

Policy suite document



TITLE: WHOLESALE ENERGY CREDIT POLICY

DOCUMENT TYPE: BOARD POLICY

This document is not to be considered in isolation, but in relation to its position in the policy suite hierarchy as illustrated under section heading: document hierarchy and questions.

1 PURPOSE

This *policy* sets out the standard credit processes to be followed for *wholesale energy trading activities* with *approved counterparties* and applies to all *Synergy staff* involved in these activities. The *policy* is intended to:

- (a) safeguard *Synergy's* financial resources through the effective implementation of a *credit risk* management framework and *credit risk* control procedures in order to minimise *credit risk* associated with *Synergy's wholesale energy trading activities*; and
- (b) ensure that *Synergy* complies with its *non-discrimination obligations* and other regulatory obligations.

This *policy* applies to all *wholesale energy trading activities* on and from 1 January 2014.

2 BACKGROUND

This *policy* together with the wholesale electricity supply policy meet the written policy requirements under regulation 23 of the *Regulations*.

The definition of terms highlighted in italics in this *policy*, are attached as schedule 2.

3 INTENT

This *policy* seeks to ensure *Synergy* complies with its legal obligations, including its *non-discrimination obligations* and obligations to:

- (a) prepare and maintain a written policy setting out standard processes to be followed in offering a wholesale supply of electricity to the *RBU*, a *retail competitor*, or a *generation competitor*, including processes for:
 - (i) assessing the ability of the *RBU*, the *retail competitor*, or the *generation competitor* to make payments for the wholesale supply of electricity; and
 - (ii) determining the terms and conditions on which the wholesale supply of electricity is to be offered, taking into account that assessed ability.
- (b) ensure credit terms are not, having regard to all relevant circumstances, more favourable to the *RBU* than terms offered to a *retail competitor* or a *generation competitor*.

This *policy* only deals with *credit risk* arising directly from *wholesale energy trading activities*. In particular, it does not address:

- (a) energy trading on the *STEM* and balancing market;
- (b) non-energy related sales and services; or
- (c) *credit risk* arising directly from treasury operations/transactions (which are governed by the treasury policy).

3.1 Breaches of this policy

Any breach of this *policy* must be reported promptly to *middle office*, the general manager of the *WBU* and the chief financial officer.

Middle office is responsible for reporting the breaches to the *TRMC* which reports to the *ACC*. The reporting must include the nature of the breach and root cause, any remediation action taken, proposed rectifying action and/or approval.

A *material breach* of this *policy* must be reported by the chairperson of the *TRMC* promptly to the chairperson of the *ACC*.

3.2 Consequences of breaching this policy

Failure to comply with this *policy* may lead to *Synergy* breaching its statutory obligations. If that occurs, then *Synergy*, may be exposed to, among other things, civil penalties under the *Act* and the *Regulations*.

Synergy is audited for compliance with the *Act* and the *Regulations*.

4 POLICY REQUIREMENTS

4.1 Standard credit processes

Standard credit processes required by the *Regulations* are attached as schedule 1.

4.2 Guiding principles of this policy

The *TRMC* is responsible for approving an *approved counterparty's assessed limit* and ensuring these are in accordance with the intent of this *policy*.

The *credit exposure* of any proposed *wholesale energy trading activity* must fall within the *approved counterparty's* existing *available limit* or be pre-paid in accordance with standard processes.

On-going monitoring and re-assessment of *approved counterparties* and *assessed limits* must be conducted in accordance with standard processes.

Any deviation from standard processes must be approved by the *TRMC* in advance of any related *wholesale energy trading activity* taking place.

5 WHOLESALE ENERGY TRADING ACTIVITIES BETWEEN WBU AND RBU

This *policy* does not apply to the *RBU* to the extent it is engaging in an activity under the *ISWA*.

If the *WBU* and the *RBU* engage in the wholesale supply of electricity that is not an *ISWA* activity, then *Synergy* must apply the standard credit processes attached as schedule 1.

