CONSULTATION ON CHANGES TO REDUCE COLLATERAL REQUIREMENTS IN THE BALANCING MARKET

SEM-22-024

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EXECUTIVE SUMMARY

The collateral requirements on Participants in the balancing market have increased significantly over the course of the last year as increasing electricity prices have meant that Participants have been required to post higher amounts of Credit Cover.

Combined with the increase in electricity prices themselves, this increased collateral burden may pose challenges to suppliers in particular.

This consultation paper proposes to reduce the collateral burden on Participants in the balancing market by reducing the Undefined Exposure Period, a parameter that is used to calculate a Participant's Required Credit Cover. The SEM Committee seeks the views of interested parties on this proposal.

This SEM Committee is also asking for views regarding the extra collateral that many Participants are posting, over and above their Required Collateral, and the approval times for Letters of Credit.

The SEM Committee considers that in the context of current high and volatile prices, this issue warrants prompt consideration and the consultation period for this paper is therefore being set to two weeks to facilitate swift decision-making. Interested parties should respond via email to TSC@cru.ie and Karen.Shiels@uregni.gov.uk by COB on 08 June 2022.

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Glossary of Terms and Abbreviations

Abbreviation or Term	Definition or Meaning
Credit Cover	means the credit cover required of and provided by a Participant in a form which meets the requirements set out in Chapter G of the Trading and Settlement Code.
CCIN – Credit Cover Increase Notice	means a notice contained in a Required Credit Cover Report provided by the Market Operator to a Participant under paragraph G.12.1.2 of the Trading and Settlement Code where the Market Operator determines in a Credit Assessment that the Participant's Credit Cover Ratio is equal to or exceeds the Breach Limit.
Credit Cover Provider	means the provider of a Participant's Letter of Credit, or the SEM Bank as provider of the Participant's SEM Collateral Reserve Account, or each or both of them as appropriate.
Generator Suspension Delay Period	means the period of time commencing at the time of issue of any Suspension Order in respect of a Generator Unit and represents the minimum period before such an Order may take effect in respect of any Generator Unit specified in the Suspension Order. The duration of the Generator Suspension Delay Period shall be as determined by the Regulatory Authorities from time to time in accordance with paragraph B.18.4.1 of the Trading and Settlement Code.
Letter of Credit	means an unconditional and irrevocable standby letter of credit, demand guarantee or charge bond in the form set out in the Trading and Settlement Code Appendix A: "Standard Letter of Credit".

MPRN – Meter Point Reference Number	as defined in the applicable Metering Code.
Participant	means a Party or business division of a Party which at the relevant time has been designated as, or deemed to be, the “Participant” in relation to any Units which have been registered in accordance with the Trading and Settlement Code.
Posted Credit Cover	means at any time the total amount of Credit Cover provided by a Participant posted in their designated Currency and in the form of Letters of Credit or a deposit in a SEM Collateral Reserve Account.
Regulatory Authorities	means the Northern Ireland Authority for Utility Regulation and the Commission for the Regulation of Utilities and the term “Regulatory Authority” shall be construed accordingly to mean any one of them as the context admits or requires.
Required Credit Cover	means the level of Credit Cover which is required to cover the Participant’s actual and potential payment liabilities under the Trading and Settlement Code and has the meaning given in paragraph G.9.1.11 of the Trading and Settlement Code.
SEM - Single Electricity Market	for the purposes of Northern Ireland has the meaning given to the term “SEM” in section 2(2) of The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 and, for the purposes of Ireland, has during the interim period (as defined in section 7 of the Energy Act 2016), the meaning given to the term “revised arrangements in the State and Northern Ireland” in section 7 of the Energy Act 2016 and, thereafter, to the term “Single Electricity Market” in

