

2 May 2025

Ms Anna Collyer
Chair, Australian Energy Market Commission
Sydney NSW 2000

Reference: ERC0403

Dear Ms Collyer,

AEMO submission to draft determination – cash as credit support

AEMO appreciates the opportunity to make a submission to the draft determination on the proposed change to the National Electricity Rules (NER) to allow cash as credit support in the NEM.

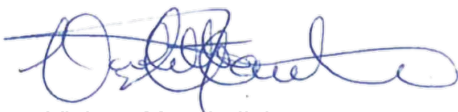
The prudential framework is designed to ensure timely and reliable settlement, essential to maintaining market confidence and incentivising ongoing reliable supply in the NEM. This is achieved by establishing a high level of certainty that all credit support held will provide immediately available and sufficient funds to fully settle the market in the event of participant default.

Allowing the use of cash as credit support represents a pragmatic enhancement to the prudential framework, offering market participants greater flexibility and operational efficiency. AEMO acknowledges the significant work in the draft rule to reduce the impact of the associated clawback risk. As such, the flexibility and efficiency benefits can be realised without materially affecting the ability to meet the framework's key objectives. Subject to resolution of some detailed drafting and implementation matters, AEMO supports the draft rule amendments to allow cash as credit support.

AEMO does not support the draft rule amendments to allow surety bonds as an additional form of credit support, or to expand the eligibility of credit support providers beyond APRA-regulated entities. AEMO considers that both these amendments are likely to compromise the integrity of the prudential framework and increase administration costs, without an established use case or evidence of material benefits for NEM participants and consumers now or going forward.

The attached submission expands on these issues in further detail and includes feedback on the rule drafting. Should you wish to discuss any aspect of our submission, please contact Hannah Heath, Group Manager, Strategic Market Reform (Hannah.Heath@aemo.com.au).

Yours sincerely,



Violette Mouchaileh
Executive General Manager, Policy & Corporate Affairs



ATTACHMENT – Detailed submission

PART A – Feedback on key changes

1. AEMO supports the provision of cash as credit support

AEMO supports the draft rule to allow participants to use cash as credit support, or 'cash security', to assist in meeting their prudential requirements. The inclusion of cash is a significant evolution of the NEM prudential framework and AEMO considers it will improve the flexibility of the framework to remain fit-for-purpose through the energy transition.

While the inclusion of cash security is a substantial change to the mechanics of the prudential framework, it is not expected to materially affect market risk. There remains a high level of confidence that, in the event of participant default, AEMO will hold both cash securities and bank guarantees providing sufficient immediately available funds to settle the market in full and on time. As pointed out in AEMO's submission to the consultation paper, however, it is important for market participants to be aware that AEMO does not undertake any financial viability checks on market participants. The current financial assurance of an acceptable credit provider's willingness to provide credit support is removed if a participant opts to meet its credit support obligations entirely in cash.

1.1. Use of cash security

The draft determination states that the provision of cash security would deliver two key benefits:

- Reducing the cost of providing credit support, particularly for small retailers, by avoiding lender fees associated with obtaining and maintaining credit support arrangements.
- Reduce risk of participants failing to provide credit support, by enabling them to provide credit support at short notice without reliance on a third-party.

AEMO agrees with the benefits as described in the draft determination and considers the appropriate use of cash security is an efficient development that acknowledges the changing nature of credit risk in the market.

As highlighted in stakeholder feedback to the consultation paper¹, the procurement of bank guarantees for NEM credit support can be more onerous for two broad categories of market participants: 1) smaller retailers who access finance at a higher relative cost, and 2) as described in Delta's rule change proposal, transitioning market participants with emissions intensive assets who have difficulty accessing bank guarantees to cover any potential maximum credit limit (MCL)² due to lender ESG policies. AEMO expects that allowing cash securities up to the draft rule's \$5 million limit would manage both issues.

