INFORMATION

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NEM financial market resilience review: Final report

The AEMC recommends a number of measures to improve the financial resilience of the National Electricity Market. These recommendations seek to minimise the disruptions to consumers and maintain the financial stability of the market and public confidence, if a market participant fails.

Purpose of this advice

The AEMC was asked to provide advice by the Council of Australian Governments' (COAG) Energy Council on risks to the financial stability of the National Electricity Market (NEM), and whether any additional measures may be required to manage those risks. Financial stability relates to the smooth flow of funds between market participants in the NEM so that the buying and selling of electricity continues to operate as intended.

While the NEM has operated effectively to date, its operating environment has evolved significantly since the market began. This includes changes to industry structure and regulatory obligations.

The range of challenges that the NEM has faced, and may face over the coming years, increases the importance of:

- understanding the potential threats to the financial stability of the NEM; and
- being prepared to manage and respond to risks, if they occur.

Responding to threats to the financial stability of the NEM

A participant with a large electricity retail business experiencing financial distress or failure could have significant flow on effects to other participants, threaten the financial stability of the NEM and potentially result in disruption to consumers. We have found that there is a need to be better prepared to respond to the failure of large participants by allowing:

- responses to be tailored to each situation, as the such a failure would be complex and the circumstances would be different in each case;
- decisions to be made in a nationally coordinated way across government and market regulatory bodies; and
- consideration of the wide range of issues by decision makers that such a failure would require, such as financial stability considerations, consumer and investor confidence, competition and market structure implications, and impacts on the broader economy.

Overview of final recommendations

In response to these findings, we have made a number of recommendations.

We recommend the COAG Energy Council implement new measures through developing changes to legislation and submitting rule changes to better respond to the financial distress and failure of *large* participants. These new measures include:

- elevating decision making to respond to a *large* participant failure from market regulatory bodies to a single decision making point. Decisions would be made by the Chair of the COAG Energy Council, in close cooperation with State and Territory energy ministers; and
- that decision making be supported by a formal structure for the provision of co-ordinated advice by market regulatory bodies, including the AEMC, the Australian Energy Market Operator (AEMO), the Australian Energy Regulator, and the Australian Securities and Investments Commission. Advice would be provided on the best course of action to maintain the financial stability of the NEM, using the existing information gathering powers of the market regulatory bodies.

The Commission's recommendations focus on minimising disruptions to consumers, and maintaining the financial stability of the NEM and public confidence, if a participant fails.

We also recommend the COAG Energy Council implement changes to existing arrangements to:

- amend the retailer of last resort (ROLR) scheme by developing changes to the National Energy Retail Law and submitting rule changes to the National Electricity Rules to reduce the immediate financial obligations on the ROLR. The ROLR scheme seeks to quickly transfer customers to a new retailer following a retailer failure, so that customers continue to receive retail electricity services without disruption. These changes would allow the ROLR scheme to operate in a broader set of circumstances following a retailer failure; and
- clarify, by submitting rule changes to the National Electricity Rules, the framework in which AEMO may not suspend a participant from the market. This may assist in maintaining financial stability in the NEM where a participant is under external administration and its generation assets are allowed to continue operating.

Finally, we recommend developing alternative arrangements which could apply instead of the ROLR scheme where a *large* participant fails, as the ROLR scheme may not always be effective in minimising disruptions to consumers and maintaining the financial stability of the NEM in such a situation. The detailed design and implementation of these arrangements would involve a range of stakeholders, both within and outside of the electricity sector. As a result, we recommend that the COAG Energy Council request jurisdictional energy departments, in consultation with Commonwealth, State and Territory Treasuries, to pursue this work further.

Benefits of the final recommendations

In the absence of preparation and planning on how to manage and respond to the failure of market participants, the stability of the NEM could be threatened and the expectation for government to directly intervene could arise. Experiences from other sectors of the economy, ranging from insurance to childcare, suggests that the absence of a planned response to the failure of a large participant can result in major disruptions to the community and a less than effective response.

The Commission's recommendations focus on enabling more timely, proportionate and suitable decisions to be made when risks to the financial stability of the NEM arise. They provide the flexibility to tailor the response to the specific circumstances of each large participant failure, increasing the likelihood of an orderly resolution. The need to strengthen and increase the range of options to respond to a participant failure was also highlighted recently in the context of the financial sector as part of the recently completed inquiry into the Australian financial system.

Our recommendations have been developed with a view to maintaining the commercial incentives on participants to manage their own risks to the extent they can. The recommendations also seek to minimise the need for and expectation of government support when risks to the financial stability of the NEM occur.

Advice on additional regulatory measures to mitigate risks in advance

The AEMC was also asked to provide advice on the potential application of the measures for over-the-counter derivative contracts developed by the Group of 20 (G20) countries to electricity market participants in the NEM.

We do not recommend any further regulatory measures for individual electricity market participants to prevent risks to the financial stability of the NEM, including the proposed G20 reforms. The case is not established for mandating such additional measures in the NEM, given the different nature and magnitude of risks in the electricity sector compared to the financial sector and the costs and impacts of introducing these measures.

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