participant by taking into account various factors specified in clause 2.37.4(a) to (j). A number of these factors have been less practical in application than the use of actual data or objective and reasonable estimations, including:
- x Clauses 2.37.4(a), (c) and (h), which require complex statistical calculations which are resource intensive and unlikely to result in a corresponding improvement in the determined amount.
 - x Clause 2.37.4(d), which requires the IMO to take into account the processes set out in clauses

Proposed Amendments

- 2.37.1. The IMO must determine a Credit Limit for each Market Participant in accordance with clause 2.37.4.
- 2.37.2. Subject to clauses 2.37.3 and 2.42.7, the IMO may review and revise a Market Participant's ~~revise the Credit Limit of a Market Participant~~ at any time.
- 2.37.3. The IMO must review each Market Participant's ~~the Credit Limit of a Market Participant~~ at least once each year.
- 2.37.4. Subject to clauses 2.37.5 and 2.37.6, the Credit Limit for a Market Participant is the dollar amount determined by the IMO as being equal to the amount that the IMO reasonably expects will not be exceeded over any 70 day period, where this amount is:
- (a) the maximum net amount owed by the Market Participant to the IMO over the 70 day period;
 - (b) determined

~~2.37.6. [Blank]~~

~~2.37.7. [Blank]~~

~~2.37.8. The IMO must notify each Market Participant of their Credit Limit, and provide details of the basis for the determination of the Credit Limit.~~

B.

Clause 2.37.5 of the Market Rules (proposed to be renumbered as clause 2.37.8) requires a Market Participant to notify the IMO of any changes in its circumstances that would affect its Credit Limit. Currently, the Market Rules only contemplate situations that affect a Market Customer's risk in the WEM (sub-clauses 2.37.5 (a) and (b)). They do not consider situations where Market Generators may also need to vary their bilateral position in the market.

C. **Guidelines for determining the expected value of a transaction**

Clause 2.37.9 requires the IMO to provide guidelines, consistent with the methodology for determining Credit Limits, for determining the expected value of a transaction in the Market Procedure. These guidelines were intended to be used by the IMO and Market Participants to assess whether a Market Participant's Trading Margin will be exceeded following a submission. Under clause 2.41.2, a Market Participant must use the guidelines to determine if a submission can be made. Under clause 2.41.3 the IMO has the right to reject a submission where, using the guidelines, the submission could result in the Market Participant's Trading Margin being exceeded.

The Market Procedure does not currently include any guidelines to calculate the expected value of a transaction.

Proposed Amendments

- 2.40.1. The Outstanding Amount for a Market Participant at any time equals the total amount calculated as follows:
- (a) ~~{Blank}~~
 - (b) ~~the total amount calculated as follows~~:
 - i. ~~the aggregate of the amounts payable by the Market Participant to the IMO under these Market Rules, including amounts for all past periods for which no Settlement Statement has yet been issued, and whether or not the payment date has yet been reached; less~~
 - (b) ii. ~~the aggregate of the amounts payable by the IMO to the Market Participant under these Market Rules, including amounts for all past periods for which no Settlement Statement has yet been issued, and whether or not the payment date has yet been reached; less~~
 - (c) the aggregate of any amounts paid by the Market Participant to the IMO for the purpose (to be specified by the Market Participant in accordance with the Market Procedure referred to in clause 2.43.1) of reducing the Outstanding Amount and increasing the Trading Margin on each day during the period from the Trading Day on which the Outstanding Amount is calculated up to and including either the next STEM Settlement Date or the next Non-STEM Settlement Date whichever settlement date occurs first.

E. Typical Accrual and the amount of Margin Call

A Margin Call represents a requirement for a Market Participant to provide a Security Deposit or additional Credit Support to cover possible losses in the event that a Market Participant's Trading Margin falls below zero. The IMO must determine the amount of the Margin Call as the Outstanding Amount less the Typical Accrual under clause 2.42.3.

The Typical Accrual is defined in clause 2.42.2 as the amount that the IMO determines would have been the Outstanding Amount at that time, resulting from the application of average prices and quantities, as applied to the most recent determination of the Market Participant's Credit Limit. In other words, to determine the Typical Accrual, the IMO must calculate what the Outstanding Amount for the Market Participant would have been, at the time of the determination, if it was calculated using average prices and quantities rather than as described in clause 2.40.1.

In practice, the IMO has found that the concept of the Typical Accrual is complex and may not produce a more reliable estimate compared to the Outstanding Amount determined under clause 2.40.1. In instances where a Market Participant's Trading Margin reaches zero, the IMO has sought to increase the Market Participant's Credit Limit, which requires additional Credit Support to be provided and therefore reduces the exposure to the market.

