



**Independent Market Operator**

**Final Rule Change Report:  
Acceptable Credit Criteria**

**Ref: RC\_2010\_36**

**Date: 21 March 2011**

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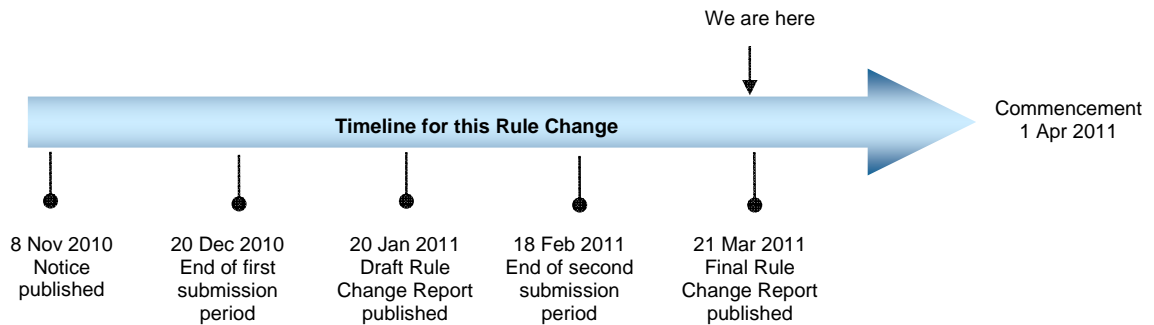
## 1. INTRODUCTION

On 29 October 2010 Synergy submitted a Rule Change Proposal regarding amendments to clauses 2.38.6, 4.13.7, the Glossary and new clauses 2.38.6A, 2.38.6B and 4.13.7A of the Wholesale Electricity Market Rules (Market Rules).

The proposal was processed using the Standard Rule Change Process, described in section 2.7 of the Market Rules. The standard process adheres to the following timelines:



The key dates in processing this Rule Change Proposal are:



The IMO's final decision is to accept the Rule Change Proposal in a modified form. The detailed reasons for the IMO's decision are set out in section 7 of this report.

In making its final decision on the Rule Change Proposal, the IMO has taken into account:

- the Wholesale Market Objectives;
- the practicality and cost of implementing the proposal;
- the views of the Market Advisory Committee (MAC); and
- the submissions received.

All documents related to this Rule Change Proposal can be found on the IMO website: [http://www.imowa.com.au/RC\\_2010\\_36](http://www.imowa.com.au/RC_2010_36)

## 2. THE RULE CHANGE PROPOSAL

### 2.1 *Submission Details*

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<b>Date submitted:</b>	29 October 2010
<b>Urgency:</b>	1 – low
<b>Change Proposal title:</b>	Acceptable Credit Criteria
<b>Market Rules affected:</b>	2.38.6, 4.13.7, the Glossary and new clauses 2.38.6A, 2.38.6B and 4.13.7A

### 2.2 *Summary Details of the Proposal*

Synergy's Rule Change Proposal sought to amend the Market Rules such that, for the purposes of clause 2.38.6, an entity is deemed to meet the Acceptable Credit Criteria if it is on the IMO's list of Acceptable Credit Providers (published on the IMO website). Therefore, a solicitor signed form would not be required for such an entity providing the Credit Support.

The full details of the Rule Change Proposal are contained in Appendix 1.

### 2.3 *The Proposal and the Wholesale Market Objectives*

Synergy submitted that the proposed amendments to the Market Rules would better address both Wholesale Market Objectives (b) and (d) by ensuring a more simple, efficient and cheaper way of certifying that an entity meets the Acceptable Credit Criteria.

### 2.4 *The Amending Rules Proposed by Synergy*

The amendments to the Market Rules originally proposed by Synergy are presented in Appendix 2 of this report.

### 2.5 *The IMO's Initial Assessment of the Proposal*

The IMO decided to proceed with the proposal on the basis that Market Participants should be given an opportunity to provide submissions as part of the rule change process.

## 3. FIRST SUBMISSION PERIOD

The first submission period for this Rule Change Proposal was between 9 November 2010 and 20 December 2010.

### 3.1 *Submissions received*

The IMO received submissions from Landfill Gas & Power (LGP), Perth Energy, and Verve Energy during the first submission period. The main points raised in the

submissions are summarised below. A copy of the full text of all submissions is available on the IMO website.

In summary, all of the submissions received support the proposed amendments. In particular, LGP noted that the proposed changes will remove a potentially obstructive bureaucracy while preserving the underlying substance. Perth Energy stated that it appears nonsensical and contrary to the efficiency objectives embodied in Market Objective (a) that a credit provider that is already pre-approved by the IMO should be subject to a reconfirmation process.

The assessment by submitting parties as to whether the proposal would better the Wholesale Market Objectives is summarised below:

Submitter	Wholesale Market Objective Assessment
LGP	supports (b) and (d)
Perth Energy	better facilitates (a)
Verve Energy	satisfies (b) and (d)

**3.2 The IMO’s response to submissions received during the first submission period**

The IMO’s response to each of the issues identified during the first submission period is presented in Appendix 3 of this report.

**3.3 Public Forums and Workshops**

No public forums or workshops were held in relation to this Rule Change Proposal.

**3.4 The IMO’s review of Acceptable Credit Criteria requirements**

The IMO noted in its Draft Rule Change Report that prior to the formal submission of RC\_2010\_36 into the Rule Change Process, the IMO had sought advice from an external consultant on:

- Avoiding the existing difficulties associated with Market Participant’s solicitors reluctance to provide a certificate that an entity meets the Acceptable Credit Criteria in the form require by the IMO;
- Simplifies the process for Market Participants and the IMO;
- Ensures adequate protection for the Market; and
- Ensures a consistent approach to the requirements for both Credit Support and Reserve Capacity Security.