More broadly, AEMO acknowledges that cash is a highly liquid and low-risk form of credit support and its use in the NEM would provide:

- Greater flexibility for all market participants to better optimise the provision of credit support with the use of cash security to efficiently respond to changing MCL requirements.

¹ Section 1.2 of the draft determination

² Market participants who are creditors to the NEM do not have credit support requirements. However, if there is significant change in their trading position, for example due to a prolonged generator outage or significant period of negative prices, their trading position may switch to that of a net debtor. AEMO monitors participants' trading position and calculates and applies MCL and credit support obligations as required.

- Administrative simplicity for participants whose credit support requirements are set at a relatively low level.
- Alignment with common practice in other financial and energy markets, including the Wholesale Electricity Market (WEM) in Western Australia also operated by AEMO.
- Simplified application in the event of default, ensuring timely access to funds to meet settlement obligations.

Clause 3.3.2A of the draft rule envisages that AEMO will develop terms, conditions and procedural requirements for the provision of cash security. AEMO is developing a draft High-Level Implementation Assessment (HLIA), which will include AEMO's initial view on the proposed approach to the operational management of cash security. This will provide detail on the treatment of interest on cash held and the cash security return process. Draft cash security guidelines will be developed following further analysis and receipt of stakeholder feedback on the HLIA, to support the delivery of cash security and the realisation of practical benefits to market participants, while maintaining the integrity of the prudential framework.

1.2. Clawback risk

Section 2.5.1 of the draft determination summarises the increased risk to the market from the use of cash security in the event of liquidator clawback. AEMO acknowledges the draft rule seeks to mitigate clawback risk by characterising cash securities in a way that supports AEMO's security interest and may establish some protection against clawback. However, the robustness of those protections in the event of any particular liquidator claim remains uncertain and, as the draft determination points out, clawback risk cannot be eliminated by the rules alone.

AEMO remains of the view that the most straightforward means of eliminating clawback risk is to broaden the displacement provisions to cover all AEMO settlement and prudential transactions but acknowledges this requires amendments to the National Electricity Law and regulations which cannot be addressed within the timeframe of an AEMC rule change process. To provide certainty and confidence to the market, AEMO recommends legislative change is pursued in parallel and would strongly support these amendments if proposed.

The draft rule seeks to minimise the impact of any residual clawback liability in two ways:

- By setting a \$5 million limit on the total amount of cash security that any individual market participant can provide.
- By allocating any liability that may arise to market participants through reduced settlement payments on a pro-rata basis.

AEMO supports the application of a limit that represents the level of risk the market is willing to bear. As such, relevant market participants upon which liability is allocated are best placed to comment on the value of the limit itself.

In general, a limit should be set at a level that represents a reasonable balance between the value of flexibility for participants to use cash as credit support, and the level of risk the market is willing to accept as a result of exposure to potential clawback liability. Given the opportunity cost of maintaining large amounts of cash as ongoing credit support, it may be a less desirable option for participants at higher amounts. As such, the benefits of cash security are unlikely to be reduced with the application of an appropriate limit, and AEMO supports this policy design to drive efficiency and balance risks and benefits.

In summary, AEMO considers the draft amendments to allow cash security represent a positive and significant evolution of the prudential framework. Absent a fully legislated solution to remove clawback risk, AEMO considers the solution design will be effective to manage the risks of cash security without compromising the intended benefits of this rule change.

2. AEMO recommends against the provision of surety bonds and changing regulatory supervision requirements for providers

AEMO does not support the draft amendments to include surety bonds as a form of credit support or allow non-APRA-regulated credit support providers ('non-APRA providers'). As the draft determination acknowledges, these changes were neither included in Delta's rule change request nor suggested in submissions. While AEMO understands the AEMC's intent is to promote optionality and possibly lower costs for participants in the provision of credit support, AEMO considers these options introduce risk that could compromise the integrity of the prudential regime without clear or material benefits.

