DECISION ON CHANGES TO REDUCE COLLATERAL REQUIREMENTS IN THE BALANCING MARKET

SEM-22-032

04 July 2022

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.

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.

In consultation paper SEM-22-024[1], the SEM Committee proposed 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 also asked 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.

Consultation paper SEM-22-024 was published on 25 May 2022 and the consultation period closed on 08 June 2022. The SEM Committee received fourteen responses to the consultation paper.

This decision paper outlines the responses to the consultation paper, the SEM Committee comments on these responses and the SEM Committee decisions, as appropriate.

Regarding the Undefined Exposure Period, the SEM Committee decision is that:

1) The Single Suspension Delay Period will be amended to 5 days; and
2) As a result, the Undefined Exposure Period will be reduced to 7 days.

Regarding the approval times for Letters of Credit, the SEM Committee encourages Participants and the Market Operator to work together to identify areas where efficiency improvements could be made, and suggests that Participants raise changes to such areas via Modifications to the Trading and Settlement Code as appropriate.

[1] https://www.semcommittee.com/sites/semc/files/media-files/SEMC-22-024%20Consultation%20on%20changes%20to%20reduce%20BM%20collateral.pdf

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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.
KPI - Key Performance Indicator	A quantifiable measure, usually part of a set of such measures, that is used to gauge the performance of a company over time.
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”.
Market Operator	See “SEMO”.
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.
SEM Collateral Reserve Account	means an account established with the SEM Bank by a Participant and the Market Operator in the name of the Market Operator pursuant to section G.1.5 for the purpose of comprising part or all of the Participant’s Posted Credit Cover.
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.
Settlement Document	means the statement of the payments required to be made by a Participant to the Market Operator, or by the Market Operator to the Participant for Trading Payments, Trading Charges, Capacity Payments and Capacity Charges issued for a period as detailed in subsection G.2.5 and Appendix G of the Trading and Settlement Code.
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 have led 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, Participants are seeing greater costs of providing larger amounts of collateral. Combined with the increase in electricity prices themselves, this increased collateral burden may pose challenges to suppliers in particular. 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. They 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.

In consultation paper SEM-22-024[2], the SEM Committee proposed 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 also asked 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 received fourteen responses to SEM-22-024 from:

- Bord Gáis Energy (BGE);
- Bord na Móna (BnM);
- Dublin Waste-to-Energy (DWTE);
- Electricity Association of Ireland (EAI);
- EirGrid and SONI;

[2] https://www.semcommittee.com/sites/semc/files/media-files/SEMC-22-024%20Consultation%20on%20changes%20to%20reduce%20BM%20collateral.pdf

- Electric Ireland;
- Energia;
- ESB GT;
- Ørsted Ireland;
- Panda Power;
- Power NI;
- Power NI Energy Limited Power Procurement Business (PPB);
- PrePayPower; and
- SSE.

1.1 Structure of this paper

The following sections of this decision paper deal separately with the two issues that were consulted on:

- 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 and questions as outlined in the consultation paper (SEM-22-024), a summary of responses received, SEM Committee comments on the responses and SEM Committee decisions as appropriate.

Section 4 outlines the next steps.

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 period 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. Additional exposure may arise, after the point at which the Participant defaults, from the additional charges that the defaulting Participant could incur during the period between the point of default and the time it can be removed from the market and prevented from incurring any further charges. Broadly-speaking, the duration of this combined 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 Credit Cover that a Participant in the balancing market is required to post.

The Undefined Exposure Period has been set at 9 days, composed of 2 days for electricity consumed but not settled and 7 days for the Single Suspension Delay Period[3], since I-SEM go-live.

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.

[3]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.

Where a supplier has defaulted, its posted Credit Cover needs to cover its exposure up until midnight on the day on which the SOLR direction is issued. After this point all further costs associated with the exiting suppliers' customers are ultimately borne by the Supplier of Last Resort (and settled at M+4 or M+13).

The Undefined Exposure Period has been consulted on annually by the SEM Committee since I-SEM go live but has not been changed.

Having evaluated the time needed to reach the decision to issue an SOLR direction in both jurisdictions and having established that a supplier's collateral is not drawn upon after midnight on the day of the SOLR direction, the SEM Committee proposed in consultation paper SEM-22-024 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 and consultation questions

In consultation paper SEM-22-024 the SEM Committee proposed 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 asked respondents to provide answers to the following questions.