	section 2 of the Electricity Regulation Act 1999.
SEM Bank	means the Bank with which from time to time the Market Operator has contracted for the provision of banking services required pursuant to the Trading and Settlement Code.
SEMO - Single Electricity Market Operator	means EirGrid plc and SONI Limited solely in their respective roles as the undertakings authorised by the Regulatory Authorities to perform the Market Operator function pursuant to the Market Operator Licences and any relevant exemption, with their rights, powers, functions, obligations and liabilities under the Trading and Settlement Code in that role alone being joint and several.
Single Suspension Delay Period	means the single, common period of time, required by SEMO's systems, commencing at the time of issue of any Suspension Order in respect of a Supplier Unit or Generator Unit in either jurisdiction and represents the minimum period before such an Order may take effect.
SOLR - Supplier of Last Resort	means: (a) in relation to Ireland, the person designated as supplier of last resort under the European Communities (Internal Market In Electricity) Regulations, 2005 (S.I. 60/2005) (Ireland); and (b) in relation to Northern Ireland, a supplier that is directed by the Northern Ireland Authority for Utility Regulation pursuant to its supply licence to supply electricity to premises in connection with the revocation of the supply licence of another supplier.

Supplier Suspension Delay Period	means the period of time commencing at the time of issue of any Suspension Order in respect of a Supplier Unit and represents the minimum period before such an Order may take effect in respect of any Supplier Unit specified in the Suspension Order. The duration of the Supplier Suspension Delay Period shall be as determined by the Regulatory Authorities from time to time in accordance with paragraph B.18.4.1 of the Trading and Settlement Code.
Suspension Order	means an order from the Market Operator to a Party in accordance with section B.18.3 stating that its participation in respect of any or all of its Units will be suspended in accordance with the terms of the Suspension Order or an order from the Market Operator stating that an Interconnector will be suspended in accordance with section B.10 of the Trading and Settlement Code.
Undefined Exposure Period	means, for any Working Day, the period from the latest Trading Day for which results have been included in a Settlement Statement, in the case of Trading Charges exposure and from the last Trading Day in the latest Settlement Document which includes Capacity Charges in the case of Capacity Charges, in each case until the time when, following payment default, a Participant's Units could be suspended. Such periods are determined under paragraph G.9.1.13 of the Trading and Settlement Code and published in the Settlement Calendar.
Working Day or WD	means a weekday which is not: (a) a public holiday or a bank holiday in Ireland or Northern Ireland; or

	(b) a non-processing day, as advised by the SEM Bank, in Ireland or the United Kingdom. The term “Non-Working Day” shall be construed accordingly.

1. Introduction

Increasing electricity prices lead to increased collateral requirements on Participants in the SEM.

The collateral requirements on Participants in the balancing market have increased significantly over the course of the last year as they have been required to post higher amounts of Credit Cover in line with the higher prices in the market. As a result, suppliers are seeing greater costs of providing larger amounts of collateral. Providing more collateral may also limit the capital available to suppliers for other parts of their business.

Particularly in the context of these current high and volatile prices, the increasing collateral requirements could actually increase the risk of an otherwise prudent and well-functioning supplier going into default. It could also increase the risk of the wholesale markets not functioning correctly more generally, for example if the collateral burden was too great for a supplier to participate in both the ex-ante markets and the balancing market, thus forcing that supplier to purchase all of their volumes from the balancing market.

Given the exceptional geopolitical situation and the unprecedented impact of this on the energy sector, and on electricity prices in the SEM more specifically, the SEM Committee is keen to reduce the collateral burden on suppliers where possible.

This consultation paper proposes to reduce the collateral burden on Participants in the balancing market by reducing the Undefined Exposure Period, a parameter that is used to calculate a Participant's Required Credit Cover. The SEM Committee seeks the views of interested parties on this proposal.

The SEM Committee is also asking for views regarding the extra collateral that many Participants are posting, over and above their Required Collateral, and the approval times for Letters of Credit.

1.1 Structure of this paper

The following sections of this paper deal with the two issues separately:

- Section 2: Reducing the Undefined Exposure Period; and
- Section 3: Participants posting extra collateral and approval times for Letters of Credit.

Each section provides a background to the issue, the relevant SEM Committee proposals, as applicable, and the relevant consultation questions.

Section 4 outlines the next steps.

1.2 Responding to this paper

This is a two-week consultation. Interested parties should respond via email to TSC@cru.ie and Karen.Shiels@uregni.gov.uk by COB on 08 June 2022.

Interested parties should respond to the questions contained in this paper. Any other relevant comments are also welcome.