In applying these processes, *Synergy* must ensure that:

- (a) any *credit premium* previously paid by the *RBU* in lieu of providing security is to be treated as *credit supported by security*;
- (b) if a *fixed credit limit* would apply to the relevant activity if the *RBU* was another *approved counterparty* under standard processes, then a *fixed credit limit* may be applied; and
- (c) If the *credit exposure* is expected to exceed the *available credit limit*, then a *credit premium* will be charged to the *RBU* instead of requiring the *RBU* to increase the *available credit limit* with security (unless the *available credit limit* can be increased in another way permitted by this *policy*).

The *RBU* is otherwise to be treated, and qualifies, as an *approved counterparty*.

6 ROLES AND RESPONSIBILITIES

6.1 Board

The *board* has ultimate responsibility for credit management. The *board* delegates its credit management function to the *TRMC*.

6.2 ACC

The *ACC* oversees credit activities as delegated formally by the *board*.

6.3 TRMC

The *TRMC* provides direction for the day to day monitoring and management of *credit risk* activities and compliance with this *policy*.

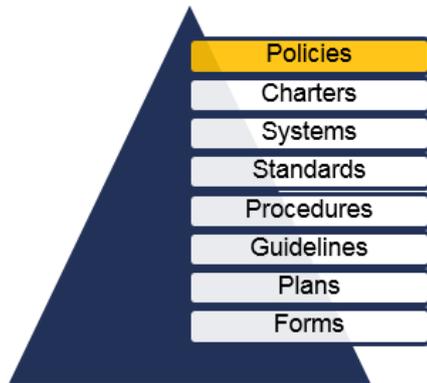
6.4 Policy governance

This *policy* is to be reviewed at least annually.

The manager financial control is responsible for managing this *policy*. Any material changes to this *policy* must be approved by the *board*.

The *board* has delegated authority to the *ACC* to approve minor amendments to this *policy* that are not material and/or do not alter the intention of this *policy*.

7 DOCUMENT HIERARCHY AND QUESTIONS



The policy standard diagram (left) shows where in the document hierarchy this standard sits and how it supports all preceding documents in the hierarchy.

Any questions or feedback related to this document should be directed to the document owner in the first instance.

8 RELATED DOCUMENTS

- (a) Electricity Corporations (Electricity Generation and Retail Corporation) Regulations 2013.
- (b) Wholesale electricity supply policy (DMS# 8886704).

9 DOCUMENT APPROVALS

| | APPROVED (yes/no) | APPROVAL DATE |
|---------------------|-------------------|---------------|
| Approver (board) | YES | August 2018 |

APPROVED DM REFERENCE (INC. VERSION NO.): 9010115

| | NAME | TITLE | BUSINESS UNIT |
|-------------------|----------------------|------------------------------|---------------|
| Document owner | SARA AMIR- ANSARI | MANAGER FINANCIAL CONTROL | FINANCE |

EFFECTIVE DATE: 1 January 2014

DATE OF LAST REVIEW: August 2018

DATE OF NEXT REVIEW: August 2019

Schedule 1: Standard process for assessing the credit risk posed by RBU and approved counterparties
Schedule 2: Definitions

SCHEDULE 1: STANDARD CREDIT PROCESS FOR ASSESSING THE CREDIT RISK OF RBU AND APPROVED COUNTERPARTIES**(a) Credit limit requirement**

Synergy must comply with the *credit limit requirement* before engaging in any *wholesale energy trading activity*. Complying with the *credit limit requirement* involves the following steps:

- (i) determining the *credit exposure*;
- (ii) calculating the *available credit limit*; then
- (iii) comparing the *credit exposure* arising from the proposed *wholesale energy trading activity* with the *available credit limit*.

Section 5 of the *policy* sets out additional requirements in relation to the application of this *policy* to *wholesale energy trading activities* between the *WBU* and the *RBU*.