During the first submission period the IMO received formal advice from its external consultant on the preferable approach to the process for Market Participants providing Credit Support and Reserve Capacity Security. The IMO noted that the advice received was generally consistent with the approach proposed by Synergy, albeit with a number of minor process related refinements which have been incorporated into the proposed Amending Rules presented in Appendix 3. As such the IMO did not consider there was a need to publish an addendum to Synergy’s proposal during the first submission period. The IMO however request that interested parties provide their views during the second submission period on the proposed revised process outlined below:

- Annual certification through an acceptable means, such as completion of an Acceptable Credit Criteria form that the financial institution meets the Acceptable Credit Criteria from either:
  - the Market Participant's external solicitors; or
  - the financial institution's external solicitors.Each certification would be valid for a period of 12 months, after which a further certification would be required;
- The IMO compiles a list of acceptable credit providers based on the certifications received and publishes the list on the Market Web Site. The IMO may at any time remove an entity from the list<sup>1</sup>;
- The IMO will monitor monthly whether the entities on the list maintain appropriate credit ratings in accordance with clause 2.38.6(f). If an entity does not maintain an appropriate credit rating, then the IMO will remove that entity from the list of acceptable credit providers published on its website;
- In the case where an entity is on the list of acceptable credit providers, the Market Participant will not need to provide the IMO with any further certification that the entity meets the Acceptable Credit Criteria; and
- In the case where an entity is not on the list of acceptable credit providers the IMO must be provided with a certification through the usual means by completion of an Acceptable Credit Criteria form that the entity meets the Acceptable Credit Criteria. The entity will then be included on the list of acceptable credit providers for a period of 12 months.

The IMO also noted that ensuring that an external party signs off annually on the credit criteria of the financial institution would provide an assurance to the market that the financial institution will be able to satisfy the obligations under the security. The IMO acknowledged that the annual certification requirements for entities to be included on the list of acceptable credit providers is an additional obligation to that originally put forward by Synergy (that the IMO would annually review the list). The IMO however considered that this increased rigour around the process will partially mitigate any risk that an entity no longer meets the Acceptable Credit Criteria but is still included on the list of entities.

The IMO noted that further details of the process will be specified in the Market Procedure: Prudential Requirements which will be developed by the IMO in conjunction with the IMO Procedure Change and Development Working Group prior to the commencement of any Amending Rules<sup>2</sup>.

### **3.5 Additional Amendments to the Amending Rules**

In preparing the Draft Rule Change Report the IMO made some additional changes to the proposed Amending Rules to better clarify the process for certifying that a bank meets the Acceptable Credit Criteria. The further changes were in line with the external advice the IMO received on the issues previously identified regarding the current Acceptable Credit Criteria requirements.

The amendments made by the IMO are presented in Appendix 4 of this report.

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<sup>1</sup> Note that in the Final Report the IMO has amended this to be restricted to where an entity no longer meets the criteria outlined in clause 2.38.6.

<sup>2</sup> The IMO notes that the proposed revision to the Market Procedure for Prudential Requirements was discussed by the Working Group at the 2 February 2011 meeting. For further details refer to: <http://www.imowa.com.au/IMO-Procedures-Working-Group>

#### 4. THE IMO'S DRAFT ASSESSMENT

The IMO's draft assessment, against clauses 2.4.2 and 2.4.3 of the Market Rules, and analysis of the Rule Change Proposal can be viewed in the Draft Rule Change Report (available on the IMO's website).

#### 5. THE IMO'S DRAFT DECISION

Based on the matters set out in the Draft Rule Change Report, the IMO's draft decision was to accept the amendments to clause 4.13.7, and new clauses 2.38.7, 2.38.8 and 2.38.9 of the Market Rules as proposed in the Rule Change Proposal and modified following the first submission period.

The IMO made its decision on the basis that the Amending Rules:

- will allow the Market Rules to better address Wholesale Market Objective (a);
- are consistent with the remaining Wholesale Market Objectives;
- had the support of the MAC; and
- have the general support of submissions received during the first submission period.

The IMO noted that the process as currently outlined in the Market Rules provides for an entity to provide certification that it meets the Acceptable Credit Criteria on each occasion that it provides an undertaking to the IMO. The IMO acknowledged that in simplifying the process around proving an entity meets the Acceptable Credit Criteria there may be enhanced risks that an entity included on the list of acceptable credit providers has a change in circumstance during the 12 month period which is not identified. While the IMO noted that this will be partially mitigated by the IMO's proposed monthly credit rating monitoring process there is still a risk that a change in circumstance for an entity may not be reflected in its credit rating being revised and therefore not be identified by the IMO.

The IMO therefore sought the views of Market Participants during the second submission period on:

- the proposed process as outlined in section 3.4; and
- whether additional process steps should be incorporated to mitigate against any potential increased risks that an entity no longer meets the Acceptable Credit Criteria.

Additional detail outlining the analysis behind the IMO's reasons was presented in the Draft Rule Change Report.

#### 6. SECOND SUBMISSION PERIOD

Following the publication of the Draft Rule Change Report on the IMO website, the second submission period was between 21 January 2011 and 18 February 2011.

##### 6.1 *Submissions received*

During the second submission period the IMO received submissions from Alinta, LGP and Synergy. The main points raised in the submissions are summarised below. A copy of the full text of all submissions is available on the IMO website.



In summary all of the submissions received generally supported the proposed amendments, though noting a number of issues with the additional amendments proposed by the IMO following the receipt of its external consultant's advice. These include:

- the annual requirement to resubmit an Acceptable Credit Criteria form to ensure an entity is maintained on the list of entities that meet the Acceptable Credit Criteria;
- the criteria for removal of an entity from the list by the IMO at any time;
- the ability for a Market Participant to secure Credit Support/Reserve Capacity Security from another entity that meets the Acceptable Credit Criteria within a short timeframe in the event that a credit provider is removed from the list without prior notice; and
- the application of civil penalties where a Market Participant fails to provide Credit Support (clauses 2.38.2 and 2.38.3) and/or Reserve Capacity Security (clauses 4.13.3 and 4.13.4).

The assessment by submitting parties as to whether the proposal would better the Wholesale Market Objectives is summarised below:

Submitter	Wholesale Market Objective Assessment
Alinta	The efficiency principle of the Market Objectives is likely to be better achieved under the proposed rule change. In particular, consistent with (a) and (b), should a mechanism to source an alternative Credit Support in a reasonable time period be included.
LGP	<i>None provided</i>
Synergy	Does not agree that the additional amendments proposed by the IMO will better facilitate the achievement of the Market Objectives.

