



## Electricity market financial resilience

### Stage 2 options paper released for stakeholder comments

**The AEMC will publish an options paper on 8 November 2013 that discusses the nature and management of risk, including systemic risk, in the electricity sector. It explores potential measures that may reduce the risk that the financial distress of one market participant could spread to other market participants.**

The options paper commences stage 2 of our advice to the Standing Council on Energy and Resources (SCER) on whether the financial relationships and markets underpinning the national electricity market (NEM) are sufficiently robust to manage the financial consequences of unexpected events.

Financial contagion occurs when the financial distress or failure of one business has flow-on effects that cause financial distress or failure in other businesses, leading to a cascading effect in the market. The first stage of our review focused on the risk of financial contagion arising from the failure of a large retailer and associated retailer of last resort event. We published draft recommendations in relation to this issue on 4 June 2013 in our first interim report.

The second stage of the review is considering other possible risks of financial contagion in the NEM. It highlights the important role played by financial contracts (known as derivatives) that are used by generators and retailers to manage their exposure to the wholesale spot price for electricity. These contracts reflect active risk management by participants. However, they also have the potential to transmit financial distress from one participant to another, if a business defaults on its contracts.

The stage 2 options paper explores how the risks faced by retailers and generators in the NEM are currently managed, both through the regulatory framework and through businesses' risk management practices, and how this may affect the degree of systemic risk in the electricity market.

The paper also sets out a number of options to address systemic risk in the NEM. These measures either seek to increase transparency or change risk management arrangements. They include reforms to the regulation of over-the-counter derivatives agreed by the 'group of 20' countries following the global financial crisis.

The options paper does not contain recommendations as to which, if any, of the options should be implemented. The Commission will consider the options in light of a range of factors including the National Electricity Objective and the views expressed by stakeholders.

In developing the stage 2 options paper, the Commission has benefited from the advice and input of an industry working group and an advisory committee, as well as discussions with a broad range of parties involved in the electricity and financial markets.

### Next steps

We invite stakeholder comments on the options and other issues discussed in the paper. Submissions close on 19 December 2013. We will consider submissions before making draft recommendations in a second interim report to be published in the first quarter of 2014.

We expect to provide our final recommendations to SCER, relating to both the first and second stages of the review, in mid-2014.

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