Step 1 – Determining credit exposure**(b) Guidelines for calculating credit exposure**

The *credit exposure* is calculated in accordance with the following guidelines:

- (i) for wholesale energy trading with monthly settlement, the credit exposure is the maximum monthly trading value or the maximum contract value if the contract term is less than one month;
- (ii) if the approved counterparty has a deferred payment arrangement, then the credit exposure is the maximum balance outstanding under the arrangement. For example, if a customer is allowed to defer payment for a period, the credit exposure for this customer in relation to the arrangement is equal to the maximum amount that could be accumulated for that period before the customer starts to make payments;
- (iii) where Synergy enters into both purchase and sale transactions with the same approved counterparty, the exposure shall be calculated as the gross sale transactions ignoring any purchase transactions, unless Synergy has been provided with legal right to offset any payable against receivables, in which case the exposure shall be calculated as the sale exposure net of the purchase amount;
- (iv) for swap contracts, consideration shall be given to the timing of sale and purchase legs. Where the purchase leg takes place first, the credit exposure shall be zero. Where the sale leg takes place first, the exposure shall be the value of the sale leg. Due to the complexity of swap contracts, the exposure shall be monitored on an ongoing basis;
- (v) credit exposure can arise from the transport charge portion under the gas swap contracts even though the purchase leg takes place first;
- (vi) GST is included in the calculation; and
- (vii) where other electricity supply related cost, including carbon cost is passed through to customers, it is included in the calculation of maximum exposure.

(c) Approval to deviate from the guidelines

Any deviation from the above guidelines must be approved by the *TRMC*. For example, where historical take-up was significantly lower than the maximum quantity, the historical average could be used with approval by the *TRMC*.

Step 2 – Calculating the *available credit limit***(d) Calculating the *assessed limit***

The *TRMC* is responsible for approving an *approved counterparty's assessed limit*.

The *assessed limit* is primarily based on the *credit rating* assessed by an *independent rating agency*. In addition to considering the *credit rating*, the *TRMC* may also consider:

- (i) financial information obtained from the *approved counterparty*;
- (ii) *approved counterparty* trade history;
- (iii) *approved counterparty* credit requirements;
- (iv) industry; and
- (v) trading activities.

(e) *Assessed limit for closed groups*

Where an *approved counterparty* is part of a *closed group*, at the *TRMC's* discretion the credit assessment may be performed on the group rather than the *approved counterparty* itself.

Where *Synergy* has more than one *approved counterparty* in the same *closed group*, the cumulative *assessed limit* for all *approved counterparties* in the *closed group* shall not exceed the *assessed limit* for the entire *closed group*.

The *TRMC* may require legal review of the cross-guarantee arrangements to ensure they support the *approved counterparty's assessed limit*.

(f) *Credit assessment of all approved counterparties*

A formal credit assessment is to be performed for all new *approved counterparties* and at least every 12 months for all *approved counterparties*, except for the following:

- (i) an *approved counterparty* with a total annual *credit exposure* of less than \$100,000;
- (ii) an *approved counterparty* with a total annual *credit exposure* of less than \$180,000, if the transactions with that counterparty are limited to physical gas swaps;
- (iii) an *approved counterparty* with which *Synergy* is not currently trading and does not expect to trade within the next three months;
- (iv) government departments and government agencies (both federal and state), including the *AEMO*;

- (v) financial institutions approved under the treasury policy and which have a current *independent rating agency* rating of A or better;
- (vi) the other statutory bodies corporate under the *Act*, namely *Horizon and Western Power*, or
- (vii) any other statutory bodies corporate which have similar government support in their enabling legislation as that offered within section 119 of the *Act* (e.g. water corporation).

A formal credit assessment for the *RBU* is to be conducted once every 12 months. In carrying out this assessment, the financial position of the *RBU* is to be taken to be the financial position of *Synergy* as provided for in the *Regulations*. See section 5 of this *policy* for further information about the application of this policy to the *RBU*.

In order to avoid unnecessary waste of resources, a credit assessment request is to be confirmed with the *approved counterparty* before *Synergy* engages an independent rating agency. Where the *approved counterparty* refuses to provide *Synergy* with the necessary information to carry out a credit assessment, then the *approved counterparty* will be assigned an average or a lower *credit rating* (based on other information available) and the *assessed limit* for the *approved counterparty* will be nil.