2. Reducing the Undefined Exposure Period

2.1 Background

Under the Trading and Settlement Code's normal settlements timescales, Participants make payment in respect of charges some time after the charges are incurred. Thus, in the event that a Participant defaults, Credit Cover is required to cover charges that may have already been incurred but not yet paid, to prevent other Parties to the Trading and Settlement Code being exposed to bad debt. Because settlement has not been calculated and completed, it is necessary to estimate the potential amount of such charges, and the Trading and Settlement Code provides rules defining how these estimates are made.

However, additional exposure arises from the additional charges that a defaulting Participant could incur during the period up until the time it can be removed from the market and prevented from incurring any further charges. Broadly-speaking, the duration of this period is referred to as the Undefined Exposure Period.

Thus, the Undefined Exposure Period is one of the parameters within the Trading and Settlement Code used to calculate the Required Credit Cover that a Participant in the balancing market is required to post.

The Undefined Exposure Period is currently set at 9 days, composed of 2 days for electricity consumed but not settled and 7 days for the Single Suspension Delay Period[1].

The Single Suspension Delay Period begins on the day that a Suspension Order is issued to a Participant by SEMO (with approval of the relevant Regulatory Authority) and is the minimum time between this day and the day on which the Suspension Order takes effect. It should be long enough so that the relevant Regulatory Authority can take time to understand why the Participant is defaulting and to discuss the issues with the Participant, and so that the Participant can have some extra time to rectify the issue, before the relevant Regulatory Authority makes the decision to issue a Supplier of Last Resort (SOLR) direction.

[1] In principle, it may be appropriate to have a different Supplier Suspension Delay Period and/or Generator Suspension Delay Period in each Jurisdiction, to reflect the different regulatory processes required to remove a Supplier/Generator. However, SEMO systems allow only a single, common Suspension Delay Period for the two Jurisdictions.

A Suspension Order can be rescinded at any time during the Suspension Order Delay Period. An SOLR direction, on the other hand, cannot be rescinded once it has been issued.

It is the SEM Committee's understanding that once an SOLR direction is issued, then the Metered Quantity of the supplier concerned is set to zero from midnight on the date that the direction is issued regardless of when the relevant MPRNs are actually moved from the exiting supplier to the SOLR. Any consumption associated with these MPRNs after this time then sits within the Residual Error Volume until resettlement at M+4 / M+13 when it is settled by the SOLR. SEMO has confirmed that this is their understanding also.

Therefore, where a supplier has defaulted, its Credit Cover need cover exposure only up until midnight on the day on which the SOLR direction is issued.

Section B.18.4.1 of the Trading and Settlement Code outlines that the Supplier Suspension Delay Period (and the Generator Suspension Delay Period) in relation to each Jurisdiction shall be determined from time to time by the Regulatory Authorities and notified to the Market Operator. However, due to current system limitations there must be a Single Suspension Delay Period that applies to both suppliers and generators in both jurisdictions[2].

Any change to the Single Suspension Delay Period shall not have effect until the expiry of a period of 10 Working Days following the amending determination, or such longer period as may be specified by the Regulatory Authorities, and, in any event, shall not affect any then current Suspension Order.

Section G.9.1.12 (c) of the Trading and Settlement Code outlines that the Market Operator shall determine the Undefined Exposure Period by applying the Single Suspension Delay Period.

The Undefined Exposure Period has been consulted on annually by the SEM Committee since I-SEM go live but has not been changed. In SEMO's submission on credit cover parameters to be applied for the 2022 year[3], they state in relation to the Undefined Exposure Period that:

"*Since a single value for all participants is currently applied, in order to ensure the market is as close to full collateralisation as possible it needs to consider the maximum of the lengths of time it takes to remove a participant from the market. This*

[2]See Balancing Market Modification Mod_16_18 "Interim Suspension Delay Periods".
[3] SEM-21-067a Recommended Values for SEM Credit Cover Parameters 2022.pdf (semcommittee.com)

will ensure that collateral requirements for those participants will not be intentionally underestimated but may result in over collateralisation of participants who can be removed from the market quicker than the maximum amount of time required."