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?

2.3 Summary of responses

Clarification

The first point to note is a clarification in relation to the following extract from the consultation paper:

> 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.

EirGrid and SONI clarified that although the exiting supplier does cease to be liable for any Metered Quantity recorded from midnight following the SOLR direction and the SOLR is liable for such consumption from this point, the quantity that accrues before the relevant MPRNs are transferred to the SOLR is not included in the Residual Error Volume. Instead, should the exiting supplier's Credit Cover not be sufficient to cover its liabilities then the shortfall is socialised according to the rules of Shortfall and Unsecured Bad Debt as per section G.2.7 of the Trading and Settlement Code. However, this is a temporary measure and the SOLR will pay for this quantity at M+4 or M+13 and the previously socialised Unsecured Bad Debt will be repaid as laid out in section G.2.7.10 of the Trading and Settlement Code. In that regard it remains the case that any final correction will take place at M+4 or M+13 as per the consultation extract.

Support for the proposal

None of the respondents explicitly disagreed 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.

A number of respondents supported the proposals without any reservations.

One respondent, for example, agreed with the Committee's view that it is unlikely to take the Regulatory Authorities longer than 5 days to issue a SOLR direction and, given this, they see very little risk or potential harm to reducing the Undefined Exposure Period from 9 to 7 days. They support improving the market rules and design to reduce unnecessary costs to participants, and they would be happy to see this change approved.

Another respondent agreed in principle to changes that make collateral costs and the collateral process more efficient and stated that five days should be sufficiently long to determine the reasons for a default.

Two respondents stated that the proposal is a positive step to alleviate some of the impacts of high pricing, and welcomed the proposal being formalised by a determination issued by the SEM Committee.

Another respondent was of the view that the SEM Committee’s proposal would not increase risk in the market for the following reasons:
1) For every day within the Undefined Exposure Period, each participant is obliged to provide credit cover in respect of 100% of their potential volumes in the balancing market. While a participant may default, it is highly unlikely that a participant would default entirely on 100% of their volumes on a given day. Even were that to happen, the market is fully insulated from the participant defaulting entirely on its traded volumes for a further 4 days.
2) Under the proposal, the Regulatory Authorities would still have five full days to decide on the viability of a supplier, before deciding whether or not to issue an SOLR direction. It is clear that the Regulatory Authorities would not delay declaring an SOLR in the case of a supplier that was irrevocably insolvent.
3) When a similar reduction in the Undefined Exposure Period occurred in preparation for I-SEM going live, there was not, to this Participant’s knowledge, any change in perception of the risk profile associated with operating in the market. In other words, the banking sector did not perceive any additional risk to operating in this market and as such did not price in additional premium to Participants in their lending costs.

EirGrid and SONI stated that they are satisfied that the value of the Undefined Exposure Period has been adequately set since I-SEM go-live, but if directed by the Regulatory Authorities, a change to this parameter could be easily achieved with immediate effect by updating the settlement system accordingly. They recognised the impact on the market from the unprecedented international circumstances and stated that they will collaborate with industry where possible to apply changes that would be considered beneficial.

Increased risk of bad debt

The majority of respondents either did not perceive any significant increase in bad debt arising from the SEM Committee's proposal or believed that the benefits of reducing the collateral on Participants outweigh any increased risk of bad debt.

One respondent, for example, was of the view that the potential level of bad debt would be very low and would be an acceptable trade off.

Another respondent stated that they do not anticipate that the SEM Committee's proposal would increase the risk of bad debt in the balancing market in any material way, and that the clear benefit to Participants of posting less collateral therefore outweighs whatever additional risk (perceived or otherwise) is created by virtue of the proposal. This respondent also noted that the SEM Committee's proposal would reduce the collateral requirements of new entrants, which can only be positive for competition and ultimately customer choice.

Another respondent made the point that a reduction in the collateral burden should assist in reducing the likelihood of a business facing financial difficulties, which would further mitigate the risk of bad debt. This respondent also noted that the cost of collateral is ultimately paid by customers and therefore over collateralisation is an avoidable cost.

Another respondent stated that the possible outcome of increased bad debt would arise solely from a difficulty in meeting the new shorter timeframe of five days for the Regulatory Authorities to issue an SOLR direction, and that this process is internal to the Regulatory Authorities and therefore, given the awareness of the possible risk to bad debt, they are comfortable that this risk can be managed.