Credit support is held as collateral in the NEM to adequately cover participant operational exposure at the level of the prudential standard. To that end, both the terms of existing credit support instruments and the rules supporting AEMO's rights to apply or draw down on securities were designed to maximise the likelihood of AEMO having sufficient available funds to settle the market by the due time for payment each week. This enables the prudential framework to fulfil its fundamental objective of providing confidence of payment for services on time and in full, incentivising participation in the NEM.

While the NER include settlement shortfall provisions³ to address the residual risk that the prudential processes fail to secure sufficient funds on settlement day, this is expected (and has proven) to be an extremely rare event. The introduction of surety bonds as credit support, and the expansion to non-APRA providers, create conditions in which settlement shortfalls following a participant default are likely – and perhaps certain – rather than an unexpected contingency. Although the draft rule proposes to bring forward repayment of any subsequently recovered shortfall amounts via routine settlement revisions, this does not manage the underlying risk of shortfall. AEMO cautions against any policy option that creates shortfall risk by design.

The following sub-sections set out our views on the specific risks and costs associated with surety bonds and non-APRA providers, and on the utility of these changes in addition to cash security.

2.1. Surety bonds

Market participants paying settlement amounts to AEMO are required to remit funds by 10.30am on settlement day, with AEMO paying recipients by 2pm. The settlement timetable is structured to give AEMO enough time to attempt contact with any non-paying participant, identify a default event⁴, apply security

³ Clause 3.15.22

⁴ Participant short payment for that billing period

deposits or call on credit support as applicable, and receive funds from the relevant financial institution to cover the default amount.

The draft determination indicates surety bond issuers may be unable to respond to a call within this settlement window, and it is unclear how long a typical payout time would be.⁵

A shortfall is a significant and administratively onerous event, requiring AEMO and every receiving counterparty to adjust their amounts for all Austraclear transactions in line with AEMO's notification, within a very short timeframe. If the required actions are not completed by either AEMO or by a large number of market participants, AEMO may be forced to delay settlement. Accordingly, the shortfall process is an entirely unsuitable mechanism to be used by design every time a surety bond is called, to cover payment periods that are inconsistent with the timing of AEMO's settlement obligation.

If settlement recipients are more likely to receive short or late payments, with uncertain recovery periods, there could be flow on impacts for participants on contracts and reallocations, potentially increasing costs and heightening the risk of financial contagion across the market.

Under the current form of bank guarantee for all its markets, AEMO provides at least one hour's notice for payment.⁶ If this is unrealistic for surety bonds and a longer period had to be allowed, the case for one hour payment is undermined, and there may be calls for that longer period to be extended to bank guarantees as an equivalent form of security. This would create a much more widespread and systemic risk of shortfall in the market.

2.2. Non-APRA providers

AEMO understands surety bond providers are typically insurers or financial institutions that may not be subject to the same prudential regulation as most banks operating in Australia. AEMO considers the inclusion of non-APRA providers could expose the market to increased counterparty risk.

By design, APRA supervised entities:

- Operate under strict capital adequacy, liquidity, and governance requirements.
- Are subject to ongoing prudential supervision and compliance.
- Must meet robust standards for creditworthiness and reliability.

While the draft rule maintains the requirement for credit support providers to be resident or have a 'permanent establishment' in Australia, it specifies that, as an alternative to APRA-regulated entities or Australian state/territory central borrowing authorities, credit support providers may be regulated by:

- an authority with formal responsibility for the supervision of banking business, that is a member of the Basel Committee on Banking Supervision; or
- a financial or insurance regulator with regulatory equivalence, as determined by AEMO in its absolute discretion, to APRA.

AEMO is concerned that these changes would:

- Expose the market to sovereign risk, and significant potential for jurisdictional enforcement challenges and costs.

