AEMO SERVICES

# Risk Management Framework

## July 2022

The risk management framework for the purpose of section 51 of the Electricity Infrastructure Investment Act 2020

# Preamble

## Overview of the Risk Management Framework

This risk management framework (Risk Management Framework) governs the management of specific risks under the *Electricity Infrastructure Investment Act 2020* (NSW) (EII Act).

The EII Act gives effect to the New South Wales Electricity Infrastructure Roadmap – an integrated policy framework to secure an affordable, reliable, and clean energy future for New South Wales. The EII Act is intended to encourage investment in new electricity generation, storage, network infrastructure, and foster local community support for investment in new energy infrastructure and in a way that supports economic development and manufacturing.

One object of the EII Act is to encourage investment in new generation, storage, network, and related infrastructure by reducing risk for investors.[1] The need for investment support is caused by several factors, including the existing fleet of power stations in NSW reaching the end of their technical operating lives. Modelling by the NSW Government has identified that underinvestment creates risk for NSW electricity customers such as the risk of persistent higher and more volatile electricity prices. Part 6 of the EII Act, the *Electricity infrastructure investment safeguard*, introduces a policy tool to support investment in electricity infrastructure by reducing risk for investors: the long-term energy service (LTES) agreement.

This Risk Management Framework recognises that LTES agreements may reduce risk by addressing underinvestment but also create new risks to NSW electricity customers which need to be acknowledged, understood and actively managed.

This Risk Management Framework is limited in its scope and the EII Act requires this Risk Management Framework to be for the purpose of protecting the financial interests of NSW electricity customers in connection with the risks associated with LTES agreements. Risks associated with LTES agreements which must be managed by the consumer trustee include:

- the risks outlined in Section 2, *Table 2 – specific risks covered by this Risk Management Framework*;
- specific risks to be considered by the consumer trustee set out in the regulations to the EII Act; and
- the requirements in the EII Act for the consumer trustee to act in the long-term financial interests of NSW electricity customers.

There are a number of other important risks facing electricity customers that are managed in other parts of the National Electricity Market and are beyond the scope of this Risk Management Framework. Examples of risks not covered by the Risk Management Framework are outlined in Section 2 *Scope* below.

This Risk Management Framework:

- is prepared by the consumer trustee in accordance with section 51(1) of the EII Act;
- is approved by the Australian Energy Regulator (AER) as the regulator in accordance with section 51(3) of the EII Act; and
- provides for the roles and responsibilities of the consumer trustee, financial trustee and scheme financial vehicle under the Framework. The roles of each entity in implementing this Risk Management Framework are outlined in Section 5 *Roles and responsibilities*.

Section 51(5) of the EII Act allows the consumer trustee to withhold the publication of parts of this Risk Management Framework on application of a public interest test.[2] For completeness, it is noted that section 51(5) of the EII Act has not been applied.

1. See section 3(1)(c) of the EII Act.
2. Note, Section 51(5) of the EII Act states that despite subsection (4), the consumer trustee is not required to publish a part of the risk management framework if—
(a) the consumer trustee considers it is in the public interest not to publish the part, and
(b) the consumer trustee has the approval of the regulator to not publish the part.

## Subsidiary policies of the consumer trustee and scheme financial vehicle

The subsidiary policies referenced in Section 8 *Subsidiary policies*, do not form part of this Risk Management Framework. Section 52(1) of the EII Act provides that the scheme financial vehicle may only enter into a risk management contract where it is consistent with this Risk Management Framework. It is a requirement of this Risk Management Framework that all LTES agreements and risk management contracts are consistent with the subsidiary policies and that the subsidiary policies be consistent with this Risk Management Framework. These subsidiary policies are solely the responsibility of the consumer trustee and scheme financial vehicle to develop, approve and implement to comply with this Risk Management Framework.

If the AER is required to review this Risk Management Framework by the Minister under the EII Act, the AER may request that the consumer trustee or scheme financial vehicle provide it with any of the subsidiary policies for review, in which case the consumer trustee must provide those subsidiary policies to the AER.

## Limited scope of the AER's approval

This Risk Management Framework has been approved by the AER, as regulator for the purposes of section 51 of the EII Act. The consumer trustee acts independently and in the long-term financial interests of NSW electricity customers. The AER's role is limited to approving this Risk Management Framework and if required by the Minister, reviewing an approved Risk Management Framework. The AER does not make decisions on the way risk is managed by the consumer trustee and scheme financial vehicle. The AER does not approve the LTES agreements, risk management contracts, subsidiary policies or other activities governed by this Risk Management Framework.

## Entities covered by this Risk Management Framework

Section 51(2) of the EII Act provides that this Risk Management Framework may provide for the functions of the consumer trustee, the financial trustee, the scheme financial vehicle and the regulator under the framework. Pursuant to this, the consumer trustee and scheme financial vehicle must act in accordance with this Risk Management Framework, and their subsidiary policies and procedures must be consistent with this Risk Management Framework. The financial trustee and AER (as the regulator for the purposes of section 51 of the EII Act) are not conferred additional roles, responsibilities or functions under this Risk Management Framework.

The scheme financial vehicle and consumer trustee will be subject to performance audits by the New South Wales Independent Pricing & Regulatory Tribunal (IPART) under section 67 of the EII Act and ongoing financial reporting audits pursuant to Australian Accounting Standards. Both audits are expected to include assessment and reporting on compliance with this Risk Management Framework and the alignment of each entity's policies and procedures with this Risk Management Framework.

## Risk context

Prior to the EII Act, NSW electricity customers were exposed to unmanaged technical (reliability and security of supply) risks and financial (price) risks. Modelling undertaken by the NSW Government in 2020 indicated that extended periods of protracted high wholesale prices would emerge and that these price increases were ultimately borne by NSW electricity customers. These risks were increasing as existing large generators reached the end of their operating lives.[3]

Entering LTES agreements creates potential benefits and risks for NSW electricity customers. For example, entering too many or too few LTES agreements will result in suboptimal outcomes for NSW electricity customers. The decision to recommend and enter an LTES agreement is the responsibility of the consumer trustee and the scheme financial vehicle respectively, and not the AER. The consumer trustee and the scheme financial vehicle are, in accordance with their respective functions, also responsible for monitoring and managing the LTES agreement exposures in the long-term financial interests of NSW electricity customers.

3. NSW Electricity Infrastructure Roadmap (NSW Department of Planning, Industry and Environment, 2020).

## Changes to this Risk Management Framework

The Minister may direct the consumer trustee to amend this Risk Management Framework under section 51(7) of the EII Act, after the process described in section 9.2 of this Risk Management Framework is followed. Changes directed by the Minister must be consistent with the EII Act and regulations.