(g) Ongoing monitoring of approved counterparties

At the discretion of the *TRMC*, *Synergy* will implement a process for ongoing monitoring of *approved counterparties*. For example, a review of the *assessed limit* may be undertaken if any financial information that may alter the level of risk is identified or where there are indications of change to financial health of the *approved counterparty*.

(h) Credit premiums

No *credit premiums* will be added to an *approved counterparty's* prices to reflect *credit risk*. The only exception to this rule is the *RBU*, which may be required to pay a credit premium in lieu of providing *credit supported by security*, as set out in section 5 of the *policy*.

(i) Calculating the available credit limit

The *available credit limit* is the sum of the *assessed limit* plus *credit supported by security* less any *overdue receivables* and *credit exposure* arising from existing *wholesale energy trading activities* which are not covered by prepayment.

Step 3 – Comparing the credit exposure arising from the proposed wholesale energy trading activity with the available credit limit

(j) Available credit limit assessment

If the *available credit limit* for an *approved counterparty* is less than the *credit exposure* for the proposed *wholesale energy trading activity*, then additional credit must be sought via one or a combination of the following:

- (i) a formal credit assessment being completed which reflects an improved financial position of the *approved counterparty* and may support a higher *assessed limit*;
- (ii) the *approved counterparty* providing additional security (refer below);
- (iii) the *approved counterparty* settling overdue balances;
- (iv) the *approved counterparty* prepaying for the sale (refer below); or
- (v) the *TRMC* or board approving an upward adjustment to the *available credit limit*.

Temporarily trading outside the *available credit limit*

In rare cases temporary trading outside the *available credit limit* (e.g. cases where trade commences a week earlier before the security can be put in place) may be allowed to suit *Synergy's* business needs. Such a trade must be temporary in nature (less than 2 weeks) with a total maximum exposure no more than \$500,000 and it must be endorsed by the general manager of the *WBU* and approved by the *TRMC*.

Adjustment to *available credit limit*

Any change to the *available credit limit* by deviating from the above guidelines is considered an adjustment. Adjustments to the *available credit limit* must meet the *Synergy's non-discrimination obligations*.

Any adjustment must be objective and based on factual information where possible. To provide full transparency, all adjustments to an *approved counterparty's available credit limit* must be documented and minuted in the meeting of the *TRMC*.

(k) Increasing the *available credit limit* with additional security

If the *available credit limit* for an *approved counterparty* is less than the *credit exposure* for the proposed *wholesale energy trading activity*, the *approved counterparty* can provide additional security to support the *wholesale energy trading activity*.

The value of proposed securities must be assessed on the basis that they are given unconditionally and irrevocably. Any *credit supported by security* may be assessed on the basis that the security be sufficient to support a multiple of the *monthly credit exposure*.

(l) Changes to the *credit limit requirement*

An adverse change in the financial health of an *approved counterparty* or market conditions may result in a change to the *credit limit requirement* for the *approved counterparty*. It is therefore good practice to ensure legal rights exist within the contract to enable an *approved counterparty* to provide additional security.

(m) Fixed credit limits

The *TRMC* may pre-approve *fixed credit limits* for *approved counterparties* in respect of a *wholesale energy trading activity* that involves *credit exposure* within specified thresholds from time to time. If the *credit exposure* of the proposed *wholesale energy trading activity* falls within the *fixed credit limit*, then *Synergy* may proceed with the activity without conducting further credit assessment.

(n) Prepaid activities

Synergy may undertake a *wholesale energy trading activity* with an *approved counterparty* that has prepaid for the *wholesale energy trading activity* in full or in part (by monthly payments prior to the start of each month during the *wholesale energy trading activity*) as agreed with *Synergy*.

Prepayment must be in the form of cash, i.e. cleared funds in *Synergy's* bank account. A prepayment in the form of a bank or financial guarantee is not acceptable.