**6.2 The IMO's response to submissions received during the second submission period**

The IMO's response to each of the issues identified during the second submission period is presented in the table over the page:



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Clause/Issue	Submitter	Comment/Change Requested	IMO's response
Annual provision of form  (clause 2.38.7)	Synergy	A key objective of Synergy's original proposal was to reduce the number of times a Market Participant was required to submit a form and in doing so provide a cheaper and more streamlined approach to Credit Support. Synergy does not believe that the proposed additional clause 2.38.7 supports this approach.	<p>The IMO considers that the proposed annual provision of a certification will improve the certainty to the market that the Credit Support/Reserve Capacity Security can be drawn on if required. This will reduce the risk to the market associated with the IMO not being able to draw down on a Credit Support/Reserve Capacity Security in a situation where this is required. The IMO notes that a balance between streamlining the process for proving that an entity meets the Acceptable Credit Criteria and ensuring that the market is not placed at risk needs to be achieved.</p> <p>Under the proposed changes only one Market Participant will need to submit a certification from either its external solicitor or the entity's once a year. Whether Market Participants want to consolidate their efforts to obtain the required certifications and therefore share costs is outside the Market Rules.</p>
Annual provision of form	Synergy	Considers it an onerous and unnecessary requirement to submit a form for each entity every 12 months. There is no requirement currently for Market Participants to submit forms annually.	<p>Refer to above.</p> <p>The IMO disagrees that the requirement to provide a certification every 12 months is onerous and unnecessary, noting that currently only a small number of entities are used for the purposes of Credit Support and Reserve Capacity Security.</p> <p>Under the Market Procedure for Reserve Capacity Security there is currently a requirement to provide an Acceptable Credit Criteria form each time a Reserve Capacity Security is provided to the IMO. The IMO however notes that for the purposes of providing Credit Support, the Market Procedure for Prudential Requirements allows for a list of acceptable credit providers to be created. For Market Participants wishing to use a Credit Support from an entity on the list of acceptable credit providers an Acceptable Credit Criteria form is not required to be provided to the IMO.</p> <p>Formalising the list of acceptable credit providers to apply for both Credit Support and Reserve Capacity Security in the Market Rules will provide a cheaper, more effective and more efficient process than each Market Participant's solicitor signing the form. The IMO also notes that this formalisation will ensure consistent treatment of both Credit Support and Reserve Capacity Security.</p>

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Clause/Issue	Submitter	Comment/Change Requested	IMO's response
<p>Monthly monitoring by IMO  (clause 2.38.8)</p>	<p>Synergy</p>	<p>Monthly IMO monitoring of the financial status of credit supporting entities is much preferred over requiring Market Participants to annually resubmit a form. Imposing a resubmission requirement on Market Participants amounts to a duplication of process (and of costs) that adds no discernable value to the market over that achieved through the IMO's proposed monthly monitoring.</p>	<p>The IMO's monthly monitoring activities will only assess whether an entity continues to have an acceptable credit rating, not whether the entity meets all of the criteria outlined in clause 2.38.6. The IMO however considers that the wider test to remove an entity from the list should be explicitly against whether an entity continues to meet the criteria outlined in clause 2.38.6. An entity should not be left indefinitely on the list of acceptable credit providers.</p> <p>The market needs to be provided with a level of certainty that any entities on the list continue to meet the Acceptable Credit Criteria given the potential financial implications of a Credit Support or Reserve Capacity Security being held which is unable to be drawn down by the IMO when needed. To not remove a substantive institution from the list where it no longer meets the Acceptable Credit Criteria would expose the market to additional risk if the IMO were to allow such an institution to provide an undertaking as security to the market. As such the IMO considers it appropriate for a certification of an entity to be provided annually in order to be maintained on the list.</p>
<p>Monthly monitoring by IMO  (clause 2.38.8)</p>	<p>Synergy</p>	<p>The financial status of credit providing entities can change quickly and monthly monitoring would allow the IMO to make further inquiries itself, if needed, to determine the materiality in the change of financial status and take any appropriate remedial action in a timely fashion.</p>	<p>Refer to above.</p> <p>Additionally the IMO does not consider it is in a position to determine the materiality of a change in the financial status of an entity or undertake any remedial action other than to remove an entity from the list that no longer has an acceptable credit rating until such time as a further certification is provided. The provision of this further certification will provide sufficient evidence to the IMO that an entity continues to meet the Acceptable Credit Criteria. Alternatively if the Market Participant can not arrange a certification for the entity it will need to source Credit Support/ Reserve Capacity Security from an alternative entity that does meet the Acceptable Credit Criteria or provide the IMO with a cash deposit.</p> <p>The IMO notes that further details around the obligations to notify a Market Participant that an entity, from which it has provided a Credit Support or Reserve Capacity Security, has been removed from the list of Acceptable Credit Providers will be incorporated into the Market Procedure for Prudential Requirements and Market Procedure for Reserve Capacity Security.</p>

