INFORMATION

Application of offsets in the prudential margin calculation

AEMC starts consultation on rule change request from AEMO

AEMO has proposed changes to the National Electricity Rules (NER) to amend the treatment of offsets in the prudential margin calculation.

The rule change request

AEMO has submitted a rule change request that seeks to amend the offsetting treatment of reallocation amounts and trading amounts in the prudential margin calculation.

The prudential margin is a key component of the National Electricity Market (NEM) prudential settings, which are used by AEMO to determine a Market Participant's credit support. The prudential margin provides a "buffer" to cover the loss that may occur between a Market Participant defaulting and its suspension from the NEM.

The Rules currently restrict offsetting between trading amounts and reallocation amounts in the prudential margin calculation, which therefore impacts on the level of credit support provided by a Market Participant to AEMO.

Reallocation amounts represent the value of an off-market trading relationship between two Market Participants (including, but not limited to, a hedging contract).

AEMO considers the restriction in the current rule raises two primary issues for the NEM:

- the impact on competition (the restriction affects Market Participants using reallocations, but does not affect them equally); and
- the current rule results in an inefficient use of (some) Market Participants' collateral (credit support).

Issues for consultation

A consultation paper has been prepared to facilitate stakeholder comment on the issues raised by the rule change request, in particular:

- the extent to which risks are allocated appropriately to the parties that have the information, ability and incentives to best manage each risk in order to minimise the long-term cost to consumers;
- the risk and impact of a Market Participant defaulting (including the time taken by AEMO to suspend the Market Participant following the default event), while maintaining the NEM prudential standard;
- the trade-off between flexibility and regulatory certainty; and
- the impact of inefficient barriers to entry in the NEM.

The consultation paper should be read in conjunction with the rule change request, which is available on the project page for this rule change request.

Background

The NEM prudential settings are a set of requirements established to minimise the risk of a payment shortfall in event of a Market Participant's default, to a level of risk consistent with the prudential standard. The prudential settings include a Market Participant's maximum credit limit, outstandings limit and prudential margin.

Submissions are due by 4 February 2016.

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