The consumer trustee may request that the Minister undertake a review pursuant to Sections 51(6) and 51(7) but the Minister is not obliged to initiate changes based on a request from the consumer trustee. The AER is not required to re-approve a Risk Management Framework following an amendment by the consumer trustee on Ministerial direction.

# Contents

# 1. Policy Statement

This Risk Management Framework is the overarching governance document meeting the requirements of Part 6, Division 5, section 51 of the *Electricity Infrastructure Investment Act 2020* (NSW) (EII Act) and is approved by the Australian Energy Regulator (regulator or AER).

The Risk Management Framework is subordinate to the EII Act and the *Electricity Infrastructure Investment Regulation 2021* (the Regulations). The Regulations provide requirements impacting this Risk Management Framework and entry into risk management contracts.

The purpose of this Risk Management Framework is to protect the financial interests of NSW electricity customers in connection with the risks associated with LTES agreements. To achieve this objective, this Risk Management Framework describes, coordinates, and governs risk management of five risks. The AER's role is limited to approving this Risk Management Framework, and the AER does not have an ongoing role in shared risk management activities or monitoring the consumer trustee, financial trustee or scheme financial vehicle.

The development of this Risk Management Framework was guided by key concepts and principles in the International Standard ISO 31000: 2018 Risk Management – Guidelines (ISO 31000).

In accordance with ISO 31000, this Risk Management Framework requires an overarching commitment to effective, transparent and accountable risk management through the development of a comprehensive risk management framework, including subsidiary policies that align to the activities and scope of the consumer trustee, financial trustee and scheme financial vehicle.

The Risk Management Framework is to be published on the website of the consumer trustee and the AER.

# 2. Scope

This section outlines the scope of this Risk Management Framework, the entities to which it applies, and the risks it proposes to manage in accordance with its statutory obligations.

Table 1 – *Risk management obligations* below details the key entities described in this Risk Management Framework and their core objectives in relation to risk management. These objectives are then reflected in each entity's roles and responsibilities in Table 3 – *Risk management roles and responsibilities conferred on entities*.

**Table 1 – Risk management obligations**

| Entity | Risk management obligations and constraints |
|---|---|
| **Consumer trustee** | • To design and establish the Risk Management Framework and relevant subsidiary policies.<br>• To comply with the Risk Management Framework and relevant subsidiary policies and regulations.<br>• To act independently and in the long-term financial interests of NSW electricity customers. |
| **Financial trustee** | • To establish and administer the scheme financial vehicle.<br>• To consult with, advise and provide information to the regulator in relation to contribution determinations.<br>• The financial trustee is not conferred any additional functions, roles or responsibilities under this Risk Management Framework. |

| | |
|---|---|
| **Scheme financial vehicle** | • To act in a commercially reasonable and prudent way under any contract or agreement made under the EII Act.<br>• To comply with the Risk Management Framework and relevant subsidiary policies and regulations. |
| **AER** | • To approve the Risk Management Framework.<br>• To review the Risk Management Framework at the direction of the Minister.<br>• The AER is not conferred any additional functions, roles or responsibilities under this Risk Management Framework. |
| **IPART** | • To audit the performance of the consumer trustee, financial trustee and scheme financial vehicle.<br>• To carry out all requirements of the regulator as set out in section 67 of the EII Act regarding performance audits and section 70 of the EII Act regarding annual reports. |
| **NSW Minister for Energy** | • Following a review by the regulator, the Minister may direct the consumer trustee to amend the risk management framework. |

The scope of this Risk Management Framework is to ensure the appropriate identification, analysis, assessment, and management of the five risks identified in Table 2 across.

**Table 2 – Specific risks covered by this Risk Management Framework**

| Risk | Description |
|---|---|
| **Risk 1 – Benefit of LTES agreements** | the risk that the expected long-term and short-term benefits of LTES agreements are not fully realised, resulting in unexpected costs and exposure to NSW electricity customers. This includes assessment of risks associated with different types of LTES agreements[4] and risks relating to entering LTES agreements for too much or too little generation or long-duration storage. |
| **Risk 2 – Electricity Infrastructure Fund liquidity** | the risk that the cash balance of the Electricity Infrastructure Fund is not sufficient to pay for the liabilities of the scheme financial vehicle under the EII Act on any specific day, including LTES agreement payments, and the administrative costs of the consumer trustee, financial trustee and the AER. |
| **Risk 3 – Contribution volatility** | the risk to the financial interests of NSW electricity customers of unexpected or significant increases in the liabilities for payments by the scheme financial vehicle under LTES agreements from year to year. |
| **Risk 4 – Contracts market liquidity** | the risk that LTES operators exercise their options resulting in liquidity reducing in the wholesale (financial electricity) contract market, which may increase costs to retailers from managing wholesale electricity price risk on behalf of their customers. |
| **Risk 5 – Prudent cash balance** | the risk that uncertainty in future payments to LTES operators leads to unnecessarily high or low contributions from distribution network service providers (who recover these contributions from electricity customers) in particular years, to provide the scheme financial vehicle with a prudent minimum cash balance. |

In addition to the five risks outlined in Table 2 – *specific risks covered by this Risk Management Framework*, regulations may require additional risks to be identified, considered or managed. Where regulations require additional risks to be identified, considered or managed, the risks identified in regulations will fall within the scope of this Risk Management Framework. The consumer trustee may also consider additional risks it determines should be considered to protect the long-term financial interest of NSW electricity customers.

There are risks for NSW electricity customers and affected communities associated with energy transition including:

- Not managing overall customer affordability and energy reliability.
- Failing to meet the energy security target under the EII Act.
- Failure to maintain power system security.
- Not achieving broader sustainability and environmental objectives.
- Providing insufficient community support and First Nations outcomes.
- Not achieving the NSW Government's Electricity Infrastructure Roadmap economic development objectives.

These risks are beyond the scope of this Risk Management Framework but are being considered elsewhere.

4. This assessment will include basis risk. A definition of basis risk is provided in the Regulations. Pursuant to that definition, basis risk is defined as differences in the variables between LTES agreements and risk management contracts, including price, volume and timing. Under this definition, basis risk does not include the liquidity risk related impacts of differences in settlement or payment terms and the funding of these differences, through funding contracts. This is to be found in the treasury and liquidity subsidiary policy.

# 3. Risk context

## 3.1 Overview of broader risk context

The Electricity Infrastructure Roadmap (the Roadmap) is the NSW Government's plan to transform the NSW electricity sector into one that is affordable, clean and reliable. It is enabled by the EII Act and the Regulations.

The Roadmap contemplates the development of renewable energy zones (REZs) and an 'electricity infrastructure investment safeguard' (Infrastructure Safeguard) mechanism in Part 6 of the EII Act to encourage private sector investment under the Roadmap. The consumer trustee coordinates with EnergyCo NSW,[5] and acts independently and in the long-term financial interests of NSW electricity customers through long-term planning and well-structured procurement processes.