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Clause/Issue	Submitter	Comment/Change Requested	IMO's response
Removal of entities from the list	LGP	The IMO needs to remain alert to the market consequences of sudden credit rating downgrades. Specifically, it would not be in the market's interests for a substantial, and solvent, entity to be denied trading rights because of a general credit crisis.	<p>The IMO agrees that it would not be in the markets best interests to deny any solvent Market Participant from trading in the WEM. The current requirements for an entity providing Reserve Capacity Security or Credit Support to meet the Acceptable Credit Criteria provides a protection to the entire market that the security can be drawn down if required. At any time an entity providing Reserve Capacity Security or Credit Support for a Market Participant is removed from the list, the Market Participant will be able to arrange Credit Support through another financial institution either on the list or alternatively provide an Acceptable Credit Criteria form for an entity not on the list. Alternatively if a Market Participant is substantial and solvent it may be possible for them to provide cash deposit under clause 2.38.4(b) – which does not require an Acceptable Credit Criteria form to be provided. The IMO acknowledges that there may be time delays and costs associated with arranging this alternative “security”.</p> <p>The IMO also notes that an extreme situation like a general credit crisis occurring, which results in a number of large financial institutions credit ratings being decreased below the ratings currently required under clause 2.38.6, would signal much wider potential issues with the economy. The IMO does not consider it appropriate to draft the Market Rules to cover all extreme scenarios.</p>
Removal of entities from the list  (clause 2.38.9)	Synergy	<p>Considers the criteria for removal of an entity from the list should be made explicit in the Market Rules, suggesting the following amendment:</p> <p>“The IMO may remove the name of an entity from the list described in clause 2.38.7 at any time if the IMO forms the view, on the basis of information available to it, that the entity fails to meet the criteria defined in clause 2.38.6.”</p>	<p>The IMO agrees that the test to remove an entity from the list of acceptable credit providers should be explicitly against whether an entity continues to meet the criteria outlined in clause 2.38.6. This will ensure greater certainty for Market Participants that an entity will not be removed from the list for any other reason (such as during the global financial crisis a government guarantee not being provided for a particular entity). In essence if an entity meets the criteria and the required certification has been provided to the IMO then the entity will be included on the list of acceptable credit providers.</p>
Removal of entities from list	Alinta	Has reservations about how the proposed change might impact on Market Participants in the event of the IMO removing a credit provider from the list without prior notice. In particular, the 1 Business Day requirements to source an alternative Credit Support	<p>The requirement to provide a replacement Reserve Capacity Security within 1 Business Day is consistent with the requirement for a replacement Credit Support where the Credit Support held by the IMO is no longer current or valid (clause 2.38.3). The IMO considers it appropriate to treat Reserve Capacity Security and Credit Support similarly with regards to the</p>

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Clause/Issue	Submitter	Comment/Change Requested	IMO's response
		provider potentially imposes requirements on Market Participants that cannot be reasonably met in a number of circumstances.	<p>timeframes for replacing invalid securities and any civil penalties to apply in these situations.</p> <p>Where a Market Participant's Reserve Capacity Security is no longer valid it will be able to provide a cash deposit to the IMO for the amount of monies required. If a Market Participant does not immediately replace a Reserve Capacity Security then the market is at risk during the period between when the entity is removed from the list (and the Reserve Capacity Security becomes invalid under clause 4.13.4) and when a new Reserve Capacity Security is provided. The IMO does not consider it appropriate for the market to incur this risk during these circumstances, as reflected by its view (as presented in RC_2010_12<sup>3</sup>) that failure to provide a replacement security within 1 Business Day should attract a civil penalty.</p>
Removal of entities from list	Alinta	Obtaining Credit Support can take between 2 and 5 Business Days, if the Market Participant has a pre-existing relationship with that financial institution. If Credit Support is sought from an institution with which there is no prior financial relationship, then this approval could take potentially a number of weeks, to ensure that the necessary financial information can be exchanged and the appropriate due diligence can occur.	Refer to above.
Removal of entities from list	Alinta	Requests the IMO to consider introducing a mechanism to allow for the transition of Credit Support should an approved credit provider currently on the list be deemed to no longer meet the credit criteria. As changes to a credit provider's financial position could occur quickly, there needs to be an avenue to seek an alternative Credit Support provider should a Credit Support provider be removed from the list without prior warning. This mechanism would recognise the timeframes that	Refer to above.

<sup>3</sup> For further details refer to the Rule Change Proposal: Required Level and Reserve Capacity Security (RC\_2010\_12) available on the following webpage: [http://www.imowa.com.au/RC\\_2010\\_12](http://www.imowa.com.au/RC_2010_12)

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Clause/Issue	Submitter	Comment/Change Requested	IMO's response
		apply to accessing alternative credit providers and exclude a Market Participant from civil penalty liabilities for a reasonable period that would allow a Market Participant to access Credit Support from another provider.	
Civil Penalties	Alinta	While submitted as a separate Rule Change Proposal, RC_2010_12 seeks to impose civil penalties on those market generators that fail to provide Reserve Capacity Security as currently required under clause 4.13.3 and 4.13.4. RC_2010_12 would impact the outcome of RC_2010_36 because a Market Participant who finds its Credit Support provider removed from the list would be subject to civil penalties for both Reserve Capacity Security and Credit Support.	<p>Refer to above.</p> <p>The IMO notes that RC_2010_12 does not propose the introduction of any civil penalties for a contravention of clauses 4.13.3 and 4.13.4 but rather simply notes that the IMO will recommend that the Office of Energy consider applying civil penalties in these cases. Any changes to the civil penalties obligations are administered by the Office of Energy and reflected in Electricity Industry (Wholesale Electricity Market) Regulations.</p> <p>The IMO notes that at present no civil penalty applies where a Market Participant fails to provide a Reserve Capacity Security under clause 4.13.3 or 4.13.4. This is despite the exposure that the market faces in these instances and inconsistent with the civil penalties that apply for not having current or valid Credit Support. Given the greater flexibility being proposed under RC_2010_36 (by formalising the list of acceptable credit providers) the IMO considers that the associated risk to the market will be potentially increased and so it is appropriate to apply a civil penalty in these cases. This will account for both the increased risk to the market and ensure that Credit Support and Reserve Capacity Security are equitably treated.</p>
Civil Penalties	Alinta	If RC_2010_12 proceeds, then these civil penalties would apply to both RCS and the failure to provide Credit Support. Obtaining Reserve Capacity Credit Support is likely to prove more problematic than Credit Support provided under clause 2.38.1 due to the likely absence of cash flow from the project until the Reserve Capacity payments are made. This differs to obtaining Credit Support because a financial institution is able to assess a Market Participants cash flow levels from operating in the market.	Refer to above.

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### 6.3 Additional amendments to the Amending Rules

Following the closure of the second submission period, the IMO made an additional change to the proposed Amending Rules to clarify that an entity will only be removed from the list of acceptable credit providers where it no longer meets the criteria in clause 2.38.6. These changes were as follows (~~deleted text~~, added text):

- 2.38.9 The IMO may remove the name of an entity from the list described in clause 2.38.7 at any time- if the IMO considers that the entity no longer meets the Acceptable Credit Criteria defined in clause 2.38.6.

