AEMC

AUSTRALIAN ENERGY MARKET COMMISSION

RULE

Consultation paper

National Electricity Amendment (Shortening the Settlement Cycle) Rule 2024

Proponent

GloBird Energy

22 February 2024

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Reference: ERC0384

About the AEMC

The AEMC reports to the energy ministers. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the energy ministers.

Acknowledgement of Country

The AEMC acknowledges and shows respect for the traditional custodians of the many different lands across Australia on which we all live and work. We pay respect to all Elders past and present and the continuing connection of Aboriginal and Torres Strait Islander peoples to Country. The AEMC office is located on the land traditionally owned by the Gadigal people of the Eora nation.

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Citation

To cite this document, please use the following:
AEMC, Shortening the Settlement Cycle, Consultation paper, 22 February 2024

Summary

1 On 6 December 2023, the Australian Energy Market Commission (the AEMC or Commission) received a rule change request from GloBird Energy Pty Ltd (the proponent). The proponent is seeking to amend the National Electricity Rules (NER) to shorten the settlement cycle from 20 business days following the end of a billing period (as is current practice), to 10 business days. This consultation paper is the first step in the rule change process.

2 The proponent states a shorter settlement cycle will reduce the costs of the prudential regime imposed on market participants by:

1. lowering credit support requirements for market participants; and,
2. reducing the impact of Call Notices from the Australian Energy Market Operator (AEMO).

3 The proponent states that this in turn will benefit retailers (particularly smaller retailers) by freeing up working capital, supporting increased investment in service innovations, lowering barriers to market entry, and reducing the risk of retailer failure. This in turn may benefit customers through access to better service offerings, increased competition, and a lower risk of customer disruption due to retailer failure.

4 In addition to amendments to the NER, the proponent has also identified procedures and contractual arrangements that would be impacted by its proposed changes. This includes:

- AEMO procedures that impact settlement (for example, section 2.5 of the Spot Market Operations Timetable)
- The Credit Limit Procedures and prudential settings established by AEMO under clause 3.3.8 of the NER
- Financial contracts of market participants which are linked to NER settlement arrangements.

5 To assess whether we should make a rule change to shorten the national electricity market (NEM) settlement cycle, the Commission is interested in stakeholder views regarding:

- the costs and benefits of a shorter settlement cycle;
- the impact of changing prudential requirements;
- the impact of changing settlement timetables for relevant financial contracts;
- implementation considerations, risks, and opportunities; and,
- the optimal length of the settlement cycle.

We consider there are four assessment criteria that are most relevant to this rule change request

6 Considering the national electricity objective (NEO)[1] and the issues raised in the rule change request, the Commission proposes to assess the rule change request against four assessment criteria:

1. **Outcomes for consumers:** we will assess the impact of shortening the settlement cycle on consumer outcomes. This includes whether changes to the settlement cycle will lead to consumer savings, better and more innovative service offerings for consumers, more competition in the retail market, and lower levels of consumer disruption from a reduced risk of retailer failure.

1 Section 7 of the NEL

2. **Principles of market efficiency:** we will assess whether shortening the settlement cycle will impact principles of market efficiency, including the impact on competition in the retail market, and the impact to current risk allocation settings.
3. **Innovation and flexibility:** we will assess whether changes to the settlement cycle support increased innovation and flexibility for market participants, by reducing the level of capital market participants must hold or lodge with AEMO.
4. **Implementation considerations:** we will assess likely implementation issues, risks, and opportunities in shortening the settlement cycle. This will include consideration of any implementation complexities associated with changes to prudential requirements and changes to the settlement of financial contracts.

7 Please provide feedback on our proposal to assess the request against these criteria.

Submissions are due by 4 April 2024 with other engagement opportunities to follow

8 There are multiple options to provide your feedback throughout the rule change process.

9 Written submissions responding to this consultation paper must be lodged with Commission by 4 April 2024 via the Commission's website, www.aemc.gov.au.

10 There are other opportunities for you to engage with us, such as one-on-one discussions or industry briefing sessions.

Full list of consultation questions

LENGTH OF THE NEM SETTLEMENT CYCLE

Question 1: Do you agree that the current length of the settlement cycle negatively impacts market participants?

- Do you agree with the proponent that the length of the settlement cycle is causing the issues raised? Or are there other causes that should be considered?
- The proponent has focused on impacts on market customers. What are the impacts on other classes of market participants?
- Is this a material issue?

COSTS AND BENEFITS OF SHORTENING THE SETTLEMENT CYCLE

Question 2: What are your estimated costs and benefits of shortening the NEM settlement cycle? Please provide supporting evidence/analysis.

- What are the financial and non-financial costs of shortening the settlement cycle?
- What are the financial and non-financial benefits of shortening the settlement cycle?
- The proponent has considered benefits for retailers and consumers - what are the potential impacts on other classes of market participants and stakeholders?

CHANGES TO PRUDENTIAL REQUIREMENTS

Question 3: What are your views on amending the prudential requirements (including Credit Limit Procedures) to reflect a shorter settlement cycle?

- Are there potential risks in amending the prudential requirements to reflect a shorter settlement cycle? For example, could such a change impact the ability of AEMO to achieve the prudential standard?

CHANGES TO THE SETTLEMENT TIMETABLE FOR FINANCIAL CONTRACTS

Question 4: What are your views on amending the settlement timetables for relevant financial contracts to align with any changes to the NEM settlement cycle?

- How would a change to the NEM settlement cycle impact relevant financial contracts?
- Noting that some contracts are contracted up to three years out, are there implications for changing the settlement timetable for contracts already in place?

IMPLEMENTATION ISSUES AND CONSIDERATIONS

Question 5: What are the potential implementation issues and considerations in shortening the settlement cycle?

- Are there other risks and opportunities in shortening the settlement cycle that should be considered?

OPTIMAL LENGTH OF THE SETTLEMENT CYCLE

Question 6: What, in your view, is the optimal length of the settlement cycle? Provide a rationale supporting your answer.