⁵ Section 2.5.2 of the draft determination

⁶ AEMO bank guarantee pro-forma, at: https://aemo.com.au/-/media/files/about_aemo/aemo-bank-guarantee-pro-forma.pdf?la=en

- Introduce unknown counterparty risks associated with standards of regulatory supervision of international providers, now or as a result of future changes to international frameworks or memberships.
- Further exacerbate the risk of delayed payment (and consequently settlement shortfalls) following a credit support demand if, notwithstanding an Australian presence, payment must be authorised by management located overseas.
- Increase the potential frequency of adverse changes resulting in a credit support provider ceasing to meet the acceptable credit criteria, obliging affected market participants to source replacement credit support within 24 hours and increasing the likelihood of default.
- Confer discretion on AEMO that is not consistent with AEMO's existing market functions, and which AEMO is not equipped to exercise in terms of resources or expertise in the regulation of financial markets.
- Increase the administrative complexity and cost of AEMO's prudential management and monitoring activities, including:
 - Significant initial and ongoing effort to structure processes and to identify and build relationships and market awareness with potential non-APRA providers. This is critical to minimise the risks associated with late or disputed payments but will increase implementation costs and extend the timeframes for delivery.
 - Existing processes to monitor adherence to the acceptable credit criteria would need to be expanded, including additional measures to comply with anti-money laundering and counter-terrorism financing legislation, with additional complexity expected on both receipt of credit support (prior to reflecting the credit support against participant MCLs), and in the daily ongoing monitoring of credit support providers and regulatory authorities in multiple jurisdictions.

2.3. Utility and benefit to the market

AEMO considers that the increased risk and complexity associated with surety bonds and non-APRA providers represent a significant increase in potential market exposure that is not in line with the fundamental design of the prudential framework. Further, it is not clear that there is any material demand from participants to use these options, or that they would deliver cost or efficiency benefits to market participants in addition to the ability to use cash. If surety bonds or non-APRA providers are to be considered, AEMO suggests the following questions must be comprehensively explored:

- Is there a reasonable pool of potential credit support providers who meet the draft rule criteria (including credit ratings and Australian residence or permanent establishment) and are willing to supply credit support in the Australian market?
- Are those providers prepared to accept unconditional, on-demand, short notice payment terms, governed by and enforceable under Australian law?
- On these terms, would these providers offer guarantees or surety bonds that are materially cheaper than either bank guarantees or cash?
- Noting that participants with small MCLs would generally find cash cheaper and more convenient, and large participants typically have established economic arrangements with their financial institutions, is there a significant group of market participants that would prefer this option over bank guarantees and/or cash, and on what basis?

- If payment periods for surety bonds inevitably exceed the times allowed for in the spot market timetable, what period is reasonable and how can the discrepancy be managed without invoking the shortfall mechanism and undertaking revisions two weeks later?

In short, if the incremental utility and value to market participants are low, in addition to being counter to the fundamental design of the prudential framework, AEMO considers the additional risk, and the implementation and ongoing management costs will outweigh any benefits.

3. Implementation

AEMO's draft HLIA will outline the expected new and changed processes, systems and regulatory measures that AEMO currently anticipates are needed to accept cash securities as envisaged in the draft rule. This will assist in determining a feasible implementation date, to inform the AEMC's final rule.

Given the material uncertainty associated with the provision of surety bonds and non-APRA providers, the draft HLIA will not detail those changes, but will seek to identify the implementation considerations to be worked through if those provisions were maintained in the final rule.

PART 2 – Feedback on rule drafting

This part provides detailed comments and drafting suggestions on the draft rule, not covered by the issues raised in Part 1 on the key changes. AEMO welcomes the opportunity to discuss drafting changes with the AEMC to ensure the final rule is clear, consistent, and facilitates the efficient implementation of the policy intent.