The consumer trustee is appointed by the Minister[6] and the financial trustee is appointed by the consumer trustee.[7] The scheme financial vehicle is the financial intermediary for the Roadmap. Neither the Minister nor the consumer trustee have control over the financial trustee.[8]

The consumer trustee is required to prepare an Infrastructure Investment Objectives (IIO) Report every two years.[9] The IIO Report includes two components: the *20-Year Development Pathway and the 10-Year Tender Plan*. The 10-Year Tender Plan sets out the tender schedule for when LTES agreements may be tendered to give effect to the 20-Year Development Pathway.

The financial liquidity of the scheme financial vehicle is essential for the proper functioning of the Infrastructure Safeguard, other entities under the Roadmap, and ensuring the scheme financial vehicle is a credit worthy counterparty to investors. Sections 56–58 of the EII Act, and its Regulations, prescribe the process for making contribution determinations. Contribution determinations are the scheme financial vehicle's primary source of funding to meet its liabilities under LTES agreements and risk management contracts.

## 3.2 Other risk management activities

This Risk Management Framework is one part of broader enterprise risk management frameworks implemented by each of the consumer trustee and scheme financial vehicle. Each component of these enterprise risk management frameworks (including this Risk Management Framework) work together to manage the financial interests of NSW electricity customers and risks to the consumer trustee and scheme financial vehicle.

5. The Energy Corporation of NSW (EnergyCo NSW) is a statutory body that has been re-established to be the infrastructure planner for the first five NSW REZs set out in the EII Act.
6. Section 60 of the EII Act.
7. Section 61 of the EII Act.
8. Section 61 of the EII Act.
9. Section 45 of the EII Act.

**Figure 1 – Hierarchy of risk management**

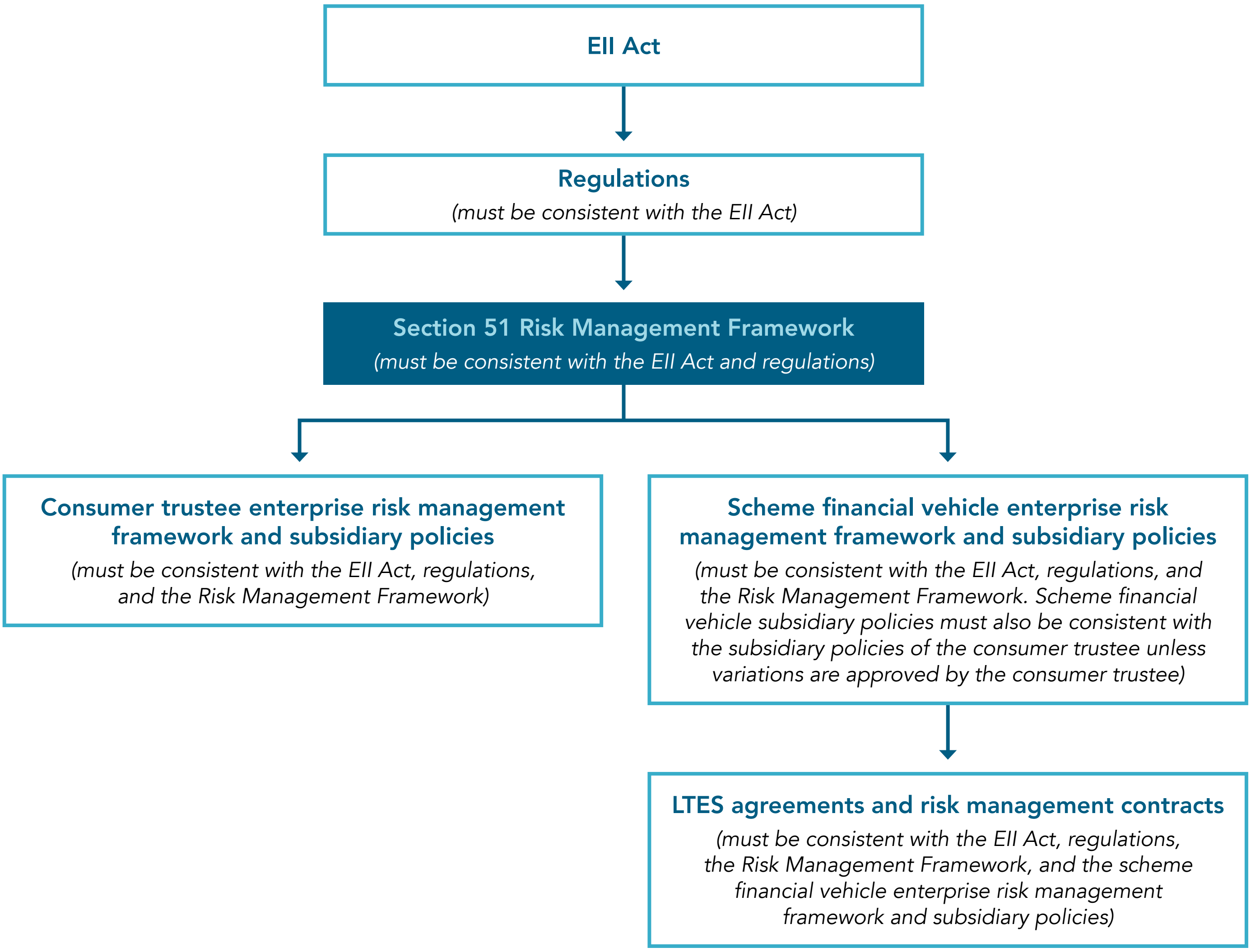


Figure 1 – *Hierarchy of risk management* outlines where this Risk Management Framework sits in the broader risk management system used by the consumer trustee and scheme financial vehicle to manage the risks associated with LTES agreements.

Both the consumer trustee and scheme financial vehicle will have enterprise risk management frameworks. In relation to the consumer trustee and scheme financial vehicle enterprise risk management frameworks:

- Each entity's subsidiary policies will contain material relevant to this Risk Management Framework, and also material relevant to each entity's broader enterprise risk management framework.
- The scheme financial vehicle's subsidiary policies must be consistent with the subsidiary policies of the consumer trustee unless otherwise authorised by the consumer trustee.
- The consumer trustee does not need to approve scheme financial vehicle subsidiary policies where these policies are consistent with the subsidiary policies of the consumer trustee. Approval from the consumer trustee of the scheme financial vehicle subsidiary policies is required where the scheme financial vehicle subsidiary policies are not consistent with the consumer trustee subsidiary policies.
- The enterprise risk management frameworks will cover a broad range of additional risks beyond the scope of this Risk Management Framework.
- The AER does not approve or regulate the enterprise risk management frameworks. These could be reviewed by IPART through the periodic performance audit.