- Are there any constraints (e.g. technological constraints), that would prevent moving to a particular settlement cycle? For example, is a 1-day settlement cycle feasible?
- The settlement cycle comprises a number of different stages (e.g. preliminary statement, final statements, dispute period, etc.). Could certain stages be adjusted more or less than other stages?
- Are there trade-offs when considering different settlement lengths? For example, does a shorter settlement cycle lead to an increased likelihood of disputes and subsequent readjustments?

Question 7: Assessment framework

Do you agree with the proposed assessment criteria? Are there additional criteria that the

Commission should consider or criteria included here that are not relevant?

How to make a submission

We encourage you to make a submission

Stakeholders can help shape the solutions by participating in the rule change process. Engaging with stakeholders helps us understand the potential impacts of our decisions and, in so doing, contributes to well-informed, high quality rule changes.

We have included questions in each chapter to guide feedback, and the full list of questions is above. However, you are welcome to provide feedback on any additional matters that may assist the Commission in making its decision.

How to make a written submission

Due date: Written submissions responding to this consultation paper must be lodged with Commission by 4 April 2024.

How to make a submission: Go to the Commission's website, www.aemc.gov.au, find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code ERC0384.[2]

You may, but are not required to, use the stakeholder submission form published with this consultation paper.

Tips for making submissions are available on our website.[3]

Publication: The Commission publishes submissions on its website. However, we will not publish parts of a submission that we agree are confidential, or that we consider inappropriate (for example offensive or defamatory content, or content that is likely to infringe intellectual property rights).[4]

For more information, you can contact us

Please contact the project leader with questions or feedback at any stage.

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2 If you are not able to lodge a submission online, please contact us and we will provide instructions for alternative methods to lodge the submission.

3 See: https://www.aemc.gov.au/our-work/changing-energy-rules-unique-process/making-rule-change-request/submission-tips

4 Further information is available here: https://www.aemc.gov.au/contact-us/lodge-submission

Contents

1 The context for this rule change request

This consultation paper seeks stakeholder feedback on a rule change request submitted by GloBird Energy Pty Ltd (the proponent), which proposes to shorten the settlement cycle for transactions on the national electricity market (NEM) between the Australian Energy Market Operator (AEMO) and market participants.

This chapter outlines:

- an overview of the problem identified by the proponent and the proponent's proposed solution
- the recent context of this issue
- the rule change process and timeline we will follow to assess this proposal.

1.1 The proponent has proposed to shorten the settlement cycle

On 6 December 2023, the proponent submitted a rule change proposal that seeks to reduce the costs of the prudential regime imposed on market participants by shortening the settlement cycle from 20 business days after a billing period, to 10 business days. Under the proponent's proposal, this change will:

- lower the quantum of credit support that market participants must lodge with AEMO; and,
- reduce the impact of Call Notices from AEMO.

The proponent states that this change will benefit retailers (particularly smaller retailers) by freeing up working capital, supporting increased investment in service innovation, lowering barriers to market entry, and reducing the risk of retailer suspension and failure. This may in turn benefit consumers through access to better service offerings, more competition, and a lower risk of customer disruption due to retailer failure.

This rule change proposal includes various changes to chapter 3 and chapter 10 of the National Electricity Rules (NER). The proponent has also identified other procedures and contractual arrangements outside of the NER that would be impacted by its proposed changes. This includes:

- AEMO procedures that impact settlement (for example, section 2.5 of the Spot Market Operations Timetable)
- The Credit Limit Procedures and prudential settings established by AEMO under clause 3.3.8 of the NER
- Financial contracts of market participants which are linked to NER settlement arrangements.

The potential impacts of changing the settlement cycle on the above procedures and contractual arrangements are explored further throughout this paper.

1.2 The Commission has previously considered the length of the settlement cycle

The length of the NEM settlement cycle has been raised as an issue previously.

In 2011 AEMO published its "Report on the Prudential Readiness Review", at the request of the then Ministerial Council for Energy (MCE). The review recommended a work program, with the final step being further work to examine measures to deliver a shorter NEM settlement cycle. [5]

5 AEMO, National Electricity Rule Request - New Prudential Standard and Framework, 2011, pg. 6

Following this report, AEMO progressed a rule change request to establish a new NEM prudential standard. The prudential standard is now defined as a 2% probability of incurring a loss or shortfall in the event of participant default, per the Commission's Final Determination for the *National Electricity Amendment (New Prudential Standard and Framework in the NEM) 2012.* The Final Determination also included stakeholder discussion regarding a shorter settlement cycle. The Commission noted that several respondents offered a strong view that the length of the settlement cycle was too long and could be shortened.

The Commission noted that AEMO's Readiness Review concluded that a potential change to the length of the settlement window could be investigated following introduction of a revised prudential standard and framework. The Commission was unable to make any determination regarding the length of the settlement cycle, as it was out of scope for that rule change request. However, the Commission did note that this stakeholder feedback was a valuable precursor to any future rule changes that might be proposed relating to a shorter settlement cycle.

1.3 We have started the rule change process

This paper is the first stage of our consultation process.

This is a standard rule change request and will include the following formal stages:

- a proponent submits a rule change request - **6 December 2023**
- the Commission commences the rule change process by publishing a consultation paper and seeking stakeholder feedback - **22 February 2024**
- stakeholders lodge submissions on the consultation paper and engage through other channels to make their views known to the AEMC project team - **4 April 2024**
- the Commission publishes a draft determination and draft rule (if made) - **13 June 2024**
- stakeholders lodge submissions on the draft determination and engage through other channels to make their views known to the AEMC project team - **25 July 2024**
- the Commission publishes a final determination and final rule (if made) - **5 September 2024**

Information on how to provide your submission and other opportunities for engagement is set out at the front of this document.

You can find more information on the rule change process on our website.[6]

To make a decision on this proposal, we seek stakeholder feedback on:

- how we propose to assess the request (our assessment criteria);
- whether the current NEM settlement cycle negatively impacts market participants;
- and whether the NEM settlement cycle should be changed, including:
  - the costs and benefits of such a change;
  - the impact of making consequential changes to prudential requirements;
  - the impact of making consequential changes to the settlement cycle for relevant financial contracts;
  - implementation considerations in changing the settlement cycle; and
  - and the optimal length of the settlement cycle.