## 7. THE IMO'S FINAL ASSESSMENT

In preparing its Final Rule Change Report, the IMO must assess the Rule Change Proposal in light of clauses 2.3.5 of the Market Rules.

Clause 2.4.2 outlines that the IMO “*must not make Amending Rules unless it is satisfied that the Market Rules, as proposed to be amended or replaced, are consistent with the Wholesale Market Objectives*”.

Additionally, clause 2.4.3 states, when deciding whether to make Amending Rules, the IMO must have regard to the following:

- Any applicable policy direction from the Minister regarding the development of the market;
- The practicality and cost of implementing the proposal;
- The views expressed in submissions and by the MAC; and
- Any technical studies that the IMO considers necessary to assist in assessing the Rule Change Proposal.

The IMO notes that there has not been any applicable policy direction from the Minister in respect of this Rule Change nor has it commissioned a technical review in respect of this Rule Change Proposal.

The IMO's assessment is outlined in the following sections.

### 7.1 Market Objectives

The IMO considers that the Market Rules as a whole, if amended, will be consistent with the Wholesale Market Objectives.

Wholesale Market Objective	Consistent with objective
(a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the South West interconnected system	Yes
(b) to encourage competition among generators and retailers in the South West interconnected system, including by facilitating efficient entry of new competitors	Yes
(c) to avoid discrimination in that market against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions	Yes
(d) to minimise the long-term cost of electricity supplied to customers	Yes



Wholesale Market Objective	Consistent with objective
from the South West interconnected system	
(e) to encourage the taking of measures to manage the amount of electricity used and when it is used	Yes

Further, the IMO considers that the Market Rules if amended would not only be consistent with the Wholesale Market Objectives but also allow the Market Rules to better address Wholesale Market Objective (a):

Impact	Wholesale Market Objectives
Allow the Market Rules to better address objective	a
Consistent with objective	b, c, d, e
Inconsistent with objective	-

The proposed amendments will remove the requirements for a solicitor to sign an Acceptable Credit Criteria form for each Market Participant providing Reserve Capacity Security where an entity has been included on the list of acceptable credit providers published by the IMO<sup>4</sup>. This will provide a degree of flexibility for a Market Participant who uses a financial institution who was on the IMO's pre-approved list. For example if Bank A is included on the list of acceptable credit providers then if Market Participants X's Reserve Capacity Security is provided by Bank A the Market Participant will not need to provide an additional Acceptable Credit Criteria form to the IMO. The IMO considers that the proposed changes will provide a more cost effective and efficient process than each Market Participant's solicitor signing the form. The proposed changes will promote market objective (a) by improving economic efficiency and lowering transaction costs.

Additionally, if an entity were to be included on the list who no longer meets the criteria and a Credit Support or Reserve Capacity Security be held from this entity, then there would a high risk to the market that the monies could not be drawn down by the IMO if required. The proposed annual certification process combined with the IMO's monthly monitoring activities of entities credit ratings will mitigate the risk that an entity no longer meets the Acceptable Credit Criteria during the year but yet remains on the list. This level of risk mitigation is not currently provided for in the Market Procedure for Prudential Requirements. The IMO considers that to incorporate these requirements into the Market Rules will represent a significant improvement on the status quo.

## 7.2 Practicality and costs of implementation

### Costs:

#### Operating and Organisational costs

The IMO will incur operating costs in:

- annually updating the list of entities which meet the Acceptable Credit Criteria; and
- undertaking monthly monitoring of whether entities on the list continue to have an acceptable credit rating in accordance with the requirements of clause 2.38.6(f).

<sup>4</sup> Currently Market Participants providing Credit Support to the IMO do not have to provide a form where an entity is included on the list of acceptable credit providers. This is provided for under the Market Procedure for Prudential Requirements.

However, the IMO considers that these tasks fall within the day to day operation of the IMO, therefore the IMO considers that there will be no additional personnel costs associated with the implementation of the proposed changes.

In order to be able to complete its monthly monitoring activities the IMO will need regular access to Standard and Poor's (Australia) and Moody's Investor Services Pty. Limited to confirm the credit rating of entities on the list of acceptable credit providers. The information required to complete these activities is publically available information and therefore no additional costs will be incurred to obtain regular access to these services.

In its submission Synergy notes that should the IMO's additional amendments be accepted, it would incur additional organisational costs as a consequence of the requirement to submit a form for each entity on an annual basis. The IMO notes that as Synergy has not quantified the costs it would incur it is difficult to assess their impact. Based on anecdotal evidence that the costs charged by a solicitor for completing the form are approximately \$200 and given the requirements to provide a certification only once per year for each entity (of which there are currently less than ten), the IMO does not consider these costs are likely to be significant.

#### IT system costs

The proposed amendments will not require any changes to the Wholesale Electricity Market Systems operated by the IMO.

#### Required Market Procedure updates

The IMO notes that there will be updates required to the following Market Procedures required for consistency with the new process for determining whether an entity meets the Acceptable Credit Criteria:

- Prudential Requirements; and
- Reserve Capacity Security.

The IMO also considers that these costs fall within the day to day operation of the IMO and therefore will no incur additional personnel costs.

#### **Practicality:**

In essence the proposed amendments will formalise the current list of acceptable credit providers for the purposes of both Credit Support and Reserve Capacity Security while incorporating some mechanisms to mitigate against the risk that an entity is included on the list that should not be. The IMO notes that there may be potentially some continued reluctance from external solicitors acting for the financial institution to certify that an entity meets the Acceptable Credit Criteria. This is given the potentially large financial liabilities associated with incorrectly certifying an entity meets the Acceptable Credit Criteria. The IMO considers there are sufficient benefits associated with clarifying that external solicitors for the banks can sign the form as they are more likely to be aware of the current financial situation of the bank than a Market Participant's external solicitor. Recent anecdotal evidence suggests that financial institutions have been actively seeking ways to be included on the list.

The IMO notes that no further solutions have been identified which would ensure that a solicitor (or similar party such an accountant) could more easily certify that an entity meets the Acceptable Credit Criteria. As such the IMO considers it is appropriate to continue with the current proposed amendments as they will represent an improvement

from the current process by clarifying that an external solicitor to the entity can also sign the form.