## 3.3 Long-term energy service agreements

One object of the EII Act is to encourage investment in new generation, storage, network, and related infrastructure by reducing risk for investors.[10] Additional electricity infrastructure is necessary because NSW's existing fleet of power stations are reaching the end of their technical lives. The four power stations expected to retire in the next twelve years provide around three quarters of NSW annual generation and will require replacement under all foreseeable demand scenarios.[11]

Part 6 *Electricity infrastructure investment safeguard* of the EII Act is intended to address the risks to NSW electricity customers associated with these changes in the electricity market.

LTES agreements are a central element of the Part 6 Infrastructure Safeguard and will support and encourage private sector investment in physical infrastructure assets by offering a series of put options to access price guarantees for eligible electricity generation, long-duration storage and firming projects.

The consumer trustee will consider how to best structure LTES agreements to effectively manage obligations and the net cost and risk outcomes for NSW electricity customers. Section 50(5) of the EII Act provides the principles the consumer trustee is to take into account when designing LTES agreements.

The consumer trustee will run competitive tenders for LTES agreements and for access rights[12] (or any combination of the two) and make recommendations on the award of LTES agreements to the scheme financial vehicle. The LTES agreements may give rise to a series of risks. This Risk Management Framework governs the management of these risks for NSW electricity customers by the scheme financial vehicle and consumer trustee.

## 3.4 Risks arising from recommending LTES agreements

The EII Act Part 6, Division 3 *Long-term energy service agreements* mandates certain features of an LTES agreement, including that an LTES agreement give the LTES operator an option to exercise a derivative arrangement. The policy intention of these requirements is to minimise financial risks to NSW electricity customers and limit impacts on the NEM wholesale contracts market. Further, to support new investments, it is expected that LTES agreements will be long dated, option instruments. The value of an LTES agreement changes as relevant variables change, including: the price referenced in the LTES agreement (e.g. wholesale electricity price), the volume of electricity produced by a project at different times of day, long-term interest rates, short-term interest rates, volatility of wholesale electricity prices, and remaining option exercise time. The value is also impacted by the option exercise behaviours of projects supported by LTES agreements.

The scheme financial vehicle has a statutory right to recover its costs, including amounts required for the scheme financial vehicle to meet its liabilities as they fall due.[13] This would occur via contributions from NSW distribution network service providers, subject to annual contribution determinations by the AER.[14] NSW distribution network service providers are permitted to pass these costs onto NSW electricity customers via charges on customers' electricity bills.

The costs of the LTES agreements could be offset by the benefit of lower overall wholesale prices. For example, where wholesale electricity prices are low, the costs of LTES agreements will be high for the scheme financial vehicle.

10. See section 3(1)(c) of the EII Act.
11. See AEMO's 2022 integrated system plan: [AEMO | 2022 Integrated System Plan (ISP)](AEMO | 2022 Integrated System Plan (ISP)).
12. An access scheme may be declared by the Minister under section 24 of the EII Act. The consumer trustee has responsibility for tendering access rights under an access scheme.
13. Part 7 of the EII Act.
14. See section 56 and section 58 of the EII Act.

## 3.5 Financial value of LTES agreements

Before the consumer trustee makes recommendations to the scheme financial vehicle about LTES agreements that the scheme financial vehicle may enter into[15], the consumer trustee, in considering the financial value of LTES agreements, must consider whether the costs of the scheme financial vehicle entering into LTES agreements will be offset by the benefit of lower wholesale prices, and whether such benefits will be passed through to NSW electricity customers.

The subsidiary policy for LTES agreements (or another subsidiary policy), as applicable to the consumer trustee, must provide for further detail on the contents of the above consideration, which may also require consideration of:

- the overall delivered cost of electricity to customers, including the cost of infrastructure construction and LTES agreements;
- the volume and timing of LTES agreements recommended by the consumer trustee;
- technology change and commercial innovation which could alter the need for, or the efficacy of, LTES agreements;
- the activities of National Electricity Market participants, including activities by retailers seeking to manage price risk on behalf of NSW electricity customers;
- investment activity which alters the need for LTES agreements. For example, retailers building new generation or storage capacity without LTES agreements;
- the range of future outcomes associated with long-dated LTES agreements and the uncertainty of those outcomes.

There are also indirect risks of recommending (or not recommending) LTES agreements. Before the consumer trustee makes recommendations to the scheme financial vehicle about LTES agreements that the scheme financial vehicle may enter into, the consumer trustee must consider indirect or secondary impacts of recommending (or not recommending) the LTES agreements.

The subsidiary policy for LTES agreements (or another subsidiary policy), as applicable to the consumer trustee, must provide for further detail on the contents of the above consideration, which may also require consideration of:

- higher hedging or operating costs for retailers due to LTES agreements impacting the wholesale contracts market;
- residual exposure of NSW electricity customers to scheme costs after electricity customers have entered into fixed-price agreements with their retailer;
- economic rent for participants who benefit from lower wholesale electricity prices but do not pay scheme costs (e.g. storage operators or transmission connected customers);
- adverse impacts on market structure, including impacts on competition;
- impacts on commercial and technical innovation in the electricity markets;
- impacts on financial risk or credit risks in the electricity sector, including systemic risks created by the scheme financial vehicle;
- impacts on financial risk or credit risks in the electricity sector, including systemic risks created by the scheme financial vehicle.

15. See section 48 of the EII Act and the requirements set out in the Regulations.

## 3.6 Mitigating risks associated with LTES agreements

Ongoing transparency and accountability of consumer trustee and scheme financial vehicle decision-making is critical to ensuring the EII Act is effective and maintains the confidence of all stakeholders.

To achieve this, the consumer trustee develops and maintains a broad and comprehensive set of decision-making, reporting and subsidiary policies and controls to guide its activities. This is to assist in mitigating the risks identified in Section 2 of this Risk Management Framework, as well as meeting community standards and regulatory requirements in relation to good corporate governance. The consumer trustee subsidiary policies provide a framework within which the scheme financial vehicle is required to make independent risk management decisions. It is the scheme financial vehicle who is responsible for making risk management decisions and it must make these decisions within the constraints of this Risk Management Framework.