The IMO proposes to remove the concept of the Typical Accrual and amend clause 2.42.3 to indicate that the amount of the Margin Call is the amount that will raise the Trading Margin to zero. This is in line with the proposed amendments to the determination of a Market

Participant's Credit Limit. The result of the IMO's proposed amendments is that the amount of the Margin Call would be determined based on the Market Participant's most recent Trading Margin and the

Proposed Amendments

- 2.38.1. ~~Where at any time a Market Participant does not meet the Acceptable Credit Criteria set out in clause 2.38.6, then the~~

- i. is from a €Credit €Support provider, who must be an entity which meets the Acceptable Credit Criteria and which itself is not a Market Participant;
- ii. is a guarantee or bank undertaking in a form prescribed by the IMO;
- iii. is duly executed by the €Credit €Support provider and delivered unconditionally to the IMO;
- iv. constitutes valid and binding unsubordinated obligations to the €Credit €

- x the Credit Support or Reserve Capacity Security must be provided either as a Security Deposit or as an obligation underwritten by entities meeting the Acceptable Credit Criteria;
- x the replacement Credit Support or Reserve Capacity Security must be provided without any time lag; and
- x the amount of the Credit Support or Reserve Capacity Security should be at least equal to the most recently determined Credit Limit or Reserve Capacity Security.

The IMO proposes to replicate the proposed amendments related to prudential obligations in the relevant clauses in section 4.13, as they apply to Reserve Capacity Security. The IMO also proposes to make appropriate amendments to the Market Procedure: Reserve Capacity Security³.

Further, the IMO notes that clauses 4.13.3 and 4.13.4 have associated civil penalties under the Regulations.

Proposed Amendments

- 4.13.1. Where the IMO assigns Certified Reserve Capacity to a Facility that is yet to enter service (or re-enter service after significant maintenance or having been upgraded), the relevant Market Participant must ensure that the IMO holds the benefit of a Reserve Capacity Security that is:
- (a) in the form specified in clause 4.13.5; and
 - (b) in an amount determined under clause 4.13.2(a) by the date and time specified in clause 4.1.13.
- 4.13.2C Where under clause 4.13.2B the IMO notifies a Market Participant that excess Reserve Capacity Security is currently held, then a Market Participant may replace the existing Reserve Capacity Security with a replacement Reserve Capacity Security. ~~The replacement Reserve Capacity Security~~ which must:
- (a) be in the form specified in clause 4.13.5;
 - (b) be in an amount not less than the amount required under clause 4.13.2(b); and
 - (~~b~~c) become effective before the IMO returns any excess Reserve Capacity Security.
- 4.13.3. Where a Market Participant's existing Reserve Capacity Security is due to ~~terminate~~ expire or cease to have effect for any other reason and after that ~~termination~~ expiration the Market Participant will continue to have an obligation to ensure the IMO holds the benefit of a Reserve Capacity Security under clause

³ The proposed amended Market Procedure: Reserve Capacity Security will be presented at a later date during the rule change process.

4.13.1, then that Market Participant must ensure that the IMO holds the benefit of a replacement Reserve Capacity Security ~~that. The replacement Reserve Capacity Security must:~~

- (a) is in the form specified in clause 4.13.5;
- (b) ~~be~~ is an amount not less than the amount required under clause 4.13.2; and
- (~~b~~c) becomes effective ~~when~~ before the termination of the existing Reserve Capacity Security expires or otherwise ceases to have effect.

4.13.4. Where a Market Participant's Reserve Capacity Security is affected by any of the circumstances specified in the Market Procedure referred to in clause 4.13.8 for the purposes of this clause ~~no longer current or valid (for example, because the Reserve Capacity Security provider ceases to meet the Acceptable Credit Criteria),~~ then that Market Participant must ensure that the IMO holds the benefit of a replacement Reserve Capacity Security that:

- (a) is in the form specified in clause 4.13.5;
- (b) is in an amount not less than the level required under clause 4.13.2; and
- (c) becomes effective

("Security Deposit") made with the IMO (on terms acceptable to the IMO in its discretion) by or on behalf of the Market Participant.

11 Glossary

Reserve Capacity Security: The reserve capacity security to be provided for a Facility that:

- (a) has the meaning given in clause 4.13.5; and
 - (b) is as calculated and re-calculated under clause 4.13 and clause 4.28C.
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2. Explain the reason for the degree of urgency:

The IMO has determined that this Rule Change Proposal is of medium urgency and proposes it is progressed through the Standard Rule Change Process.