### **7.3 Views expressed in submissions**

The IMO received three submissions during the first submission period in support of Synergy's proposed amendments. During the second submission period the IMO received three submissions which generally supported the proposed amendments, though noting a number of issues with the additional amendments proposed by the IMO following the receipt of its external consultant's advice. The IMO response to these is provided in section 6.2 of this report.

### **7.4 Views expressed by the Market Advisory Committee**

The proposal was discussed at the 10 November 2010 MAC meeting.

During the meeting, it was noted that the IMO has received a great deal of feedback around issues relating to the Acceptable Credit Criteria requirements. The IMO noted that it had engaged an external consultant to undertake a review of these issues. The IMO noted that it expected the results of this review to be available to the IMO by the end of November 2010. It was noted that Synergy had formally submitted RC\_2010\_36 into the rule change process. The scope of Synergy's proposal overlapped with the IMO's review of the Acceptable Credit Criteria requirements.

The following additional points were raised during the meeting:

- Mr Stephen MacLean noted that RC\_2010\_36 sought to remove the requirement in the Market Rules for a participant to provide a solicitor signed Acceptable Credit Criteria form in relation to a Credit Support Provider on the IMO's list of acceptable credit providers.
- Mr MacLean questioned why the Queensland Treasury Corporation was on the IMO's list but not the Western Australian Treasury. Mr Peter Huxtable responded that he understood that the Western Australian Treasury Corporation was not permitted to provide this type of support and that the Queensland Treasury Corporation was probably a provider of Credit Support for a current Market Participant.
- The Chair proposed that the IMO process the Rule Change Proposal but delay its progress until the results of the IMO review can be considered. Mrs Jacinda Papps noted that the IMO would publish the relevant outcomes of its review in an addendum to the Rule Change Notice, so that participants could consider this information when preparing their first period submissions. The MAC supported this proposal.

## **8. THE IMO'S FINAL DECISION**

Based on the matters set out in this report, the IMO's final decision, in accordance with clause 2.7.8 (e), is to accept the Rule Change Proposal as modified by the amendments outlined in section 6.3 of this report.

### **8.1 Reasons for the Decision**

The IMO has made its decision on the basis that the Amending Rules:

- will allow the Market Rules to better address Wholesale Market Objective (a);
- are consistent with the remaining Wholesale Market Objectives;

- provides a more practicable solution than the current process;
- mitigates the risk to the market that a Credit Support or Reserve Capacity Security can not be drawn down when required;
- have the support of the MAC; and
- have the general support of submissions received during both submission periods.

Additional detail outlining the analysis behind the IMO's decision is outlined in section 7 of this Final Rule Change Report.

## 9. AMENDING RULES

### 9.1 Commencement

The amendments to the Market Rules resulting from this Rule Change Proposal will commence at **8.00am** on **1 July 2011**.

### 9.2 Amending Rules

The IMO's final decision is to amend the Market Rules. The following clauses are amended (~~deleted wording~~, new wording):

2.38.7 The IMO must maintain on the Market Web Site a list of entities which have provided the IMO, in the previous twelve months, with evidence satisfactory to the IMO that they meet the Acceptable Credit Criteria outlined in clause 2.38.6.

2.38.8 The IMO must monitor the entities included on the list described in clause 2.38.7 against the requirements in clause 2.38.6 (f).

2.38.9 The IMO may remove the name of an entity from the list described in clause 2.38.7 at any time if the IMO considers that the entity no longer meets the Acceptable Credit Criteria defined in clause 2.38.6.

4.13.7. An entity meets the Acceptable Credit Criteria if it meets the criteria defined in clause 2.38.6. ~~is:~~

(a) ~~either:~~

i. ~~a bank under the prudential supervision of the Australian Prudential Regulation Authority; or~~

ii. ~~a central borrowing authority of an Australian State or Territory which has been established by an Act of Parliament of that State or Territory;~~

(b) ~~resident in, or has a permanent establishment in, Australia;~~

(c) ~~not an externally administered body corporate (within the meaning of the Corporations Act), or under a similar form of administration under any laws applicable to it in any jurisdiction;~~

(d) ~~not immune from suit;~~

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- ~~(e) — capable of being sued in its own name in a court of Australia; and~~
- ~~(f) — has an acceptable credit rating, being either:
  - ~~i. — a rating of A-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Standard and Poor's (Australia) Pty. Limited; or~~
  - ~~ii. — a rating of P-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Moodys Investor Services Pty. Limited; or~~~~
- ~~(g) — if it is named on the List of Acceptable Credit Providers posted on the Market Web Site.~~

## APPENDIX 1: FULL DETAILS OF SYNERGY'S PROPOSAL

Synergy noted in its Rule Change Proposal that under clause 2.38.1 of the Market Rules, any time a Market Participant or a Network Operator does not meet the Acceptable Credit Criteria set out in clause 2.38.6, then the Market Participant or Network Operator must ensure that it provides the IMO with Credit Support.

To confirm whether the Credit Support meets the Acceptable Credit Criteria listed in clause 2.38.6 a Market Participant or Network Operator must, under the Market Procedure for Prudential Requirements, complete the Acceptable Credit Criteria Form (**Form**) available on the IMO's website. This includes ensuring that the Form has been signed by a solicitor of reputable commercial law firm that is acceptable to the IMO.

Synergy noted that it has found a growing reluctance by solicitors to sign the Form as it requires responses to statements concerning the credit provider. Solicitors can only base their responses on information in the public domain and, as such, are reluctant to be held accountable for failings of the credit provider.

Synergy noted that the IMO provides, on its website, a List of Acceptable Credit Providers (**List**). This List (refer to Appendix B) includes financial institutions that the IMO has deemed as meeting the Acceptable Credit Criteria. Synergy noted that the List preamble indicates that the financial institution inventory will be reviewed and updated annually.

Synergy proposed a change to the Market Rules such that, for the purposes of clause 2.38.6, an entity is deemed to meet the Acceptable Credit Criteria if it is on the IMO's List. A solicitor signed Form would not be required for such an entity providing the Credit Support.