Section 52 of the EII Act authorises the scheme financial vehicle entering any risk management contract that is consistent with this Risk Management Framework. Three examples of risk management contracts which are contemplated by this Risk Management Framework and could be used by the scheme financial vehicle are a derivative contract, a funding contract and other contracts for the purposes of Part 6 of the EII Act if it is consistent with this Risk Management Framework and the subsidiary policies. Details of these three example contract types are as follows:

- **Derivative contract:** For example, the consumer trustee may establish subsidiary policies which allow the scheme financial vehicle to actively hedge the future uncertain payments to be made under LTES agreements by entering into financial derivatives in the wholesale electricity market. The objective of active hedging could be to provide increased certainty about the magnitude of contribution orders.
- **Funding contract:** For example, the scheme financial vehicle may access grants or borrow money to manage its short-term cash position, and create improved predictability in contribution orders and customer electricity bills. Scheme financial vehicle borrowings can be used to manage the liquidity risks of LTES agreements and also the broader liquidity requirements of the scheme financial vehicle. These borrowings will be important to the operation of the scheme financial vehicle and the Roadmap.
- **Other risk management contracts for the purposes of Part 6 of the EII Act:** The scheme financial vehicle may enter into a risk management contract for the purposes of Part 6 of the EII Act if it is consistent with this Risk Management Framework and the subsidiary policies. This could include, for example, contracts ancillary to LTES agreements (e.g. a project development agreement), a contract ancillary to a funding contract (e.g. a grant of security), or a sale and purchase agreement for products obtained in connection with the scheme financial vehicle's roles and responsibilities under Part 6 (such as sale agreements for large-scale generation certificates or other green products).

The requirements for transacting risk management contracts are set out in Section 7 of this Risk Management Framework.

# 4. Risk management objectives and approach

The following sections provide an overview of how the risks identified in Table 2 are managed and the broader approach to risk management.

## 4.1 Overarching risk perspective

The Roadmap involves the delivery of infrastructure, and the management of customer interests, across three key areas of activity:

- the development and operation of REZs through land availability, investment in network assets and access arrangements;
- the promotion of private sector investment in generation capacity and other services using LTES agreements;
- the management of the financial risks of LTES agreements.

Each activity involves the balancing of objectives, including outcomes in the long-term financial interests of NSW electricity customers, and management of different risks. Each activity uses different tools to manage these risks. Specific entities outlined in the EII Act are assigned responsibility for delivering each activity, including managing the risks associated with that activity.

The following section outlines examples of three risks arising in connection with the risks associated with LTES agreements. These examples are included only to describe the risk context in which the consumer trustee and the scheme financial vehicle will fulfil their roles and responsibilities. Each of these risks could have an adverse impact on NSW electricity customers. Following the description of these three risks, the approaches to risk management are discussed.

### 4.1.1 LTES agreement related risks

There are risks which could result in the expected benefits of LTES agreements not being achieved or in unexpected or material increases in liabilities under LTES agreements (refer to Section 2, *Table 2, Risk 1 – Benefit of LTES agreements and Risk 3 – Contribution volatility).*

These risks are to be governed and managed by subsidiary policies outlined in Section 8 *Subsidiary policies*.

### 4.1.2 Treasury and liquidity related risks of the scheme financial vehicle

The scheme financial vehicle may face risks associated with cash flow shortfalls or insolvency due to insufficient liquidity or lack of a minimum prudent cash balance (refer to Section 2, Table 2, *Risk 2 – Electricity Infrastructure Fund liquidity,* and *Risk 5 – Prudent cash balance).*

There is a risk that the cash balance of the scheme financial vehicle will not be sufficient to make its expected payments to LTES operators and to cover administrative costs. Any actual or perceived risk of scheme financial vehicle insolvency would undermine investor confidence. There may also need to be unnecessarily high contributions from distribution network service providers in particular years to provide the scheme financial vehicle with a prudent cash balance.

The management of these risks is governed by a specific treasury subsidiary policy outlined in Section 8.

### 4.1.3 Wholesale market liquidity risks

The wholesale electricity financial market liquidity could be adversely impacted if LTES agreement operators exercise their options (refer to Section 2, Table 2, *Risk 4 – Contracts market liquidity*). The possible reduction of liquidity could increase costs to retailers from managing wholesale electricity price risk on behalf of their customers. The scheme financial vehicle may enter into risk management contracts in the wholesale electricity market in accordance with the wholesale energy subsidiary policy outlined in Section 8.

## 4.2 Financial product risks

A key contributor to the risks noted above are the financial product risks derived from LTES agreements, risk management contracts or both that include:

- wholesale energy market risks due to mismatches in electricity customer load, LTES agreements, risk management contract volumes, basis risks and/or adverse movements in wholesale electricity prices;
- counterparty credit risk due to defaults by counterparties;
- operational risk due to failing of people, processes or systems;
- risks associated with physical products received through LTES agreements, for example, large-scale generation certificates; and
- risks associated with the consumer trustee making inefficient judgements on the strike price, timing or volume of LTES agreements it recommends.

The management of these risks is governed by specific policies as outlined in Section 8. Each of these risks is distinct and requires different risk management policies and approaches.

## 4.3 Approach to risk management

This Risk Management Framework and subsidiary policies and processes are typical of global best-practice in the energy markets but have been customised to be responsive and proportionate to the external and internal context within which the consumer trustee, financial trustee and scheme financial vehicle operate.

Risks can emerge, change or disappear as an organisation's external and internal context changes. Risk management anticipates, detects, acknowledges and responds to those changes and events in an appropriate and timely manner.

The Boards and executive management of the consumer trustee and the scheme financial vehicle must oversee that risk management is integrated into all organisational activities and demonstrate their commitment by:

- allocating necessary resources to manage risk;
- ensuring suitable systems for monitoring, communication and oversight are in place;
- assigning authority, responsibility and accountability at appropriate levels within the organisation.

The approach to risk management is based on the principles of ISO 31000 and involves the systematic application of policies, procedures and practices to the activities of:

- communicating and consulting about risk;
- establishing the context, including indirect or secondary risks and impacts on market participants;
- identifying, assessing, treating, monitoring, reviewing, recording and reporting risk;
- auditing on organisational compliance.

Section 6 of this Risk Management Framework provides further detail on the risk management requirements.

This approach to risk management is to be reflected within the enterprise risk management frameworks of the consumer trustee and scheme financial vehicle.

# 5. Roles and responsibilities

The table below outlines the organisational level responsibilities including those that cannot be delegated by each entity's senior governance body or subcommittee of that senior governance body (e.g. for a company, its board of directors) to a subordinate governance body of that entity. Where this Risk Management Framework allows delegation, the consumer trustee and scheme financial vehicle must develop its internal delegations framework. This delegations framework must:

1. consider and outline the broader organisational structure including any Board sub committees and management level committees as they relate to risk management; and

2. detail the scope, accountabilities and decision-making authority of each committee as it relates to each role in the table across.

These roles and responsibilities are conferred on and undertaken by each entity in discharging the entity's duties under the EII Act. Each entity being assigned a role or responsibility must develop functions that fulfil these roles and responsibilities.