On the other hand, a number of respondents were concerned that the SEM Committee's proposals would lead to an increased risk of bad debt.

One respondent, for example, stated that they had considerable concerns around the risks to remaining Participants, and in turn consumers, who could face significant bad debt exposure if the Regulatory Authorities were to take longer than five days to make their decision on issuing an SOLR direction. In this situation the bad debt accrued by the exiting supplier would be levied on remaining Participants, raising the cost of doing business for those Participants with possible negative impacts for end-consumers. This respondent was of the view that the tradeoff between this increased risk of bad debt and the reduced collateral burden would only be acceptable if measures were adopted that protect against remaining Participants being wholly responsible for funding the bad debt of a supplier that exits. They stated that they support a reduction in the Undefined Exposure Period if the new potential risk this market design change presents is borne by the Regulatory Authorities and/or SEMO.

This respondent argued that the risk should sit with the entity that can best control it and, in this instance, they believe that the Regulatory Authorities are the entities that can control whether bad debt on the part of a Participant that must exit will arise. They went on to argue that it would be possible to mitigate this longer-term risk to consumers (of the five-day SOLR decision-making window being exceeded) in a number of ways including:

a) If the Regulatory Authorities could reasonably assure Participants of their planned adherence to the five-day limit. They suggested that such an assurance could be given by inserting a provision into section G.12 of the Trading and Settlement Code or into Agreed Procedure 9 outlining that the Regulatory Authorities are timebound to five days to make the SOLR decision (or will at least exercise best endeavours to meet the timeline);
b) The SEMO contingency fund could be referred to, in either of the G.12 of the Trading and Settlement Code or Agreed Procedure 9, to outline that in instances where the five days was exceeded any bad debt accrued by an exiting Participant would be covered by the SEMO contingency fund;
c) SEMO could procure a letter of credit to cover those instances where the Regulatory Authorities may exceed their five-day limit in order to cover the bad debt accrued by a Participant that must exit.

They argued that either (a) and (b) or (a) and (c) need to be incorporated into the final decision on the SEM Committee’s proposals in order to provide suppliers with the benefit of reduced collateral costs but also, as importantly, to protect consumers against the increased risk of bad debt.

Another respondent argued that the increased risk of bad debt arising from a shorter Single Suspension Delay Period is driven by an increased regulatory risk, as the Regulatory Authorities are not giving a commitment to issue an SOLR direction within five days in all cases. They stated that generators bear the burden of this risk.

This respondent argued that the Regulatory Authorities must commit to issuing an SOLR direction within five days to ensure the market remains appropriately collateralized, and if they are not willing or able to make this commitment then the burden of any bad debt should not be socialised over generators (as is currently the case under the Trading and Settlement Code) but should be socialised over all customers, given they are the ultimate beneficiaries of reduced collateral arrangements.

Another respondent argued that reducing the Single Suspension Delay Period to five days is only possible if the Regulatory Authorities have the necessary processes and resourcing in place to ensure that they can meet the new reduced timeframe of five days. They argued that any additional risk that is caused by reducing time periods should be adequately mitigated against through assurances from the Regulatory Authorities that timeframes will be committed to by them and not leave generators exposed to bad debt.

EirGrid and SONI stated that the Market Operator has identified no issues in carrying out the potential changes as proposed by the SEM Committee and has no strong position with regards to Question 2 other than certain concerns they outlined for consideration by the Regulatory Authorities, as follows:

- Whether the market is over-collateralised and therefore putting an unnecessary burden on Participants or whether the over-collateralisation is within an acceptable tolerance to provide adequate protection to the market in consideration of the aim of full collateralisation;
- Whether reducing the Single Suspension Delay Period would mean a departure from the principle set in the I-SEM Market Design of aspiring to full collateralisation;
- Whether this is a temporary measure in response to a specific context and current market conditions due to the sudden increase of fuel prices and security of supply, and under what criteria would it be reversed;
- Whether this change is signalling a perceived potential for default in the SEM and if that could result in a more cautious approach to trading reducing liquidity in the market;
- Whether reducing the Single Suspension Delay Period would actually hinder the chances of a Participant to rectify its financial situation as they would have less time at their disposal to rearrange their finances and discuss their situation with the Regulatory Authorities as required by the process; and
- Whether an increase in the level of bad debt would become a burden on SEMO’s resources and SEMO’s ability to meet its timelines.