6 See our website: https://www.aemc.gov.au/our-work/changing-energy-rules

2 The problem raised in the rule change request

The proponent considers that the current length of the NEM settlement cycle may have unintended adverse impacts on retailers (particularly smaller retailers), and therefore consumers. This chapter seeks feedback on the current length of the settlement cycle and its impact on stakeholders. Specifically, we are seeking feedback on whether the current length of the settlement cycle negatively impacts market participants and other stakeholders, and if so, in what ways and to what extent.

This section outlines:

- the current process for NEM settlement under the rules
- the problem with the length of the current settlement cycle, as stated by the proponent
- our questions for stakeholders regarding their views on the impact of the length of the settlement cycle

2.1 There is a 20 business-day settlement process from the end of a billing period to the final payment date

Rule 3.15 of the NER outlines how AEMO manages settlements for the NEM. Under the NER, a "billing period" is a 7-day period from the start of the trading interval at 12.05 am Sunday. There is currently a 20 business-day settlement process between the end of each billing period and the payment date, when AEMO and market participants settle all transactions for the relevant billing period. This 20 business day settlement period accounts for:

- **Preliminary statements** - AEMO must give each market participant a preliminary statement within 5 business days after the end of each billing period;[7]
- **Final statements** - AEMO must give each market participant a final statement no later than 18 business days after the end of each billing period;[8]
- **Disputes** - in the event of a dispute between a market participant and AEMO concerning either the net amount payable stated in the preliminary statement or any supporting data, parties must use reasonable endeavours to resolve the dispute within 15 business days of the end of the relevant billing period;[9] and,
- **Payment date** - the 20th business day after the end of a billing period, or 2 business days after receiving a final statement, whichever is the later. [10]

Any disputes relating to final statements or the supporting data provided with these statements must be raised within 6 months of the relevant billing period.[11]

2.2 A longer settlement cycle increases the quantum of credit support that market participants must lodge with AEMO

The length of the settlement cycle may increase the impact of prudential requirements on market participants.

7 Clause 3.15.14 of the NER
8 Clause 3.15.15 of the NER
9 Clause 3.15.18 of the NER
10 Chapter 10 of the NER
11 Clause 3.15.18 of the NER

Under AEMO's Credit Limit Procedures, market participants must lodge credit support with AEMO. This credit support is typically provided in the form of cash or prudential instruments, such as bank guarantees. The purpose of lodging this credit support is to eliminate any risk to AEMO or the NEM in the event that a market participant defaults and is unable to settle its outstandings at the end of a settlement cycle.

Each participant must lodge credit support with AEMO that is at least equivalent to its "Maximum Credit Limit" (MCL).[12]The MCL is calculated based on a 42-day trading average for that participant, multiplied by a volatility factor. The 42-day figure used in each participant's MCL calculation comprises the below two components:

- **The Oustandings Limit (OSL)** - the OSL is based on a 7-day billing period and an estimated 28-day (20 business day) settlement period. Accordingly, the OSL time period is 35 days. The purpose of the OSL is to ensure that the NEM is not exposed to prudential risk inconsistent with the prudential standard during the OSL time period.[13]
- **The Prudential Margin (PM)** - the PM is 7 days. The purpose of the PM is to ensure that the NEM is not exposed to prudential risk during the period of suspending a defaulting market participant. The PM is always assessed over a period equal to the reaction period, which is 7 days. [14]

Accordingly, ***MCL = OSL + PM***

Therefore, there is a direct link between the length of the settlement cycle (captured in the OSL) and the quantum of credit support market participants must lodge with AEMO. For example, a longer settlement period would lead to a higher MCL, and thus a greater quantum of credit support required.[15]

Whilst credit support requirements protect the NEM in the event of failures, potential negative impacts should also be considered:

- there is an opportunity cost to lodging credit support for market participants (particularly smaller participants), which might otherwise direct this capital toward business expansion, innovation, and improved service offerings for consumers
- the cost of maintaining this credit support may be higher for smaller market participants, which will usually have a higher cost of finance
- the requirement to lodge credit support and tie up working capital may act as a barrier to market entry, reducing competition in the retail market which negatively impacts consumers

2.3 A longer settlement cycle may impact how market participants manage the risk of Call Notices

The length of the settlement cycle may increase the impact of Call Notices on market participants.

AEMO calculates a daily trading limit for each market participant. The trading limit (TL) for each participant is the credit support provided by the participant to AEMO, less the participant's PM[16]:

12 AEMO, National Electricity Market Credit Limit Procedures, 2023, 10

13 AEMO, National Electricity Market Credit Limit Procedures, 2023, 3.2, 4.3.1

14 AEMO, National Electricity Market Credit Limit Procedures, 2023, 3.3

15 See Appendix A.2 for further detail on prudential requirements and Credit Limit Procedures

16 Clause 3.3.10 of the NER

When a participant's outstandings with AEMO exceeds its trading limit, AEMO can issue a Call Notice that the participant must respond to by 11 am the following business day. The participant may respond to the Call Notice by:

- providing additional credit support to AEMO by an amount no less than the call amount;
- paying AEMO in cleared funds a security deposit by an amount no less than the call amount;
- lodging a reallocation request by an amount no less than the call amount[17]; or,
- some combination of the above three options.[18]

If a retailer fails to promptly respond to a Call Notice it may be suspended from the market, with its customers transferred to other retailers under the Retailer of Last Resort (RoLR) scheme.[19] [20]

Call Notices are often larger and occur more frequently during periods of high price volatility. Market participants often manage their exposure to price volatility in the NEM through various hedging contracts, which have varying settlement arrangements. Over-the-counter (OTC) contract trades are typically documented using the industry standard International Swaps and Derivatives (ISDA) Master Agreement, and have been standardised so that settlement occurs on the same day as settlement on the NEM. The proponent has provided an extract of the relevant section of the ISDA Master Agreement, as below:

"For each Calculation Period, the Settlement Date is the day upon which the party …, if it were a market participant under the National Rules, would be obliged to make a payment under the National Rules … in respect of electricity bought by it in that Calculation Period." — edited clause 6(i) from the ISDA Master Agreement

Because the settlement period for these financial contracts is 20 business days (per the NEM settlement calendar), there may be significant time lags between when a market participant is issued a Call Notice, and when contracts are settled. This means that participants must fund Call Notices from existing financial resources without the benefit of any offsetting difference payments from their hedging contracts.