**Table 3 – Risk management roles and responsibilities conferred on entities**

| Entity | Role / responsibility | Covered by this Risk Management Framework | Not to be delegated[16] |
|---|---|---|---|
| **Consumer trustee** | | | |
| **Designing the broader risk management framework** | Design and approve the Risk Management Framework and subsidiary policies for implementation by the consumer trustee and scheme financial vehicle. | ✓ | ✓ |
| | Determine the appropriate governance frameworks for LTES agreement, tender processes and risk management contracts. | ✓ | ✓ |
| | Develop and gazette LTES agreement tender rules. | ✓ | – |
| | Consider and (where appropriate) approve variations in the scheme financial vehicles subsidiary policies. | ✓ | – |
| **Implementation of specific aspects of the Risk Management Framework** | Determine the terms and conditions of the LTES agreements consistent with an overall approach to managing risks and costs in the long-term financial interests of NSW electricity customers. | ✓ | – |
| | Assess, monitor, and manage the financial risks and the impact of LTES agreements on financial risks. Monitoring activities to provide ongoing protection of the long-term financial interests of NSW electricity customers. | ✓ | – |
| | Conduct competitive tenders for LTES agreements and REZ access rights (unless otherwise authorised by the regulator under section 47(1) of the EII Act). | ✓ | – |
| | Negotiate, in accordance with any requirements prescribed by the regulations, with a person in relation to LTES agreements. | ✓ | – |
| | Review the financial trustee and scheme financial vehicle's performance in accordance with the instrument of appointment. | ✓ | ✓ |
| | Consider and approve the subsidiary policies of the scheme financial vehicle where the scheme financial vehicle subsidiary policies are not consistent with the subsidiary policies of the consumer trustee. | ✓ | – |

16. These roles and responsibilities cannot be delegated by an entity's senior governance body, or a subcommittee of that senior governance body, (e.g. for a company, its board of directors) to a subordinate governance body of that entity. Restrictions on the ability to delegate risk management functions are to ensure accountability for substantive risk management decisions.

| Entity | Role / responsibility | Covered by this Risk Management Framework | Not to be delegated[16] |
|---|---|---|---|
| **Reporting in relation to risk management** | Make recommendations to the scheme financial vehicle about the LTES agreements that the scheme financial vehicle may enter. | ✓ | – |
| | Ensure that the scheme financial vehicle report on the net financial exposure of NSW electricity customers, and impacts on net financial exposure, is included in the audited statutory accounts of the scheme financial vehicle in accordance with the relevant Australian accounting standards. | ✓ | – |
| | Provide an annual compliance statement to IPART for the purpose of its annual reporting, including a summary of the performance of and any breaches under the Risk Management Framework, including any risk management contract.[17] | ✓ | ✓ |
| **Financial trustee** | | | |
| | Establish and administer the scheme financial vehicle. | ✓ | – |
| | Consult with the AER in relation to contribution determinations.[18] | ✓ | – |
| | Provide the AER with all necessary information for it to make its contribution determination. | ✓ | – |
| **Scheme financial vehicle** | | | |
| **LTES related activities** | Review and decide on the recommendations on LTES agreements made by the consumer trustee. | ✓ | ✓ |
| | Execute and manage the approved LTES agreements. | ✓ | – |
| | Provide the AER with all necessary information for it to make its contribution determination. | – | – |

17. IPART is responsible for performance monitoring and reporting under sections 67 and 70 of the EII Act.
18. Section 56(6) of the EII Act.

| Entity | Role / responsibility | Covered by this Risk Management Framework | Not to be delegated[16] |
|---|---|---|---|
| **Risk management contract related activities** | Independently analyse the financial product risk to inform the decisions to execute risk management contracts. | ✓ | – |
| | Make independent decisions to execute and manage risk management contracts. | ✓ | – |
| | Adapt, approve and implement the subsidiary policies. | ✓ | ✓ |
| | Seek approval from the consumer trustee where scheme financial vehicle subsidiary policies are proposed to not be consistent with the subsidiary policies of the consumer trustee. | ✓ | – |
| **Reporting in relation to risk management** | Ensure that differences between risk management contracts and LTES agreements are managed (including basis risk). | ✓ | – |
| | Ensure that the net effect of risk management contracts and LTES agreements reduce the net exposure of the NSW electricity customers contributing to Roadmap costs. | ✓ | ✓ |
| | Provide its audited statutory accounts and an annual report to IPART[19] and consumer trustee. | ✓ | – |
| | Report to the consumer trustee on its performance against the requirements of the Risk Management Framework and subsidiary policies, including the overall performance of the framework, risk management contracts and any breaches of the Risk Management Framework or scheme financial vehicle subsidiary policies. | ✓ | ✓ |
| **AER** | | | |
| | Approve the Risk Management Framework. | ✓ | – |
| | Review the Risk Management Framework when requested by the Minister. | ✓ | – |
| | Consider requests from the consumer trustee that a part of the Risk Management Framework not be published.[20] | ✓ | – |

19. IPART is responsible for performance monitoring and reporting under sections 67 and 70 of the EII Act. While this reporting obligation on the consumer trustee is limited to a summary of the performance of and any breaches under the Risk Management Framework, IPART can request additional information covering all breaches, including technical or administrative breaches, at any time.
20. Section 51(5)(b) of the EII Act.

| Entity | Role / responsibility | Covered by this Risk Management Framework | Not to be delegated[16] |
|---|---|---|---|
| **Minister** | | | |
| | The Minister may require the regulator to review an approved risk management framework. | ✓ | – |
| | Following a review by the regulator, the Minister may direct the consumer trustee to amend the risk management framework. | ✓ | – |

# 6. Risk management requirements

## 6.1 Introduction

The consumer trustee and scheme financial vehicle must have the necessary understanding, resources, capabilities and controls to manage risk and fulfill their roles and responsibilities under this Risk Management Framework in a prudent, professional and capable manner. This involves the systematic application of policies, procedures and practices for each entity. Where relevant and applicable, the required capabilities or controls must reflect practices as detailed in ISO 31000.

In establishing the functions and developing the capabilities to manage the roles and responsibilities conferred by this Risk Management Framework, the consumer trustee and scheme financial vehicle must each consider the role of the following principles:

- Integrated and embedded risk management across all organisational activities through a strong risk management culture.
- Structured and comprehensive approaches to risk management, including consideration of shared risks across the entities.
- Customised frameworks and processes that are proportionate to each entity's external and internal context and related to its objectives.
- The ability to be dynamic and responsive to changes in internal and external environments.
- Continual improvement based on each entity's learning and experience.
- Transparent with the best available information provided to it, and input from all relevant stakeholders in a timely and clear manner.

## 6.2 Processes and procedures

The risk management process must be an integral part of management and decision-making and integrated into the structure, operations and broader processes of each of the consumer trustee and scheme financial vehicle. It can be applied at strategic and operational levels.