Other comments

Several respondents raised the issue of dual collateralisation of the ex-ante markets and the balancing market in their response and requested that this issue be considered.

One respondent requested that the settlement of supplier capacity charges move to weekly settlement rather than monthly. They argued that this change would reduce the build-up of collateral on suppliers at certain times in the month. If weekly payments cannot be facilitated, they requested that pre-payment of capacity charges be facilitated. They argued that this change would prevent the requirement of posting additional collateral while fulfilling their capacity payment obligation.

One respondent proposed that the Undefined Exposure Period continue to be consulted upon annually by the SEM Committee.

2.4 SEM Committee comments

Clarification

The SEM Committee would like to thank EirGrid and SONI for clarifying what happens in respect of an exiting supplier's metered quantities after an SOLR direction has been issued. As the SOLR is liable for these quantities from midnight on the day the SOLR direction is issued and pays for these quantities at M+4 or M+13 the SEM Committee considers that this clarification does not have a material impact on its proposal.

SEM Committee proposal and the increased risk of bad debt

The SEM Committee welcomes the fact that there was general support for its proposals to amend the Single Suspension Delay Period to 5 days and thereby reduce the Undefined Exposure Period to 7 days.

The SEM Committee notes that the majority of respondents either did not perceive any significant increase in bad debt arising from the SEM Committee's proposal or believed that the benefits of reducing the collateral on Participants outweigh any increased risk of bad debt, but also acknowledges that a number of respondents were concerned that the SEM Committee's proposals would lead to an increased risk of bad debt.

The SEM Committee remains of the view that a Single Suspension Delay Period of five 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. However, the SEM Committee cannot give a firm commitment that the relevant Regulatory Authority will issue an SOLR direction within five days in all cases as a scenario could arise where this was not the best course of action, for example if a supplier in financial difficulty was genuinely on the cusp of obtaining new investment.

As such, it would not be appropriate to insert a commitment into the Trading and Settlement Code that a strict five-day limit to issue an SOLR direction would always be met. However, the SEM Committee would note in this regard that it is currently the case that the seven-day Single Suspension Delay Period is not a strict limit, and that it could exceeded if the circumstances warranted. Therefore, it has always been the case that the Regulatory Authorities could have taken longer than the Single Suspension Delay Period to decide to issue an SOLR direction and so this is not a new risk, albeit the risk increases with a shorter Single Suspension Delay Period.

Regarding the suggestion that SEMO be made liable for any bad debt occurring, either through the SEMO contingency fund or the procurement of a Letter of Credit, in order to protect consumers against the increased risk of bad debt, the SEM Committee disagrees that this would protect consumers as ultimately the end consumer would fund SEMO's costs in this regard.

Having considered all the responses to the consultation, the SEM Committee is of the view that its proposal would benefit the market overall by reducing the collateral burden on Participants and that any increase in the risk of bad debt as a result is expected to be small and, on balance, is an acceptable trade-off. The SEM Committee will keep this matter under review however and continue to consult annually as appropriate on the Undefined Exposure Period.

Other comments

The SEM Committee acknowledges that the dual collateralisation of the ex-ante markets and the balancing market is an issue for many respondents but this is outside the scope of this paper, which has focused on changes to collateral requirements that can be made effective, and alleviate the burden on suppliers, quickly.

The introduction of weekly settlement of supplier capacity charges and/or the prepayment of supplier capacity charges would require a change to the Market Operator's systems. This would need to be raised with the system vendor for materiality and timeline assessment and also for possible further impacts based on the system architecture before any such changes were considered.

As above, the SEM Committee agrees that the Undefined Exposure Period should continue to be consulted upon annually.

2.5 SEM Committee decisions

The SEM Committee decision is that: 1. The Single Suspension Delay Period will be amended to 5 days; and 2. As a result, the Undefined Exposure Period will be reduced to 7 days.

This decision will be given effect via a determination from the Regulatory Authorities that the Single Suspension Delay Period is to be amended. 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 SEM Committee will keep this matter under review and the Undefined Exposure Period will continue to be consulted upon annually as part of the Trading and Settlement Code parameters consultation.

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.

The SEM Committee considers that one reason for this may be that Participants 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.

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.

3.2 Consultation questions

The SEM Committee asked respondents to provide answers to the following questions.