3. Provide any proposed specific changes to particular Rules: (for clarity, please use the current wording of the Rules and place a ~~strickthrough~~ where words are deleted and underline words added)

The IMO has reproduced the Prudential Requirements section of the Market Rules in Appendix 1 to facilitate a holistic view and better understanding of the proposed amendments.

4. Describe how the proposed Market Rule change would allow the Market Rules to better address the Wholesale Market Objectives:

The Rule Change Proposal would allow the Market Rules to impact the Wholesale Market Objectives, as described below.

Impact	Market Objectives
Allow the Market Rules to better address the objective	a
Consistent with objective	b, c, d, e
Inconsistent with objective	

(a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system;

(b) to encourage competition among generators and retailers in the South West

interconnected system, including by facilitating efficient entry of new competitors;

- (c) to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions;
- (d) to minimise the long-term cost of electricity supplied to customers from the South West interconnected system; and
- (e) to encourage the taking of measures to manage the amount of electricity used and when it is used.

The IMO believes the proposed amendments to the prudential requirements will allow the Market Rules to better achieve Wholesale Market Objective (a) as it will:

- x increase transparency in the WEM and reduce barriers to entry by providing more information on a Market Participant's Credit Limit determination, thereby promoting economic efficiency;
- x provide clarity on the Outstanding Amount and the inclusion of voluntary prepayments which will promote accuracy in monitoring Trading Margins and making Margin Calls, thereby minimising the potential financial risk to the WEM; and
- x allow better timelines and handling processes around Credit Support arrangements which will reduce overall risk created in the WEM due to Suspension Events, thereby promoting overall prudential security.

The IMO considers that the proposal is consistent with the remaining Wholesale Market Objectives.

The proposed amendments will also improve the overall integrity of the Market Rules by employing a principles-based approach, moving the more prescriptive detail into the Market Procedure. It will also improve the linkages between the Market Rules and the Market Procedure.

5. Provide any identifiable costs and benefits of the change:

Costs

The move to dynamic monitoring of prudential liabilities will require some changes within the Settlement system and its integration with the Wholesale Electricity Market System (WEMS). A formal costing for these IT changes has not yet been obtained by the IMO. However, it is expected that any costs will be outweighed by the benefits to the market.

It is not anticipated this change will result in any additional IT expenses to Market Participants.

The proposed amendments allow for more transparency with respect to en.o

Appendix 1: Proposed Amending Rules: Prudential Requirements

Prudential Requirements

2.37. Credit Limit

2.37.1. The IMO must determine a Credit Limit for each Market Participant in accordance with clause 2.37.4.

2.37.2. Subject to clauses 2.37.3 and 2.42.7, the IMO may review and revise a Market Participant's ~~revise the Credit Limit of a Market Participant~~ at any time.

2.37.3. The IMO must review each Market Participant's ~~the Credit Limit of a Market Participant~~ at least once each year.

2.37.4. Subject to clauses 2.37.5 and 2.37.6, the Credit Limit for a Market Participant is the dollar amount determined by the IMO as being equal to the amount that the IMO reasonably expects will not be exceeded over any 70 day period, where this amount is:

(a) the maximum net amount owed by the Market Participant to the IMO over the 70 day period;

(b) determined by applying the factors set out in clause 2.37.5; and

(c) calculated in accordance with the Market Procedure referred to in clause 2.43.1.

~~2.37.4. The Credit Limit for each Market Participant is the dollar amount determined by the IMO as being equal to the maximum net amount that the Market Participant is expected to owe the IMO over any 70 day period where this amount is not expected to be exceeded more than once in a 48 month period. When determining the Credit Limit for a Market Participant the IMO must take into account:~~

~~(a) the average level and volatility of the Balancing Price and the STEM Clearing Price for the previous 48 months, or such shorter time period as data is available for;~~

~~(b) the metered quantity data for the Market Participant, or an estimate of their expected generation and consumption where no meter data is available;~~

~~(c) the correlation between the Relevant Dispatch Quantity and the Balancing Price;~~

- ~~(d) the length of the settlement cycle and the process set out in clauses 9.23, 9.24 and 2.32;~~
- ~~(e) a reduction in the Credit Limit reflecting applicable bilateral contract purchase quantities, where these quantities are the historical bilateral contract submissions, or an estimate of the Market Participant's expected~~