Noting the significant consequences of failing to promptly respond to a Call Notice (i.e. market suspension), prudent market participants may take the precaution of holding additional working capital so that they can quickly respond to any Call Notices (including multiple Call Notices) over a settlement cycle. As is the case with the credit support requirements, holding this additional working capital to respond to Call Notices can have a range of negative impacts on market participants, including:

- there is an opportunity cost to holding additional working capital for market participants (particularly smaller participants), which might otherwise direct this capital toward business expansion, innovation, and improved service offerings for consumers;
- the cost of holding this additional working capital may be higher for smaller market participants, which will usually have a higher cost of finance; and,
- the requirement to hold additional working capital may act as a barrier to market entry, reducing competition in the retail market and negatively impacting consumers.

The proponent also notes that the length of the settlement cycle may increase the risk of retailer failure due to an inability to promptly respond to a Call Notice. This in turn leads to customer

17 A "reallocation" is a process by which two market participants request AEMO to make matching debits and credits to the position of those market participants with AEMO, as defined in Chapter 10 of the NER

18 Clause 3.3.13 of the NER

19 Section 136 of the NERL

20 Clause 3.15.21 of the NER

disruption, as customers of the failed retailer are transferred to alternate retailers under the RoLR scheme.

2.4 Does the current length of the NEM settlement cycle negatively impact market participants?

As outlined above, the proponent has identified a range of issues stemming from the current length of the settlement cycle that impact both retailers (particularly smaller retailers), and consumers. The Commission is interested in whether other market participants and stakeholders similarly believe that the length of the current settlement cycle is a problem, and leads to the adverse impacts identified by the proponent.

LENGTH OF THE NEM SETTLEMENT CYCLE

Question 1: Do you agree that the current length of the settlement cycle negatively impacts market participants?

- Do you agree with the proponent that the length of the settlement cycle is causing the issues raised? Or are there other causes that should be considered?
- The proponent has focused on impacts on market customers. What are the impacts on other classes of market participants?
- Is this a material issue?

3 The solution raised in the rule change proposal

This chapter outlines the solution proposed by the proponent and seeks feedback on:

- the costs and benefits of the proponent's proposal to shorten the settlement cycle
- the impact of changing prudential requirements to reflect a shortened settlement cycle
- the impact of changing settlement timetables for relevant financial contracts
- implementation considerations, risks, and opportunities
- the optimal length of the settlement cycle.

3.1 The proponent has proposed shortening the settlement cycle to 10 business days following the end of a billing period

To address the problems identified in Chapter 2, the proponent has proposed changes to the NER so that AEMO and market participants settle faster following the end of each billing period. Under the proponent's proposed rule change the settlement cycle would take place over 10 business days following the end of a billing period, rather than 20 business days as is current practice.

The proponent has proposed changes to rule 3.15 of the NER to amend the timing of each component of the settlement cycle, as well as the glossary in chapter 10, as below:

Table 3.1: Proposed changes to the settlement cycle in the NER

Subject	Relevant clause of the NER	Current settlement process	Proposed changes
Preliminary statements	**3.15.14**	AEMO must give each market participant a preliminary statement within **5** business days after the end of each billing period	AEMO must give each market participant a preliminary statement within **3** business days after the end of each billing period
Final statements	**3.15.15**	AEMO must give each market participant a final statement no later than **18** business days after the end of each billing period	AEMO must give each market participant a final statement no later than **8** business days after the end of each billing period
Disputes	**3.15.18**	In the event of a dispute between a market participant and AEMO concerning either the net amount payable stated in the preliminary statement or any supporting data, parties must use reasonable endeavours to resolve the dispute within **15** business days of the end of the relevant billing period	In the event of a dispute between a market participant and AEMO concerning either the net amount payable stated in the preliminary statement or any supporting data, parties must use reasonable endeavours to resolve the dispute within **7** business days of the end of the relevant billing period
Payment date	**Chapter 10 Glossary**	The payment date is the **20th** business day after the end of	The payment date is the **10th** business day after the end of

Subject	Relevant clause of the NER	Current settlement process	Proposed changes
		a billing period, or 2 business days after receiving a final statement, whichever is the later.	a billing period, or 2 business days after receiving a final statement, whichever is the later.
Payments by market participants	**3.15.16**	On each payment date and in accordance with the timetable, each market participant must pay AEMO in cleared funds the net amount payable per the final statement	No change proposed
Payments to market participants	**3.15.17**	On the **day on which AEMO is to be paid under clause 3.15.16**, AEMO must pay each market participant in cleared funds the net amount payable to the market participant as per the relevant statement given to it under clause 3.15.15	On the **payment date**, AEMO must pay each market participant in cleared funds the net amount payable to the market participant as per the relevant statement given to it under clause 3.15.15

Source: NER, Chapter 3, Chapter 10

The exact proposed changes to the NER can be found at Appendix C, pg. 11 of the proponent's rule change request.

To achieve the benefits of shortening the settlement cycle in the NER, the proponent has identified a range of other procedures and contractual arrangements that would also be amended, as below:

- AEMO procedures that impact settlement (for example, section 2.5 of the Spot Market Operations Timetable)
- The Credit Limit Procedures and prudential settings established by AEMO under Clause 3.3.8 of the Rules
- Financial contracts Market Participants which are linked to the NER settlement arrangements.

The impacts of these changes are explored further in Chapter 3.3 and 3.4 of this paper.