Draft clause	Description	Suggested change
Glossary	Definition of <i>credit support</i>	Reposition the words 'or a <i>cash security</i> ' so it appears before the phrase 'supporting the obligations of a <i>Market Participant</i> ' – which apply to all forms of credit support.
1.11(d)(2A)(ii)/ 3.3.2A/ 3.3.13B	Payment of interest on cash securities	Annual interest payments would be a new process, different to other instances where AEMO processes interest at the time of application in the next available final statement. Creating a new process within AEMO's systems for annual interest payments is a material change that will impact project delivery. To maximise AEMO's ability to meet delivery timeframes, AEMO recommends processing the interest payments for cash security at the time of application. Move the interest provision from 1.11 to 3.3.13B, so the latter covers all substantive rights and obligations for repayment from the fund. Update cross reference in 3.3.2A(b) accordingly.
3.1.1A	Definition of surety bond	The description in this definition includes some of the requirements presently specified in 3.3.2 for credit support, and others that are not specified in the rules but left to the approved form of credit support instrument. Consistency is needed to avoid any implication that requirements are different for different forms of credit support. AEMO suggests removing the defined term and expanding 3.3.2 to incorporate the characteristics of unconditionality, irrevocability, and on-demand non-referable payment.
3.3.2A(d)	AEMO discretion to agree cash security can be subject to other interests	In the same way as credit support must be unsubordinated under 3.3.2(d), cash security must also always be free of all prior claims. Amend 3.3.2A(d) to remove any AEMO discretion to agree otherwise.
3.3.2A(h)	CPI increase of cash limit	AEMO suggests it is unnecessary to index the limit amount. The proposed \$5m comfortably covers all participants we may

		<p>expect to preference cash over guarantees. Indexation would require AEMO to adjust its systems annually, but on recent average inflation rates the change would be so negligible that it would take many years (during which many more market reforms are likely) to reach a level at which more participants would be able to provide all cash credit support.</p> <p>If indexation is retained, CPI is already defined in the glossary. For drafting simplicity and consistency, that definition should be updated if necessary and used as a defined term in all rules where it is applied and intended to mean the same thing.</p>
3.3.13B(b)	'Total credit support' terminology	Suggest terminology should be consistent between clauses where the same concept is intended (e.g. 3.3.5, 3.3.7).
3.3.13B(b)	Requests to return cash security	Unrestricted frequency/ number of returns would be administratively inefficient. Credit support is intended to be a longer-term security aligned with a market participant's MCL, so there should be no potential to use this as a ready cash access account. Suggest that AEMO may specify reasonable limits on the amount and frequency of returns (e.g. following an MCL revision).
3.3.13B(c)	Right to repayment under guidelines	<p>Paragraphs (a) and (b) should provide for all circumstances in which AEMO is obliged to repay cash security, so there should be no ability for the cash security guidelines to specify any others.</p> <p>The guidelines should instead specify things like the requirements for repayment requests (including limits as noted above) and the repayment process.</p>
3.15.21(b)(2)	Structure of clause and set-off	For simplicity and readability, AEMO suggests separate subparagraphs to cover cash security from other credit support. AEMO would welcome the opportunity to discuss the proposed set-off provision.
3.15.22(a)(6)	Timing for recovery of clawback liability and costs to avoid funding deficit	Should any clawback liability arise following a successful claim by a liquidator, AEMO will need the ability to recover the amount payable (as ordered or agreed) at the time it is payable to avoid funding shortfalls. This means (a)(6) must refer to amounts payable within 5 business days after the <i>payment date</i> .
3.15.22A/ 3.15.23/ 3.15.24	Resettlement following recovery to occur at regular revision dates	<p>Consider whether the process outlined in 3.15.22A for the use of regular revisions to repay late credit support payments could also be extended to any type of shortfall amount that is subsequently recovered. AEMO considers this would be a beneficial change to the process overall.</p> <p>Also, the payment of interest by AEMO on subsequently recovered and reimbursed shortfall amounts can only occur to the extent interest was paid by the defaulting participant and for the period that AEMO held the funds.</p>