## APPENDIX 2: PROPOSED AMENDING RULES IN THE RULE CHANGE PROPOSAL

Synergy proposed the following amendments to the Market Rules (~~deleted text~~, added text):

2.38.6. An entity meets the Acceptable Credit Criteria if it is:

- (a) either:
  - i. under the prudential supervision of the Australian Prudential Regulation Authority; or
  - ii. a central borrowing authority of an Australian State or Territory which has been established by an Act of Parliament of that State or Territory;
- (b) resident in, or has a permanent establishment in, Australia;
- (c) not an externally-administered body corporate (within the meaning of the Corporations Act), or under a similar form of administration under any laws applicable to it in any jurisdiction;
- (d) not immune from suit;
- (e) capable of being sued in its own name in a court of Australia; and
- (f) has an acceptable credit rating, being either:
  - i. a rating of A-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Standard and Poor's (Australia) Pty. Limited; or
  - ii. a rating of P-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Moodys Investor Services Pty. Limited; or
- (g) if it is named on the List of Acceptable Credit Providers posted on the Market Web Site.

2.38.6A If an entity is named on the List of Acceptable Credit Providers then the Market Participant or Network Operator is not required to submit an Acceptable Credit Criteria Form to the IMO.

2.38.6B The IMO must maintain a list of Acceptable Credit Criteria providers on the Market Website (**List of Acceptable Credit Providers**), and must update this list at least once a year before 1 April.

4.13.7. An entity meets the Acceptable Credit Criteria if it is:

- (a) either:
  - i. a bank under the prudential supervision of the Australian Prudential Regulation Authority; or
  - ii. a central borrowing authority of an Australian State or Territory which has been established by an Act of Parliament of that State or Territory;



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- (b) resident in, or has a permanent establishment in, Australia;
- (c) not an externally-administered body corporate (within the meaning of the Corporations Act), or under a similar form of administration under any laws applicable to it in any jurisdiction;
- (d) not immune from suit;
- (e) capable of being sued in its own name in a court of Australia; and
- (f) has an acceptable credit rating, being either:
  - i. a rating of A-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Standard and Poor's (Australia) Pty. Limited; or
  - ii. a rating of P-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Moodys Investor Services Pty. Limited; or
- (g) if it is named on the List of Acceptable Credit Providers posted on the Market Web Site.

4.13.7A If an entity is named on the List of Acceptable Credit Providers then the Market Participant is not required to submit an Acceptable Credit Criteria Form to the IMO.

**List of Acceptable Credit Providers: Listing of acceptable financial institutions posted on the Market Web Site and updated annually in accordance with clause 2.38.6B.**

## APPENDIX 3: THE IMO'S RESPONSE TO SUBMISSIONS RECEIVED DURING THE FIRST SUBMISSION PERIOD

Clause/Issue	Submitter	Comment/Change Requested	IMO's response
Consistency between Credit Support and Reserve Capacity Security provisions	Verve Energy	Although it is not explicitly stated in the Rule Change Proposal, it is assumed that the Acceptable Credit Criteria covers both Credit Support and Reserve Capacity Security. If this is not the case then the proposal should be expanded so that both are captured.	The proposed amendments will apply for both the provision of Credit Support and Reserve Capacity Security. The IMO considered that the proposed process as presented in section 5.5 of the draft report would ensure consistent treatment between these two types of "security" provided to the market.
Removal of institutions from the IMO's list of acceptable credit providers	LGP	It is feasible that a substantive institution with good credit ratings could be downgraded relatively quickly. In the case of the WEM this could lead to institutions suddenly being removed from the IMO's list, thereby stranding solvent institutions depending on them for credit support. LGP suggest that the impact of this potentially should be more thoroughly contemplated and provided for.	<p>The risk of sudden removal from the list will be partially mitigated by the IMO's proposed monthly monitoring process (outlined in section 5.5. of the draft report) of the credit ratings of all entities on the list of acceptable credit providers. The IMO however considered that to not remove a substantive institution from the list where it no longer meets the Acceptable Credit Criteria would expose the market to additional risk if the IMO were to allow such an institution to provide an undertaking as security to the market.</p> <p>At any time an entity providing Reserve Capacity Security or Credit Support for a Market Participant is removed from the list, the Market Participant will be able to arrange Credit Support through another financial institution either on the list or alternatively provide an Acceptable Credit Criteria form for an entity not on the list. The IMO acknowledged that there may be time delays and costs associated with arranging this alternative "security".</p>
Reserve Capacity Security Market Procedure	Verve Energy	The IMO may wish to review the Reserve Capacity Security Market Procedure to ensure it is consistent with the proposed amendments.	The IMO noted that it will be undertaking a substantive review of the Market Procedure for Reserve Capacity Security in light of the proposed changes under the Rule Change Proposal: Required Level and Reserve Capacity Security (RC_2010_12). Any changes to the Amending Rules resulting from RC_2010_36 would also be incorporated into any revised Market Procedure, to be developed in conjunction with the IMO Procedure Change and Development Working Group prior to the commencement of any resultant Amending Rules.
Consistency between Credit Support and Reserve Capacity Security provisions	LGP	The elegance of clause 4.13.7 could be improved by citing clause 2.38.6 and removing the duplication	The IMO agreed and has amended the proposed Amending Rules accordingly. For further details refer to Appendix 4.

## APPENDIX 4: ADDITIONAL AMENDMENTS MADE BY THE IMO FOLLOWING THE FIRST SUBMISSION PERIOD

The IMO made some amendments to the Amending Rules following its assessment of the first submission period responses. These changes were as follows (~~deleted text~~, added text):

The proposed amendment will remove the reference to an entity meeting the Acceptable Credit Criteria if it is named on the list on acceptable credit providers. The IMO considered that stating an entity meets the criteria if it is included on the list of acceptable credit providers is unnecessary and creates circularity with regard to the specifications surrounding the requirements for an entity to meet the Acceptable Credit Criteria. Further, the correct test of whether an entity meets the Acceptable Credit Criteria is set out in the rules. The list will act as a record of those entities that have met the test in the rules, but entry on the list should not by itself provide evidence that the test have been met.