3.2 What are the costs and benefits of shortening the settlement cycle?

The Commission is interested in stakeholder views regarding the costs and benefits of a shorter NEM settlement cycle. This section outlines:

- the potential benefits of shortening the settlement cycle, as outlined by the proponent
- our questions for stakeholders regarding possible costs and benefits of shortening the settlement cycle

3.2.1 The proponent has identified a range of benefits in shortening the settlement cycle

The proponent anticipates that there will be financial benefits in shortening the settlement cycle. These financial benefits stem from lower credit support and working capital requirements, which in turn reduce holding costs for market participants (particularly smaller participants with higher financing costs). The proponent estimates that the following savings could be achieved through a 10-day settlement cycle:

- **Reducing credit support costs** - the proponent estimates that the lower credit support requirements from a shorter settlement cycle would lead to total savings of $14.4 million per annum, which is approximately $1.50 per year in savings per customer per annum, across the 9.7 million NEM customers.
- **Reducing the impact of AEMO Call Notices** - the proponent estimates that the lower working capital requirements from a shorter settlement cycle would lead to total savings of $88 million per annum, which is approximately $9.10 per year in savings per customer per annum, across the 9.7 million NEM customers.

There may also be a number of non-financial benefits in shortening the settlement cycle, as identified below:

- **Lower level of customer disruption** - a shorter settlement cycle may reduce the risk that retailers cannot respond to Call Notices promptly, and are suspended from the market. This in turn would lower the risk of customer disruption from being transferred from the failed retailer to another retailer under the RoLR scheme.
- **Increased competition in the NEM** - a shorter settlement cycle may lower credit support requirements for market participants, and reduce the quantum of working capital participants must hold to promptly respond to Call Notices from AEMO. As these capital requirements are a barrier to market entry, shortening the settlement cycle may support participant entry into the market, and increase competition.
- **Increased investment in service innovations and customer offering**s - lower credit support and working capital requirements for retailers may increase their ability to invest this capital in service innovations and improved customer offerings.

3.2.2 There will likely be some costs associated with shortening the settlement cycle

The Commission is interested in further understanding the likely costs associated with shortening the settlement cycle. These may include financial costs, such as initial implementation costs associated with system changes, and any ongoing procedural costs required to support a shorter settlement cycle. For example, a shorter settlement cycle may lead to a higher number of data errors or disputes that require additional resources to resolve.

We also note that the proponent's benefit analysis focuses on benefits to retailers (in particular smaller retailers), and customers. Noting that changes to the settlement cycle will impact all market participants, we are also interested in stakeholder views as to the impacts on other classes of market participants.

COSTS AND BENEFITS OF SHORTENING THE SETTLEMENT CYCLE

Question 2: What are your estimated costs and benefits of shortening the NEM settlement cycle? Please provide supporting evidence/analysis.

- What are the financial and non-financial costs of shortening the settlement cycle?

- What are the financial and non-financial benefits of shortening the settlement cycle?
- The proponent has considered benefits for retailers and consumers - what are the potential impacts on other classes of market participants and stakeholders?

3.3 What is the impact of changing the prudential requirements?

The Commission is interested in stakeholder views regarding changes to the prudential requirements to reflect a shorter NEM settlement cycle. This section outlines:

- how the proponent's proposed changes may impact prudential requirements in the NEM
- the impact of current prudential settings on market participants
- our questions for stakeholders regarding changes to prudential requirements to align with a shorter settlement cycle

Under the proponent's solution, AEMO's Credit Limit Procedures would be updated to reflect a 10 business day settlement timetable. This shorter settlement cycle would reduce the size of the OSL, which is currently based on an estimated 28-day (20 business day) settlement period (plus a 7-day billing period). This in turn would reduce the size of each participant's MCL, and thus the quantum of credit support each participant must lodge with AEMO.

The impact of prudential requirements may be increasing

The Commission notes that as at 2023, total MCL obligations across the NEM have increased to their highest levels since 2011, increasing from $1.2 billion in August 2022, to $2.1 billion in August 2023. [21]

In 2022 the ACCC considered the impact of recent extreme price volatility in the NEM on the prudential requirements of smaller retailers. The ACCC noted that there were a range of impacts on smaller retailers in the first half of 2022. Four smaller retailers reported no material change in their prudential requirements with AEMO, however it was noted that at least some of these retailers had used settlement reallocation arrangements to minimise the impact of prudential requirements. The five remaining respondents identified material increases in the quantum of their prudential requirements. The scale of this increase ranged from almost doubling to a 6-fold increase in the first half of 2022. All the smaller retailers who responded were able to meet AEMO's prudential requirements, however, these requirements did add additional financial pressure.[22]

The Commission also notes that scheduled increases to the Maximum Price Cap (MPC) may lead to a higher MCL and therefore increased credit support obligations for market participants. [23]

Prudential settings must support achievement of the prudential standard

A key aspect of the prudential requirements is the "prudential standard". The prudential standard of 2% means that prudential settings target no payment shortfall in 98 out of 100 instances of a market participant defaulting on its market payments.

The proponent suggests that a shorter settlement cycle may help AEMO in ensuring that the prudential standard is met as it will reduce:

21 AEMO, Report: Effectiveness of the NEM Prudential Settings Methodology, December 2023, p.g. 3, 8

22 ACCC, Report: Inquiry into the National Electricity Market, November 2022, pg. 57

23 AEMC, *Amendment of the Market Price Cap, Cumulative Price Threshold and Administered Price Cap*, 2023

- prudential requirements and the size and frequency of Call Notices issued which require sudden calls on participant funds
- the probability of loss given default (P(LGD)) for generators
- the potential for customer and market disruption arising from RoLR events

The Commission is interested in stakeholder views as to whether changes to the settlement cycle that impact the prudential settings under the Credit Limit Procedures, may impact the achievement of the prudential standard.

> CHANGES TO PRUDENTIAL REQUIREMENTS
>
> **Question 3: What are your views on amending the prudential requirements (including Credit Limit Procedures) to reflect a shorter settlement cycle?**
>
> - Are there potential risks in amending the prudential requirements to reflect a shorter settlement cycle? For example, could such a change impact the ability of AEMO to achieve the prudential standard?