This involves risk identification, risk analysis and risk evaluation and must be conducted systematically, iteratively and collaboratively, drawing on the knowledge and views of stakeholders. It must use the best available information, supplemented by further enquiry as necessary.

The consumer trustee and scheme financial vehicle must each have appropriately developed and documented processes and procedures to:

- enable the identification, assessment, execution, ongoing monitoring and management, settlement and reporting of all transactions to be undertaken pursuant to this Risk Management Framework and the subsidiary policies; and
- identify, assess, monitor and report on broader organisational and environmental risks and their mitigations.

These processes and procedures must be regularly reviewed and updated so they remain consistent with this Risk Management Framework, relevant subsidiary policies and include the implementation and management of key controls.

## 6.3 Systems

The consumer trustee and scheme financial vehicle must each ensure that it has appropriate systems to:

- enable the identification, capture, assessment, execution, ongoing monitoring and management, settlement and reporting of transactions to be undertaken pursuant to this Risk Management Framework and the subsidiary policies. For the avoidance of doubt, this includes LTES agreements and risk management contracts; and
- identify, capture, assess, monitor and report on broader organisational and environmental risks and their mitigations.

These systems must be regularly tested and maintained including ensuring appropriate data storage, retention, access rights and security.

## 6.4 Skills and Training

Key personnel in each of the consumer trustee and scheme financial vehicle must have completed the appropriate training and qualifications or have the appropriate industry experience to enable them to fulfil their role in managing risk and meeting the requirements of this Risk Management Framework and relevant subsidiary policies.

The required skills and training applicable in each role must be regularly reviewed and reported.

Where skills gaps are identified the appropriate training or other remedies must be implemented.

## 6.5 Reporting

The consumer trustee and scheme financial vehicle must each communicate through regular reporting of key risks, the management of those risks and audit findings to:

- its own board of directors,
- its own senior management,
- in the case of the scheme financial vehicle, to the consumer trustee (including to enable the consumer trustee to fulfil reporting requirements to IPART); and
- where relevant, other entities covered by this Risk Management Framework.

The reporting is designed to improve risk management activities, assist stakeholder interactions, support decision making and planning by coordinating, compiling and presenting timely, clear and concise risk information.

The reporting must also take into account, but not be limited to: its use, information sensitivity and the external and internal context.

The reporting of risk will be further detailed in the relevant subsidiary policies (Section 8) considering:

1. External and internal reporting requirements, including those outlined in Section 2, Table 2 – *specific risks covered by this Risk Management Framework*.
2. Frequency, timeliness and method of reporting.
3. Relevance of information to organisational objectives and decision-making.
4. Information requirements relevant to decision making and organisational objectives such as the risk profile, mitigants and specific control responsibilities.

## 6.6 Audit (including internal audit)

An audit function must provide timely and useful information to the consumer trustee Board and management of each of the consumer trustee and scheme financial vehicle in relation to the adequacy of, and its compliance with, the system of policies, procedures, controls and staff skill and training requirements.

Each of the consumer trustee and scheme financial vehicle must develop and maintain an annual audit program that outlines the areas to be audited in the forthcoming year.

## 6.7 Culture

The Boards and senior leadership teams of the consumer trustee and scheme financial vehicle must consistently and positively demonstrate and discuss the expectation that all staff are responsible for identifying, evaluating, managing and reporting risks appropriately.

The purpose of this is to develop and maintain a strong risk management culture with clear accountabilities.

# 7. Risk management contracts

The EII Act (section 52) provides that the scheme financial vehicle may enter a risk management contract (that may be a derivative agreement) for the purposes of Part 6 of the EII Act if it is consistent with this Risk Management Framework.

## 7.1 Types of risk management contracts

For the purposes of section 52 of the EII Act, the following types of contracts are intended to be risk management contracts consistent with this Risk Management Framework:

- **Derivative contract –** a derivative contract to manage risks 1, 3, 4 and 5 as described in Section 2, Table 2, of this Risk Management Framework;
- **Funding contract –** a loan or repayable grant to the scheme financial vehicle to manage risks 1 and 2 as described in Section 2, Table 2, of this Risk Management Framework; and
- **Other risk management contracts for the purposes of Part 6 of the EII Act –** a risk management contract to protect the financial interests of NSW electricity customers in connection with LTES agreements and manage the risks outlined in Section 2, including Table 2. This could include, for example, a contract for the development and construction of projects relevant to LTES agreements (e.g. a project development agreement), a contract ancillary to a funding contract (e.g. a grant of security), or a contract of sale for products obtained in connection with the scheme financial vehicle roles and responsibilities under Part 6 of the EII Act (such as sale agreements for large-scale generation certificates or other green products received in accordance with a LTES agreement).

For the avoidance of doubt, an LTES agreement is not a risk management contract.

## 7.2 Entry into risk management contracts

In addition, the following requirements must be satisfied for a risk management contract to be consistent with this Risk Management Framework.

### 7.2.1 Consistent with subsidiary policy

Any risk management contract must be permitted by or otherwise consistent with a subsidiary policy set out in Section 8.2, Table 4 – *Subsidiary risk management policies*.

Note that the consumer trustee may include conditions and/or restrictions on its own activities or the activities of the scheme financial vehicle in the subsidiary policies, including with respect to the entry into a risk management contract.

### 7.2.2 Scheme financial vehicle satisfaction

In accordance with the Regulations, if a risk management contract is a derivative arrangement, the scheme financial vehicle must not enter into the contract unless satisfied that entering into the contract:

(a) is a reasonable and appropriate way to mitigate a risk specified in this Risk Management Framework;

(b) is in the long-term financial interests of NSW electricity customers; and

(c) will not result in the scheme financial vehicle exceeding the cap on basis risk identified in the relevant subsidiary policy.

# 8. Subsidiary policies

The subsidiary policies are the risk policy documents that describe the detailed operation of this Risk Management Framework. The consumer trustee may only recommend an LTES agreement, and the scheme financial vehicle may only enter a LTES agreement or risk management contract, in accordance with the EII Act, the Regulations,[21] this Risk Management Framework and an approved subsidiary policy.

## 8.1 Development of subsidiary policies

The subsidiary policies do not form part of this Risk Management Framework, but it is a requirement of this Risk Management Framework that subsidiary policies are consistent with this Risk Management Framework.

The subsidiary policies outlined in Section 8.2, Table 4, will be developed and approved by the consumer trustee, and the scheme financial vehicle must adopt subsidiary policies which are consistent with the subsidiary policies of the consumer trustee. The consumer trustee's oversight of the subsidiary policies is protective in nature and is intended to ensure that the scheme financial vehicle is provided with adequate (but not excessive) flexibility to make independent risk management decisions.