2.38.6. An entity meets the Acceptable Credit Criteria if it is:

- (a) either:
  - i. under the prudential supervision of the Australian Prudential Regulation Authority; or
  - ii. a central borrowing authority of an Australian State or Territory which has been established by an Act of Parliament of that State or Territory;
- (b) resident in, or has a permanent establishment in, Australia;
- (c) not an externally-administered body corporate (within the meaning of the Corporations Act), or under a similar form of administration under any laws applicable to it in any jurisdiction;
- (d) not immune from suit;
- (e) capable of being sued in its own name in a court of Australia; ~~and~~ and
- (f) has an acceptable credit rating, being either:
  - i. a rating of A-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Standard and Poor's (Australia) Pty. Limited; or
  - ii. a rating of P-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Moodys Investor Services Pty. Limited. ~~or~~
- ~~(g) if it is named on the List of Acceptable Credit Providers post on the Market Web Site.~~

The IMO proposes to remove clauses 2.38.6A and 2.38.6B to better reflect the process order and to update the numbering of the new proposed clauses. The specifications

surrounding the list of acceptable credit providers will be provided in new clauses 2.38.7 and 2.38.8.

~~2.38.6A If an entity is named on the List of Acceptable Credit Providers then the Market Participant or Network Operator is not required to submit an Acceptable Credit Criteria Form to the IMO.~~

~~2.38.6B The IMO must maintain a list of Acceptable Credit Criteria providers on the Market Website (**List of Acceptable Credit Providers**), and must update this list at least once a year before 1 April.~~

The proposed new clause 2.38.7 will clarify that the IMO will maintain a list of acceptable credit providers where it has received an appropriate certification that a financial institution meets the Acceptable Credit Criteria (from either the Market Participant's or the entity's external solicitors). Entities for which an appropriate certification is received by the IMO will be incorporated on the list for a period of 12 months.

The IMO noted that the proposed amendments surrounding the provision of a certification that an entity meets the Acceptable Credit Criteria every 12 months will mean that a Market Participant which provides a Reserve Capacity Security from an entity not currently on the list will be required to provide the IMO with a complete certification potentially every 12 months. While this is an additional obligation on the Market Participant the IMO considered that this will improve the certainty to the market that the Reserve Capacity Security can be drawn on if required and thereby reduce risk to the market.

The IMO noted that in the case where it does not receive certifications for any financial institutions then there will be no list and so Market Participants must submit a complete Acceptable Credit Criteria form to the IMO

The requirements to provide an appropriate certification that the entity meets the Acceptable Credit Criteria is generally consistent with the IMO's current process as outlined in the Market Procedure: Prudential Requirements. A copy of the form is currently available on the on the following webpage:  
[http://www.imowa.com.au/f158,595498/acceptable\\_credit\\_criteria.doc](http://www.imowa.com.au/f158,595498/acceptable_credit_criteria.doc)

Further details of the form for complete certification and the process for providing the IMO with the certification will be outlined in the Market Procedure: Prudential Requirements and the Market Procedure for Reserve Capacity Security, along with a process for applying to be listed as an acceptable credit provider. Further clarification that the certification can be from either the Market Participant or the financial institution's external solicitor will also be provided in both of the Market Procedures.

The IMO noted that it will develop the amendments to the Market Procedures in conjunction with the IMO Procedure Change and Development Working Group prior to the commencement of any Amending Rules.

2.38.7 The IMO must maintain on the Market Web Site a list of entities which have provided the IMO, in the previous twelve months, with evidence satisfactory to the IMO that they meet the Acceptable Credit Criteria outlined in clause 2.38.6.

The proposed new clause will outline the requirements for the IMO to monitor whether entities on the list continue to have an acceptable credit rating. The IMO will undertake this monitoring on a monthly basis.

2.38.8 The IMO must monitor the entities included on the list described in clause 2.38.7 against the requirements in clause 2.38.6 (f).

The proposed new clauses will allow the IMO to remove an entity from the list of acceptable credit providers at any time. This will allow for extraordinary circumstances where credit ratings are suddenly downgraded with the effect that the financial institution no longer meets the Acceptable Credit Criteria.

2.38.9 The IMO may remove the name of an entity from the list described in clause 2.38.7 at any time.

The proposed amendment will remove the duplication between clauses 2.38.6 and 4.13.7 of the Market Rules. The IMO considered that this will improve the integrity of the Market Rules and ensure that no inconsistencies between the requirements for an entity to meet the Acceptable Credit Criteria for the purposes of Credit Support and Reserve Capacity Security.

4.13.7. An entity meets the Acceptable Credit Criteria if it meets the criteria defined in clause 2.38.6 is:

- (a) ~~either:~~
  - i. ~~a bank under the prudential supervision of the Australian Prudential Regulation Authority; or~~
  - ii. ~~a central borrowing authority of an Australian State or Territory which has been established by an Act of Parliament of that State or Territory;~~
- (b) ~~resident in, or has a permanent establishment in, Australia;~~
- (c) ~~not an externally-administered body corporate (within the meaning of the Corporations Act), or under a similar form of administration under any laws applicable to it in any jurisdiction;~~
- (d) ~~not immune from suit;~~
- (e) ~~capable of being sued in its own name in a court of Australia; and~~
- (f) ~~has an acceptable credit rating, being either:~~
  - i. ~~a rating of A-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Standard and Poor's (Australia) Pty. Limited; or~~
  - ii. ~~a rating of P-1 or higher for short term unsecured counterparty obligations of the entity, as rated by Moodys Investor Services Pty. Limited; or~~
- (g) ~~if it is named on the List of Acceptable Credit Providers posted on the Market Web Site.~~

~~4.13.7A If an entity is named on the List of Acceptable Credit Providers then the Market Participant is not required to submit an Acceptable Credit Criteria Form to the IMO.~~

The proposed amendment will remove the “List of Acceptable Credit Providers” as being a defined term in the Glossary of the Market Rules. The IMO did not consider that there is any need to specifically define the meaning of the list and incorporate this into the glossary.

~~**List of Acceptable Credit Providers:** Listing of acceptable financial institutions posted on the Market Web Site and updated annually in accordance with clause 2.38.6B.~~