2.37.8. A Market Participant must notify the IMO as soon as practicable where it considers

~~the purposes of this clause increased, or where the existing Credit Support is no longer current or valid (for example, because the credit support provider ceases to meet the Acceptable Credit Criteria) or where some or all of the Credit Support has been drawn on by the IMO in accordance with these Market Rules, then that Market Participant must ensure that the IMO holds the benefit of a replacement Credit Support that:~~

~~(a) is in the form specified in clause 2.38.4;~~

~~(b) is in an amount not less than the level required under clause 2.38.1(b); and~~

~~(c) becomes effective within 24 hours after the Market Participant first becomes aware of the relevant change in circumstance (whether by reason of the Market Participant's own knowledge or a notification by the IMO) one Business Day.~~

2.38.4. The Credit Support for a Market Participant must be:

(a) an obligation in writing that:

- i. is from a ~~€~~Credit ~~s~~Support provider, who must be an entity which meets the Acceptable Credit Criteria and which itself is not a Market Participant;
- ii. is a guarantee or bank undertaking in a form prescribed by the IMO;
- iii. is duly executed by the ~~€~~Credit ~~s~~Support provider and delivered unconditionally to the IMO;
- iv. constitutes valid and binding unsubordinated obligations to the ~~€~~Credit ~~s~~Support provider to pay to the IMO amounts in accordance with its terms which relate to ~~obligations of~~ the relevant Market Participant's obligations under the Market Rules; and
- v. permits drawings or claims by the IMO up to a stated amount; or

(b) a cash deposit ("**Security Deposit**") made with the IMO by or on behalf of the Market Participant.

2.38.5. Where Credit Support is provided as a Security Deposit in accordance with clause 2.38.4(b), it will accrue interest daily at the Bank Bill Rate, and the IMO must pay the Market Participant the interest accumulated at the end of each calendar month less any liabilities and expenses incurred by the IMO, including bank fees and charges.

2.38.6. An entity meets the Acceptable Credit Criteria if it is:

(a) either:

- i. under the prudential supervision of the Australian Prudential Regulation Authority; or

- ii. a central borrowing authority of an Australian State or Territory which has been established by an Act of Parliament of that State or Territory;
- (b) resident in, or has a permanent establishment in, Australia;
- (c) not an externally-administered body corporate (within the meaning of the Corporations Act), or under a similar form of administration under any laws applicable to it in any jurisdiction;
- (d) not immune from suit;
- (e) capable of being sued in its own name in a court of Australia; and
- (f) has an acceptable credit rating, being either:
 - i. a rating of A-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Standard and Poor's (Australia) Pty. Limited; or
 - ii. a rating of P-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Moodys Investor Services Pty. Limited.

2.38.7. The IMO must maintain on the Market Web Site a list of entities which:

- (a) ~~have provided the IMO is satisfied, based on evidence provided by Market Participants in the previous 12~~ is satisfied, based on evidence provided by Market Participants in the previous 12 months, ~~with evidence satisfactory to the IMO that they~~ meet the Acceptable Credit Criteria outlined in clause 2.38.6; or
- (b) the IMO has determined in its absolute discretion meet the Acceptable Credit Criteria outlined in clause 2.38.6.

2.38.8 The IMO must monitor the entities included on the list described in clause 2.38.7 against the requirements in clause 2.38.6 (f).

2.38.9 The IMO may remove the name of an entity from the list described in clause 2.38.7 at any time if the IMO considers that the entity no longer meets the Acceptable Credit Criteria defined in clause 2.38.6.

2.39. Trading Limit

2.39.1. The Trading Limit for a Market Participant is to equal the prudential factor specified in clause 2.39.2 multiplied by the total amount which can be drawn or claimed under, or applied from, its Credit Support.

2.39.2. The prudential factor is 0.87.

2.40. Outstanding Amount

2.40.1. The Outstanding Amount for a Market Participant at any time equals the total amount calculated as follows:

(a) {Blank}

~~(b) — the total amount calculated as follows:~~

i. — the aggregate of the amounts payable by the Market Participant to the IMO under these Market Rules, including amounts for all past periods for which no Settlement Statement has yet been issued, and whether or not the payment date has yet been reached; less

(b) pay2e by217 B re f* EMC /H4 <</MCID 2 >>BDC 4pnT /TT1 1 Tf -0.005 Tc 0.005 Tw 11.04 0

~~Notice to that Market Participant of the relevant Market Participant and increase the Credit Limit in line with the amount of the Margin Call.~~

2.43. Prudential Market Procedure

2.43.1. The IMO must develop a Market Procedure dealing with:

...

(e)