The consumer trustee can authorise the scheme financial vehicle to develop some or all of its own subsidiary policies or can authorise inconsistencies between the consumer trustee subsidiary policies and the scheme financial vehicle subsidiary policies. Other requirements relating to subsidiary policies are set out in Section 3.2, above.

The AER is not authorised under the EII Act to approve the subsidiary policies. The AER may request the subsidiary policies at any time.

The consumer trustee must notify the scheme financial vehicle of approved revisions to the consumer trustee's subsidiary policies. These amendments must be adopted by the scheme financial vehicle as soon as practicable unless otherwise authorised by the consumer trustee.

## 8.2 Required subsidiary policies

The subsidiary policies will not be published and are not approved by the AER or considered by the AER when approving this Risk Management Framework. Under Section 9, if the AER is required to review this Risk Management Framework by the Minister, the AER may request that the consumer trustee or scheme financial vehicle provide it with any of the subsidiary policies for review, in which case the consumer trustee must provide those subsidiary policies to the AER.

It is the obligation of the consumer trustee and scheme financial vehicle to ensure that subsidiary policies are consistent with this Risk Management Framework, Regulations and ISO 31000.

Table 4 outlines the relevant policies, their broad purpose, and the key components to be included in each policy. The subsidiary risk management policies must address and seek to mitigate the risks identified in Section 2 *Scope*.

21. Note that the scheme financial vehicle must be satisfied of certain matters set out in Regulation before entering into a risk management contract that is a derivative.

Table 4 – Subsidiary risk management policies

| Subsidiary policy | Overview of purpose | Key components |
| --- | --- | --- |
| **LTES agreements** | The risk associated with the consumer trustee recommending LTES agreements | • Policy scope and purpose<br>• Policy review and approval<br>• Policy compliance<br>• Risk appetite<br>• Methods for: (a) assessing value energy from projects; (b) risk management of the resulting contracts, including potential basis risks associated with risk management contracts used to manage LTES agreement financial exposures (including so that the subsidiary policy for the scheme financial vehicle demonstrates to the consumer trustee how the basis risk arising from a risk management contract that is a derivative arrangement will be managed)<br>• LTES agreement: tender and recommendation processes (including requirements set out in Section 3.5)<br>• Quantitative methodologies assessing cost and risk to NSW electricity customers |
| **Wholesale electricity** | Risk of financial losses to the scheme financial vehicle due to wholesale electricity markets including differences in LTES agreement and risk management contract volumes and / or adverse movements in wholesale electricity prices | • Policy scope and purpose<br>• Policy review and approval<br>• Policy compliance<br>• Risk appetite (including a cap on basis risk)<br>• Governance, roles and responsibilities<br>• Training requirements<br>• Risk management contracts: approval and management processes<br>• Australian Financial Services Licence compliance requirements.<br>• Financial product risk: measurement methodologies, valuation approaches and reporting requirements (including basis risk)<br>• LTES agreements: approval, execution and contract management processes and ongoing monitoring of risk<br>• Wholesale contract market liquidity considerations<br>• Risk limits including a cap on basis risk<br>• Approved risk management contract types<br>• Any delegations of authority to make decisions under the subsidiary policy |

| Subsidiary policy | Overview of purpose | Key components |
|---|---|---|
| **Counterparty credit** | Risk of losses to the scheme financial vehicle due to counterparty default | • Policy scope and purpose<br>• Policy review and approval<br>• Policy compliance<br>• Risk appetite<br>• Governance, roles and responsibilities<br>• Counterparty approval process<br>• Credit risk: measurement methodologies and reporting requirements<br>• Risk limits<br>• Credit support requirements<br>• Contract documentation requirements<br>• Anti-money laundering (AML)/counter terrorism financing (CTF) compliance requirements<br>• Any delegations of authority to make decisions under the subsidiary policy<br>• Other legal & regulatory requirements |
| **Operational risk** | Risk of losses to the scheme financial vehicle due to failing of people, processes or systems | • Policy scope and purpose<br>• Policy review and approval<br>• Policy compliance<br>• Risk tolerance and appetite statement<br>• Organisational design and governance<br>• Roles and responsibilities<br>• Process design and controls<br>• Risk assessment matrix<br>• Information management<br>• Fraud prevention<br>• User access control<br>• Cyber-security<br>• Documentation, processes, systems, reporting and training<br>• Model and systems audit<br>• Business continuity and disaster recovery<br>• Legal, regulatory and compliance risk<br>• Other relevant operational policies |

| Subsidiary policy | Overview of purpose | Key components |
|---|---|---|
| **Treasury and liquidity** | Risk of cash flow shortfalls / insolvency to the scheme financial vehicle due to insufficient liquidity of the scheme financial vehicle | • Policy scope and purpose<br>• Policy review and approval<br>• Policy compliance<br>• Risk appetite<br>• Managing treasury financial risk<br>• Risk management objectives<br>• Roles and responsibilities<br>• Contribution order determination, approval process and methodologies<br>• Liquidity risk<br>• Interest rate risk<br>• Authorised instruments<br>• Any delegations of authority to make decisions under the subsidiary policy<br>• Reporting |

# 9. Review process for Risk Management Framework

## 9.1 Reviews by the consumer trustee

The consumer trustee Board will establish a process for reviewing this Risk Management Framework and its subsidiary policies to ensure:

- ongoing compliance with law (including EII Act) and Regulations including changes occurring after the approval of this Risk Management Framework;
- that consumer trustee's subsidiary policies are consistent with this Risk Management Framework;
- consistency with the principles outlined in ISO 31000; and
- periodic updates to subsidiary policies so they reflect the risks relevant to the long-term financial interests of NSW electricity customers.

## 9.2 Review and amendment by Ministerial direction

An amendment will only be made to this Risk Management Framework in accordance with the following procedure:

1. The Minister may, request the AER to review this Risk Management Framework under section 51(6) of the EII Act. The reason for the request can be based on request from the consumer trustee or for any other reason.
2. Following the review by the AER, the Minister may direct the consumer trustee to amend this Risk Management Framework under section 51(7) of the EII Act. Changes to this Risk Management Framework directed by the Minister and made by the consumer trustee must be consistent with the EII Act and regulations.
3. The AER is not required to re-approve the Risk Management Framework after a direction of the Minister under section 51(7).

## 9.3 Developing & approving and amending subsidiary policies

The risk management roles and responsibilities of the consumer trustee and scheme financial vehicle are in a development and establishment phase. Accordingly, it is acknowledged that the full operation of this Risk Management Framework will not occur immediately. Activities contemplated under this Risk Management Framework (including entering any risk management contract or recommending LTES agreements) cannot be undertaken until the consumer trustee and scheme financial vehicle have established the necessary functions to discharge their roles and responsibilities.