Having evaluated the time needed to reach the decision to issue an SOLR direction and having established that a supplier's collateral is not drawn upon after midnight on the day of the SOLR direction, the SEM Committee is of the view that it would be reasonable to reduce the number of days in the Single Suspension Delay Period, and therefore in the Undefined Exposure Period, with the aim of reducing the collateral burden on suppliers in particular given current high and volatile prices.

2.2 SEM Committee proposals

The SEM Committee proposes that: The Single Suspension Delay Period be amended to 5 days; and As a result, the Undefined Exposure Period be reduced to 7 days.

The SEM Committee is of the view that a Single Suspension Delay Period of 5 days would generally be adequate time for the relevant Regulatory Authority to make a decision to issue an SOLR direction following the issuance of a Suspension Order. This proposal would reduce the collateral burden on Participants in the Balancing Market by reducing their Required Credit Cover.

However, the reduction in the Undefined Exposure Period would lead to an increase in the risk of bad debt in the market, in the event that the relevant Regulatory Authority takes longer than 5 days to make the SOLR decision.

The SEM Committee considers that, on balance, the benefit of reducing the Undefined Exposure Period outweighs the risk but invites stakeholders' views on this.

Any decisions arising from this consultation regarding the Undefined Exposure Period will be given effect via a determination from the Regulatory Authorities that the Single Suspension Delay Period is to be amended.

It should also be noted that the annual Trading and Settlement Code parameters review consultation will provide an opportunity to reassess the Undefined Exposure Period in future years.

2.3 Consultation questions

Respondents to this consultation should answer the following questions. It would greatly assist the SEM Committee in its consideration of stakeholders' views, if respondents could provide clear reasoning for their answers.

Question 1
Do you agree with the SEM Committee's proposals to amend the Single Suspension Delay Period to 5 days and thereby reduce the Undefined Exposure Period to 7 days?

Question 2
Do you agree that an increased risk of bad debt in the balancing market is an acceptable trade-off when weighed against the reduced collateral burden on all Participants in the market on an ongoing basis?

3. Participants posting extra collateral and approval times for Letters of Credit

3.1 Background

The SEM Committee has become aware that many Participants in the balancing market are posting significantly more Credit Cover than actually required on an ongoing basis.

One reason for this may be that they are posting extra Credit Cover in order to give themselves "headroom" and thereby reduce the risk of receiving a Credit Cover Increase Notice (CCIN) if electricity prices rise.

The SEM Committee would like to understand why many Participants choose to do this, rather than rectify a CCIN if or when they receive one, as the practice of posting "headroom" is increasing their collateral burden on an ongoing basis and appears to be inefficient.

3.2 Conditions and approval times for Letters of Credit

One issue that has been raised with the SEM Committee, and which may explain why many Participants are posting extra Credit Cover as "headroom", is the approval times for Letters of Credit.

The Trading and Settlement Code Agreed Procedure 9 deals with the management of credit cover and credit default.

Section G.12.1.3 of the Trading and Settlement Code sets out that where a Participant receives a Credit Cover Increase Notice (CCIN) said Participant must meet the terms of the CCIN before 17:00 on the second Working Day thereafter.

A Participant can increase its Posted Credit Cover in order to meet the terms of a CCIN by:

- Registering a new Letter of Credit from a new Credit Cover Provider;
- Registering a new Letter of Credit from an existing Credit Cover Provider;
- Amending an existing Letter of Credit; or
- Depositing cash in its SEM Collateral Account and providing SEMO with a Deed of Charge and Account Security.

Agreed Procedure 9 sets out the following relevant points, *inter alia*.

- It is the responsibility of each Participant to ensure that in obtaining a Letter of Credit, its Credit Cover Provider meets the Bank Eligibility Requirements as set out in the Trading and Settlement Code and continues to meet them throughout the entire period for which it is the Participant's Credit Cover Provider.

- In order to assist Participants in obtaining appropriate Credit Cover, SEMO shall maintain a List of Eligible Banks setting out those Banks which meet the Bank Eligibility Requirements.

- When presenting a Letter of Credit as a part of or in respect of its entire Credit Cover, each Participant must comply with the requirements set out in Appendix A "Standard Letter of Credit" of the Trading and Settlement Code.

