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Financial Markets Working Group – Papers on shorter NEM settlement cycle and Survey of second tier retailers

The National Generators Forum (NGF) represents the vast majority of market facing generators in the National Electricity Market. As such, our members are legally obliged under the National Electricity Rules to sell our product through the National Electricity Pool. This makes our members the main creditors of the pool, and as such critically interested in the maintenance of its credit quality.

In this context we are pleased to have the opportunity to comment on the output of the Financial Markets Working Group (FMWG), and in particular the Survey of second tier retailers and Discussion paper on a shorter NEM settlement cycle. We understand that the FMWG is now to be discontinued, with its output to be referred to the Australian Energy Market Operator (AEMO) as part of an upcoming Ministerial Council on Energy (MCE) initiated review. This approach is supported, and in the expectation that the AEMO process will provide adequate participation opportunities for the NGF and other impacted stakeholders, we limit our comments on the FMWG papers to be brief.

1. Shorter NEM settlement cycle

In its recent submission to the AEMC prudential review process, the NGF strongly advocated implementation of a shorter NEM settlement cycle as a means of reducing the prudential funding requirements of the NEM and reducing the risk of systemic NEM failure. This was seen as particularly critical given the potential for privatisation of the NSW retail sector, with the resulting need for up to 40% of the guarantees currently held by AEMO and supplied by the NSW treasury to be funded by the private sector banks in a tight credit environment.

In this light the paper produced by the FMWG is of value as it provides some further detail on the implications of a shorter settlement cycle, and also presents several potential options for consideration.

While we believe more work and discussion would be required to fully consider the implications of the change and associated mechanics (eg. contract market considerations require further assessment), our tentative view is that a weekly settlement cycle appears the most attractive option put forward in the discussion paper.

In our considerations to date, we have explored both the “T+2” and the weekly settlement option. We do not consider the “extended use of daily margining” as a credible option, as it would unacceptably increase the credit risk of the pool, without significant benefits.

The key trade offs our initial considerations of the two remaining options can be characterised as follows:

- The “T+2” option would have the benefit of reduced outstandings in the pool, but incur additional operational overheads and risks; while the
- Weekly settlement cycle option involves slightly higher outstandings, but would require minimal changes to existing operational resources.

On this basis, our tentative preference was for the weekly option, subject to further consideration and review during the upcoming AEMO review process.

2. *Survey of Second tier retailers*

We will not comment on detail on this survey, other than to note that many of the issues raised appear to be related to the challenges that would be faced by any new entity entering any market and facing capital constraints. We note that the healthy list of survey respondents is not indicative of a market with unmanageable entry barriers.

From the NGF point of view, a basic requirement of a credit worthy NEM pool is essential, and all retailers need to be able to meet a threshold level of credit quality to participate. As noted above, generators have no option but to sell their energy to the pool, and it would not be reasonable to mandate this without ensuring the pool is of sound credit quality.

We also note the ongoing advocacy of the Futures Offset Approach. As outlined in our submission to the AEMC prudential review, the NGF continues to believe that the current proposals for Futures Offsets unacceptably undermine the credit quality of the pool, and cannot be supported. We are working proactively to seek to address the problems of this model through the AEMC prudential review process, however at this stage we remain unconvinced that an acceptable model will be possible while Clearing Members refuse to participate directly in the NEM settlement.

We would be pleased to discuss the matters raised in this submission further if required. Alternatively the NGF looks forward to participating actively in the forthcoming AEMO review and in particular is keen to pursue implementation of a shorter settlement cycle.

Yours Sincerely,



Alex Cruickshank
Chairman, NGF Market Working Group