SCHEDULE 2: DEFINITIONS

The following definitions apply in this *policy*. Defined terms are highlighted by use of italics.

| Term | Definition |
|----------------------------------|--|
| <i>ACC</i> | the audit and compliance committee. |
| <i>Act</i> | the Electricity Corporations Act 2005 (WA). |
| <i>Independent rating agency</i> | an approved rating agency such as Standard and Poor's, Moody's or Equifax. |
| <i>Assessed limit</i> | is the amount determined in accordance with schedule 1, sections (d) to (g) and is a component of the <i>available credit limit</i> of an <i>approved counterparty</i> . |
| <i>Available credit limit</i> | <p>is the measure by which the <i>credit exposure</i> of <i>wholesale energy trading activities</i> of an <i>approved counterparty</i> is compared in order to comply with the <i>credit limit requirement</i>, as set out in schedule 1, section (i).</p> <p>The available credit limit for each individual <i>approved counterparty</i> is calculated in accordance with the following formula:</p> $ACL = (AL + S_e) - (AD_{>30D} + CE_e)$ <p>where:</p> <p>AL = <i>assessed limit</i></p> <p>S_e = the total <i>credit supported by security</i></p> <p>AD_{>30D} = <i>overdue receivables</i></p> <p>CE_e = the total existing <i>monthly credit exposure</i>.</p> |
| <i>Approved counterparty</i> | a counterparty that has been approved by the <i>TRMC</i> in accordance with <i>Synergy's</i> trading risk policy (<i>tier 4 instrument</i>). |
| <i>Board</i> | the board of directors of <i>Synergy</i> . |
| <i>Business unit</i> | a part of <i>Synergy</i> which is responsible for the conduct and operation of a distinct area of the business, including each of the <i>GBU</i> , the <i>RBU</i> and the <i>WBU</i> . |
| <i>Carbon cost</i> | costs arising as a result of the carbon price mechanism in the Clean Energy Act 2011 (Cth), including purchase cost of carbon units, additional purchase costs for fuel and energy supplies. |
| <i>Closed group</i> | a group bound by cross guarantee. |
| <i>Credit exposure</i> | the maximum financial losses <i>Synergy</i> could suffer due to the <i>credit risk</i> associated with a <i>wholesale energy trading activity</i> , which is calculated in accordance with schedule 1, section (b) and (c). |

| Term | Definition |
|--|---|
| <i>AEMO</i> | the Australian Energy Market Operator |
| <i>Credit limit requirement</i> | is the requirement that the <i>credit exposure</i> of any proposed <i>wholesale energy trading activity</i> must fall within the existing <i>available credit limit</i> of an <i>approved counterparty</i> . It is determined as set out in schedule 1, section (a). |
| <i>Credit premium</i> | the premium charged to the <i>RBU</i> in addition to the contract price for energy trading, as detailed in section 5 of the <i>policy</i> . |
| <i>Credit risk</i> | the risk of potential loss caused by the <i>approved counterparty</i> to a contract being unable or unwilling to meet their financial obligations. |
| <i>Credit rating</i> | a rating assessed by an <i>independent rating agency</i> which forms the basis of <i>assessed limit</i> . |
| <i>Credit supported by security</i> | an increase to the <i>available credit limit</i> assigned to an <i>approved counterparty</i> that is supported by security acceptable by <i>Synergy</i> as set out in schedule 1, section (k). |
| <i>Synergy</i> | Electricity Generation and Retail Corporation established under the Electricity Corporations Act 2005. |
| <i>Finance business unit (FBU)</i> | the business unit led by the chief financial officer. |
| <i>Fixed credit limit</i> | a fixed amount of credit made available to an <i>approved counterparty</i> as detailed in schedule 1, section (m). |
| <i>Generation business unit (GBU)</i> | that part of the <i>Synergy</i> that conducts the generation business as defined in the <i>Regulations</i> . |
| <i>Generation competitor</i> | has the meaning given to that term in the <i>Regulations</i> . |
| <i>GST</i> | goods and services tax. |
| <i>Horizon</i> | the Regional Power Corporation. |
| <i>Internal synergy wholesale arrangement (ISWA)</i> | an arrangement to apply to the operations of the <i>WBU</i> and the <i>RBU</i> made in accordance with the <i>Regulations</i> and for which a price determined under the foundation transfer price mechanism applies, together with any directly related arrangements (including a supply balancing cost allocation arrangement and forecasting error settlements cost allocation arrangement). |
| <i>Material breach</i> | A material breach of this <i>policy</i> . A breach is considered material if either: <ul style="list-style-type: none"> (a) the breach may result in an uncovered <i>credit exposure</i> of \$1 million or more; or (b) the breach may breach <i>non-discrimination obligations</i> or competition provisions of the <i>Regulations</i>, including tier 1, |