3.4 What is the impact of changing the settlement cycle for financial contracts?

The Commission is interested in stakeholder views regarding changes to the settlement of financial contracts to reflect a shorter NEM settlement cycle. This section outlines:

- how the proponent's proposed changes may impact the settlement of relevant financial contracts
- our questions for stakeholders regarding changing the settlement timetable for relevant financial contracts.

Under the proponent's solution, a rule change to shorten the NEM settlement cycle would flow through to all financial contracts which have settlement dates linked to the NEM settlement calendar. Such a change would shorten the period between when market participants receive Call Notices that they must respond to, and when participants receive offsetting difference payments from any hedging contracts. Participants would therefore need to hold less working capital to cover the risk of any Call Notices from AEMO.

The Commission is interested in the implications of such a change to the settlement of relevant financial contracts. The Commission notes that some contracts may be contracted up to three years out, and there may therefore be complexities in changing the settlement timetable for contracts already in place. The Commission is also interested in the views of stakeholders that may be party to such financial contracts but are not market participants in the NEM.

> CHANGES TO THE SETTLEMENT TIMETABLE FOR FINANCIAL CONTRACTS
>
> **Question 4: What are your views on amending the settlement timetables for relevant financial contracts to align with any changes to the NEM settlement cycle?**
>
> - How would a change to the NEM settlement cycle impact relevant financial contracts?
> - Noting that some contracts are contracted up to three years out, are there implications for changing the settlement timetable for contracts already in place?

3.5 What are the key implementation considerations and issues?

The Commission is interested in stakeholder views regarding the implementation of a shorter NEM settlement cycle. This section outlines:

- potential implementation considerations in shortening the settlement cycle
- our questions for stakeholders regarding implementing a shortened settlement cycle

There are a range of important implementation considerations in shortening the NEM settlement cycle. For both AEMO and market participants, implementation may involve changing existing settlement systems and processes to align with a shorter settlement cycle. There may be costs and complexities associated with implementing such changes, and we are interested in stakeholder views as to how long implementation might take.

The availability of supporting technology is also an important implementation consideration. For example, the growing availability of smart meter technology may assist in implementing a shorter settlement cycle, as the ability to quickly and accurately read meter data may reduce the time needed to issue preliminary and final statements, and the likelihood and complexity of disputes. The Commission notes that work is underway in various jurisdictions to support the roll out of smart meters. We are interested in stakeholder views as to how this might tie in with implementing a shorter settlement cycle.

Another implementation consideration (as raised in section 3.4 of this paper) is how any changes to the NEM settlement calendar will be aligned with the settlement calendar for existing financial contracts. As some hedging contracts may be contracted up to three years out, any changes to the NEM settlement calendar may lead to a misalignment between NEM settlement dates, and the settlement dates of existing financial contracts. We are interested in stakeholder views as to whether this is a potential implementation risk, and if so, how it might be managed.

Finally, as part of this rule change proposal the proponent has identified various changes to the NER as well as various procedures and contracts, that would be required to achieve its identified solution. We are interested in stakeholder views as to whether there are other changes beyond those identified by the proponent that are required in order to effectively implement this rule change.

IMPLEMENTATION ISSUES AND CONSIDERATIONS

Question 5: What are the potential implementation issues and considerations in shortening the settlement cycle?

- Are there other risks and opportunities in shortening the settlement cycle that should be considered?

3.6 What is the optimal length of the settlement cycle?

This section outlines our questions for stakeholders regarding the optimal length of the NEM settlement cycle.

The proponent has proposed shortening the settlement cycle on the basis that it will lead to a range of benefits for market participants and consumers. The proponent has not however included any analysis as to why a 10-business-day period specifically is the optimal settlement cycle, relative to other potential shorter time frames.

The Commission is interested in stakeholder views as to what the optimal length of the settlement cycle is. If stakeholders believe that the settlement cycle should be shortened based on the issues raised by the proponent, do stakeholders have a view as to what the optimal length of the settlement cycle is? This view may be informed by information and analysis provided by stakeholders in response to other questions in this consultation paper.

OPTIMAL LENGTH OF THE SETTLEMENT CYCLE

Question 6: What, in your view, is the optimal length of the settlement cycle? Provide a rationale supporting your answer.

- Are there any constraints (e.g. technological constraints), that would prevent moving to a particular settlement cycle? For example, is a 1-day settlement cycle feasible?
- The settlement cycle comprises a number of different stages (e.g. preliminary statement, final statements, dispute period, etc.). Could certain stages be adjusted more or less than other stages?
- Are there trade-offs when considering different settlement lengths? For example, does a shorter settlement cycle lead to an increased likelihood of disputes and subsequent readjustments?

4 Making our decision

When considering a rule change proposal, the Commission considers a range of factors.

This chapter outlines:

- issues the Commission must take into account
- the proposed assessment framework
- decisions the Commission can make

We would like your feedback on the proposed assessment framework.

4.1 The Commission must act in the long-term interests of consumers

The Commission is bound by the National Electricity Law (NEL) to only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the national electricity objective.[24]

The NEO is:[25]

> 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; and
>
> (c) the achievement of targets set by a participating jurisdiction—
>
> (i) for reducing Australia's greenhouse gas emissions; or
>
> (ii) that are likely to contribute to reducing Australia's greenhouse gas emissions.

The targets statement, available on the AEMC website, lists the emissions reduction targets to be considered, as a minimum, in having regard to the NEO.[26]

4.2 We propose to assess the rule change using these four criteria

4.2.1 Our regulatory impact analysis methodology

Considering the NEO and the issues raised in the rule change request, the Commission proposes to assess this rule change request against the set of criteria outlined below. These assessment criteria reflect the key potential impacts – costs and benefits – of the rule change request. We consider these impacts within the framework of the NEO.