- SEMO shall not accept a Letter of Credit unless a Participant supplies adequate proof that the associated Credit Cover Provider meets the Bank Eligibility Requirements.

- Where a Participant intends to use a Credit Cover Provider which is not contained in the List of Eligible Banks, the Participant shall provide proof to SEMO that the potential Credit Cover Provider meets the Bank Eligibility Requirements. Such proof shall be provided by the Participant before instructing its Credit Cover Provider to register a Letter of Credit with the SEM Bank. On receipt of such proof, SEMO shall add the potential Credit Cover Provider to the List of Eligible Banks.

- If a Participant uses a Credit Cover Provider that is on the List of Eligible Banks, it shall nevertheless request proof from the relevant Bank that it continues to meet the Bank Eligibility Requirements. In the event that the Participant fails to receive satisfactory proof from such Bank, the Participant shall inform SEMO that such Bank has not provided confirmation as required and SEMO shall remove the Bank from the List of Eligible Banks.

Section 3.2 of Agreed Procedure 9, *Procedural steps for Submitting a Letter of Credit (Eligibility of Credit Cover Provider)*, sets out that where a Participant wishes to register a new Letter of Credit:

- The Participant must submit a Letter of Credit from a new or existing Credit Cover Provider at least 4 WD prior to the date from which the Letter of Credit needs to be accepted.

- The Participant must submit proof that the new Credit Cover Provider meets the Bank Eligibility Requirements at least 4 WD prior to the date from which the Letter of Credit needs to be accepted.

- SEMO must review the Letter of Credit and proof provided by the Participant to confirm that:
(a) the Letter of Credit meets the requirements as set out in the Trading and Settlement Code (particularly Appendix A "Standard Letter of Credit" of the Code); and
(b) the new Credit Cover Provider meets the Bank Eligibility Requirements;
within 2 WD of receipt of Letter of Credit and proof.

- SEMO must inform the Participant of the results of status checks and compliance with the Letter of Credit requirements within 2 WD of receipt of the Letter of Credit and proof.

Section 3.4 of Agreed Procedure 9, *Procedural steps for Changes to Posted Credit Cover*, sets out that where a Participant wishes to make an amendment to an existing Letter of Credit:

- The Participant must submit the amended Letter of Credit by 12:00 on any WD in order for the procedure to commence on that WD.

- SEMO must retrieve and validate the Letter of Credit details from the SEM Bank and confirm that the Credit Cover Provider is on the List of Eligible Banks and the Letter of Credit requirements have been met, and accept or reject the amended Letter of Credit within 2WD of the request.

The SEM Committee notes that the timelines outlined in Agreed Procedure 9 may make it difficult for a Participant to meet the terms of a CCIN with a Letter of Credit within 2 WD, and that this may be putting pressure on Participants to post more Credit Cover than actually required on an ongoing basis in order that they give themselves “headroom” and so reduce the risk of receiving a CCIN if electricity prices rise.

3.3 Consultation questions

Respondents to this consultation should answer the following questions. It would greatly assist the SEM Committee in its consideration of stakeholders' views, if respondents could provide clear reasoning for their answers.

Question 3
In your view, what are the reasons why many Participants in the balancing market are posting extra Credit Cover, significantly over and above their Required Credit Cover?

Question 4
In your view, are the approval times for Letters of Credit causing Participants to post extra Credit Cover as "headroom" as they believe they may find it difficult to meet the timelines of a Credit Cover Increase Notice (CCIN) with a Letter of Credit?

Question 5
What are your views on the approval times for Letters of Credit generally? Are there any changes that could be made to the current approval processes that would allow Letters of Credit to be approved more quickly (bearing in mind that Letters of Credit must meet the conditions set out in Agreed Procedure 9)?

4. Next Steps

This is a two-week consultation. Interested parties should respond via email to TSC@cru.ie and Karen.Shiels@uregni.gov.uk by COB on 08 June 2022.

Any decisions arising from this consultation regarding the Undefined Exposure Period will be given effect via a determination from the Regulatory Authorities that the Single Suspension Delay Period is to be amended.