| Term | Definition |
|---------------------------------------|--|
| | tier 2 or tier 3 instruments; or (c) the breach was knowingly or intentionally conducted; or (d) the breach is part of a repetitive series of breaches. |
| <i>Middle office</i> | the trading risk manager, within the <i>FBU</i> . |
| <i>Monthly credit exposure</i> | is taken as the <i>credit exposure</i> for the purposes of calculating the <i>available credit limit</i> . |
| <i>Non-discrimination obligations</i> | refers to the requirement that <i>Synergy</i> must ensure: (a) that a wholesale supply of electricity is not offered to the <i>RBU</i> on terms and conditions that are, having regard to all relevant circumstances, more favourable than the terms on which a wholesale supply of electricity is offered to <i>retail competitors</i> or <i>generation competitors</i> ; and (b) that the financial interests of the <i>RBU</i> are not taken into account in determining the terms and conditions on which a wholesale supply of electricity is offered to <i>retail competitors</i> or <i>generation competitors</i> . |
| <i>Overdue receivables</i> | receivables overdue from the <i>approved counterparty</i> for more than 30 days. |
| <i>Policy</i> | this policy, the wholesale energy credit policy. |
| <i>Purchase leg</i> | refers to where commodity is delivered to <i>Synergy</i> . |
| <i>Regulations</i> | the Electricity Corporations (Electricity Generation and Retail Corporation) Regulations 2013. |
| <i>Retail business unit (RBU)</i> | the business unit that conducts the "retail business" as defined in the <i>Regulations</i> . |
| <i>Retail competitor</i> | has the meaning given to that term in the <i>Regulations</i> . |
| <i>Sale leg</i> | refers to where commodity is delivered to the <i>approved counterparty</i> . |
| <i>Staff</i> | has the meaning given in regulation 3 of the <i>Regulations</i> . |
| <i>STEM</i> | the short term energy market. |
| <i>Tier 1 instruments</i> | refers to acts made by the parliament of Western Australia, such as the <i>Act</i> . |
| <i>Tier 2 instruments</i> | refers to subsidiary legislation made under any <i>tier 1 instruments</i> , such as the <i>Regulations</i> . |
| <i>Tier 3 instruments</i> | refers to protocols, policies, mechanisms and directives issued or approved by the minister that are not <i>tier 2 instruments</i> . |

| Term | Definition |
|--|---|
| <i>Tier 4 instruments</i> | refers to internal <i>Synergy</i> policies. |
| <i>TRMC</i> | the trading risk management committee. |
| <i>Trading risk policy</i> | tier 4 policy developed to ensure <i>Synergy</i> manages its energy trading risk effectively. |
| <i>Western Power</i> | the Electricity Networks Corporation. |
| <i>Wholesale business unit (WBU)</i> | the business unit that conducts the "wholesale business" as defined in the <i>Regulations</i> . |
| <i>Wholesale energy trading activities</i> | any energy, environmental, capacity or fuel transaction between the <i>WBU</i> and <i>RBU</i> , and between the <i>WBU</i> and third parties. Transactions between the <i>GBU</i> and <i>WBU</i> are not in the scope of this <i>policy</i> . |