The Commission's regulatory impact analysis may use qualitative and/or quantitative methodologies. The depth of analysis will be commensurate with the potential impacts of the proposed rule change. We may refine the regulatory impact analysis methodology as this rule change progresses, including in response to stakeholder submissions.

Consistent with good regulatory practice, we also assess other viable policy options - including not making the proposed rule (a business-as-usual scenario) and making a more preferable rule - using the same set of assessment criteria and impact analysis methodology where feasible.

24 Section 88 of the NEL.

25 Section 7 of the NEL.

26 Section 32A(5) of the NEL

4.2.2 Assessment criteria and rationale

The proposed assessment criteria and rationale for each is as follows:

- **Outcomes for consumers:** we will assess the impact of shortening the settlement cycle on consumer outcomes, including whether changes to the settlement cycle will lead to consumer savings, better and more innovative service offerings for consumers, more competition in the retail market, and lower levels of consumer disruption from a reduced risk of retailer failure.
- **Principles of market efficiency:** we will assess whether shortening the settlement cycle will impact principles of market efficiency, including the impact on competition in the retail market, and the impact to current risk allocation settings.
- **Innovation and flexibility:** we will assess whether changes to the settlement cycle support increased innovation and flexibility for market participants, by reducing the level of capital market participants must hold or lodge with AEMO.
- **Implementation considerations:** we will assess likely implementation issues, risks, complexities, and opportunities in shortening the settlement cycle. This will include consideration of any implementation complexities associated with changes to prudential requirements and changes to the settlement of financial contracts.

Question 7: Assessment framework

Do you agree with the proposed assessment criteria? Are there additional criteria that the Commission should consider or criteria included here that are not relevant?

4.3 We have three options when making our decision

After using the assessment framework to consider the rule change request, the Commission may decide:

- to make the rule as proposed by the proponent[27]
- to make a rule that is different to the proposed rule (a more preferable rule), as discussed below, or
- not to make a rule.

The Commission may make a more preferable rule (which may be materially different to the proposed rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule is likely to better contribute to the achievement of the NEO.[28]

4.4 The proposed rule would not apply in the Northern Territory

Parts of the NER, as amended from time to time, apply in the Northern Territory, subject to modifications set out in regulations made under the Northern Territory legislation adopting the NEL.[29]

27 The proponent sets out its proposed rule in Appendix C (pg. 11) of the rule change request.

28 Section 91A of the NEL

29 National Electricity (Northern Territory) (National Uniform Legislation) Act 2015 (**NT Act**). The regulations under the NT Act are the National Electricity (Northern Territory) (National Uniform Legislation) (Modification) Regulations 2016.

The proposed rule would not apply in the Northern Territory, as it amends provisions in NER chapter 3 that do not apply in the Northern Territory.[30] Consequently, the Commission will not assess the proposed rule against additional elements required by the Northern Territory legislation.

30 Under the NT Act and its regulations, only certain parts of the NER have been adopted in the Northern Territory. The version of the NER that applies in the Northern Territory is available on the AEMC website at: https://energy-rules.aemc.gov.au/ntner.

A Overview of the settlement cycle

The role of AEMO in settlement

Rule 3.15 contains the rules regarding the settlement of transactions on the NEM between AEMO and market participants.

AEMO has a market clearing role in the NEM. In accordance with the NER, AEMO must provide a financial settlement service for the billing and clearance of all NEM market trading transactions under Chapter 3 of the NER including:

- spot market transactions
- reallocation transactions
- ancillary service transactions[31].

Calculating net settlement amounts

A "billing period" is a period of 7 days commencing at the start of the first trading interval on each Sunday.[32]

For each billing period, AEMO must calculate a net settlement amount for each market participant, by aggregating the trading amounts for each market participant from each transaction in respect of each trading interval in that billing period, together with participant fees and any other amounts payable or receivable by the market participant in that billing period. The settlement amount will be a positive or negative dollar amount for each market participant.[33]

AEMO may calculate an *estimate* of the net settlement amount for each market participant if, within the time provided for the giving of preliminary statements AEMO is prevented from calculating the net settlement amount by factors which are beyond the control of AEMO and deprive AEMO of the relevant data required to calculate the net settlement amount.[34]

When the settlement amount for a market participant is negative, the absolute value settlement amount is payable by the market participant to AEMO. When the settlement amount for a market participant is positive, the settlement amount is receivable by the market participant from AEMO.[35]

Data collection for energy trading

Metering Data Providers (MDPs) download electricity metering data through communication links after the end of each billing period. The energy flows through the connection points are recorded as trading interval values, validated for completeness and substituted with estimated values to replace any missing or incorrect values.

The MDP passes the validated metering data to AEMO by the second business day after the end of the billing period.[36]

Preliminary statements

31 AEMO, NEM Settlements Process, 2019, 1.1
32 Chapter 10 of the NER
33 Clause 3.15.12(a) of the NER
34 Clause 3.15.12(b) of the NER
35 Clause 3.15.13 of the NER
36 AEMO, NEM settlements process, 2019, 2.1

Within 5 business days after the end of each billing period, AEMO must give each market participant a draft statement, together with supporting data relating to all transactions in that billing period and the prices at which electricity was bought and sold by the market participant.[37]

Final statements

No later than 18 business days after the end of each billing period, AEMO must give each market participant a final statement, stating the amount either payable by the participant to AEMO, or receivable by the participant from AEMO, in respect of the relevant billing period.[38] Statements issued must include supporting data for all amounts payable or receivable.

Payment by market participants to AEMO

On each payment date, and in accordance with the timetable, each market participant must pay AEMO cleared funds in the net amount stated to be payable in the relevant final statement, whether or not the participant continues to dispute the net amount payment.[39]

The "payment date" is the 20th business day after the end of a billing period, or 2 business days after receiving the final statement, whichever is later.[40]

Payment by AEMO to market participants

On the day on which AEMO is to be paid by market participants (per clause 3.15.16 of the NER), AEMO must pay each market participant in cleared funds the net amount stated to be payable to that market participant in the relevant final statement.[41]

Disputes

In the event of a dispute between AEMO and a market participant concerning the net amount payable in a preliminary statement or the supporting data, parties must each use reasonable endeavours to resolve the dispute within 15 business days of the end of the relevant billing period.

Disputes in respect of final statements or the supporting data provided with them must be raised within 6 months of the relevant billing period.[42]

Payment process

The NER require that AEMO arrange an EFT mechanism for settlements and the collection of market fees. AEMO uses Austraclear as the provider of the EFT settlement facility called Exigo.[43]

Market participants must pay AEMO in cleared funds by 10.30am Sydney time on the payment day. AEMO receives electronic confirmation of cleared funds via Austraclear in real time.

After confirmation by AEMO that full receipts have been received from all paying market participants, the AEMO Full Payment process takes place, and AEMO pays creditor market participants by 2pm Sydney time.

If all receipts are not cleared by 10.30am, then the Shortfall Payment process is commenced. [44]

Default procedures

37 Clause 3.15.14 of the NER
38 Clause 3.15.15 of the NER
39 Clause 3.15.16 of the NER
40 Chapter 10 of the NER
41 Clause 3.15.17 of the NER
42 Clause 3.15.18 of the NER
43 AEMO, NEM Settlements Process, 3.3.1
44 AEMO, NEM settlements process, 3.3.2, 3.3.3

If one or more receipts have not been cleared by the 10.30am deadline, AEMO becomes aware of this through the Austraclear facility and confirms with the market participant. Upon recognising a default event, AEMO may:

- issue a Default Notice to the defaulting market participant/s, to be remedied within 24 hours of the Default Notice being issued; and/or,
- draw upon credit support or security deposits provided by the defaulting market participant/s in order to recover funds necessary to meet settlement payment obligations.[45]

Maximum Total Payments

The NER provide that AEMO's obligations to make payments otherwise due to market participants are limited to the money available to AEMO from receipts from market participants. This means that any shortfall in AEMO's recovery of payments from market participants in relation to a given billing period is shared across all settlement recipients (typically generators and reallocators), by reducing the amount paid to them for supply and reallocations through the market in that billing period.[46] [47] If credit support payments received cover the shortfall, then no reduction in payments is necessary.[48]

Settlements calendar

The annual settlements calendar published by AEMO shows the dates for delivery of statements and settlement of trading amounts relating to each billing period. The monthly settlement calendars show the dates for delivery of statements and settlement trading amounts relating to each billing period. Both calendars include posting dates for 20-week and 30-week revised statements. The calendars are published on the AEMO website.[49]

45 AEMO, NEM settlements process, 3.3.4

46 AEMO, NEM settlements process, 2019, 3.1

47 Clause 3.15.22 of the NER

48 AEMO, NEM settlements process, 2019, 3.3.4

49 AEMO, NEM Settlements Process, 2019, 2.3

B Overview of relevant prudential requirements

Rule 3.3 of the NER sets out the prudential settings for market participants in the NEM. Prudential requirements help minimise risk in the NEM.

The prudential standard

A key aspect of the prudential requirements is the “prudential standard”. The prudential standard is set at 2% under clause 3.3.4A of the NER. A prudential standard of 2% means that prudential arrangements target no payment shortfall in 98 out of 100 instances of a market participant defaulting on its market payments. In the remaining 2 out of 100 instances, AEMO would not hold sufficient prudential collateral, resulting in payment shortfall to the remaining market participants who are net creditors in the market.[50]

Credit Limit Procedures

AEMO’s Credit Limit Procedures (establish the methodology by which AEMO determines the “prudential settings” for each market participant so that the prudential standard for the NEM of 2% is met.[51]

The prudential settings for each market participant comprise its Maximum Credit Limit (MCL), Outstandings Limit (OSL), and Prudential Margin (PM).

- **Maximum Credit Limit (MCL)** - Each participant must lodge credit support with AEMO that is at least equivalent to its ”Maximum Credit Limit” (MCL).[52]The MCL is calculated based on a 42-day trading average for that participant, multiplied by a volatility factor to account for seasonal differences. The 42-day figure used in each participant’s MCL calculation comprises the below two components:
  - **The Outstandings Limit (OSL)** - the OSL is based on a 7-day billing period and an estimated 28-day (20 business day) settlement period. Accordingly, the OSL time period is 35 days. The purpose of the OSL is to ensure that the NEM is not exposed to prudential risk inconsistent with the prudential standard during the OSL time period.
  - **The Prudential Margin (PM)** - the PM is 7 days. The purpose of the PM is to ensure that the NEM is not exposed to prudential risk inconsistent with the prudential standard during the period of suspending a defaulting market participant. The PM is always assessed over a period equal to the reaction period, which is 7 days.

Accordingly, ***MCL = OSL + PM***

Credit support in the NEM

As above, each market participant must lodge credit support with AEMO equivalent to its MCL.

AEMO’s obligation to settle any payments due to market participants in relation to a billing period, is limited to the extent of funds received from market participants in respect of that billing period, or provided under credit support arrangements.[53]

Any shortfall in AEMO’s recovery from any market participant in relation to a billing cycle is shared proportionally by market participants that are due payment in that billing cycle.[54]

50 AEMO, Report: Effectiveness of the NEM Prudential Settings Methodology, 2023, pg. 6

51 AEMO, Report: Effectiveness of the NEM prudential settings methodology, 2013

52 AEMO, National Electricity Market Credit Limit Procedures, pg. 35

53 Clause 3.15.22 of the NER

54 AEMO, National Electricity Market Credit Limit Procedures, pg. 5, 6

Abbreviations and defined terms

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CLP	Credit Limit Procedures
Commission	See AEMC
ISDA	International Swaps and Derivatives Association
MCL	Maximum Credit Limit
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NERL	National Energy Retail Law
NERO	National Energy Retail Objective
NERR	National Energy Retail Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
OSL	Oustandings Limit
OTC	Over the Counter
PM	Prudential Margin
Proponent	The proponent of the rule change request
RoLR	Retailer of Last Resort
TL	Trading Limit