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)?

3.3 Summary of responses

Reasons why many Participants are posting extra Credit Cover

Respondents to the consultation provided a number of potential reasons why many Participants in the balancing market are posting extra Credit Cover, significantly over and above their Required Credit Cover. These potential reasons are summarised below.

Volatility in the fuel and electricity markets
The volatility in the fuel markets has caused substantial swings in Credit Cover requirements for Participants in the electricity markets over the past year. As these large increases have been experienced, Participants may be seeking to ensure an adequate margin of cover is put in place to ensure compliance with Credit Cover requirements in this dynamic landscape.

Seriousness of a breach
A potential breach of Credit Cover requirements is a serious event for a Participant that would carry significant reputational damage within the SEM, or any commodity market for that matter. Management of Credit Cover requires an investment in time and resources on forecasting and carries overheads in terms of management of the credit position. Any rational Participant will look to carry an additional buffer in order to protect against a breach of Credit Cover requirements or any unforeseen rapid movement in the underlying market.

Difficulty of forecasting Required Credit Cover
One respondent stated that it is extremely difficult to forecast their Required Credit Cover, even when following the Trading and Settlement Code formulae, SEMO training slides, and worked examples, and that they have not been able to reproduce the values in their daily credit reports. Therefore, they cannot forecast as accurately as desired when an increase in collateral may be required. They believe that more help should be provided by SEMO in assisting the market with forecasting Credit Cover requirements.

Time to remedy a Credit Cover Increase Notice (CCIN)
The timeline from receiving a CCIN to when the additional Credit Cover must be posted is short and there are administrative burdens to posting the additional Credit Cover. To avoid the risk of not having sufficient Credit Cover and to avoid having to post cash at short notice to meet CCIN requirements it can be prudent to leave some "headroom" above the required amount.

Approval times for Letters of Credit
The majority of respondents agreed that the approval times for Letters of Credit is one of the main reasons why Participants are posting excess Credit Cover in the balancing market. This issue is considered further later in this section.

Cash collateral refunds
One respondent stated that SEMO take the maximum number of days, which is 5 days, to issue cash collateral refunds. This respondent's experience is that, despite confirming the refund request on Day 1, SEMO waits until the fifth Working Day to issue the refund. They requested clarification regarding why cash collateral refunds are not issued in a timely manner i.e., within one or two Working Days.

Another respondent also stated that the return of excess cash collateral can be a frustrating process which ties up working capital unnecessarily which could be used to pay a settlement document that is yet to be published.

Delays to settlement runs
One respondent stated that delays to settlement runs can considerably increase Traded not Delivered exposure. For example, in the event of a metering issue, the number of days feeding into the Traded not Delivered exposure calculation will increase by one each day until the issue is resolved. They stated that this means that a prudent generator, which takes all reasonable steps to ensure balance responsibility, can be exposed to a sudden increase in its collateral burden.

Difficulty of forecasting generation
One respondent made the point that under scenarios where a Participant's collateral requirements could be offset by generation, the difficulties of forecasting real-time generation (including constraints) mean that forecast generation cannot be accurately relied upon in respect of managing collateral postings.

Approval times for Letters of Credit as a reason for Participants posting extra Credit Cover

The majority of respondents agreed that the approval times for Letters of Credit is one of the main reasons why Participants are posting excess Credit Cover in the balancing market. The challenging timelines mean that if a Participant waits to receive a CCIN before amending a Letter of Credit to increase their Credit Cover, it is possible that the Letter of Credit will not be approved on time and for this reason Participants will likely favour posting excess collateral, rather than risk receiving a CCIN.

One respondent, for example, stated that in their experience increasing the value of a Letter of Credit generally takes 2 to 3 weeks and raising a new Letter of Credit can take longer. They therefore believe it is often prudent to maintain a level of “headroom” between their Required Credit Cover and the value of the Letter of Credit to reduce the likelihood of needing to post cash to meet a CCIN.

Another respondent was firmly of the view that the current approval timelines for Letters of Credit contribute to Participants posting extra Credit Cover as “headroom”. They stated that prudent Participants post additional collateral to hold sufficient surplus to mitigate the risk of market volatility and that the current 4 WD timeframe for SEMO to accept a Letter of Credit amendment makes reacting to increased collateral requirements or a CCIN via a Letter of Credit unachievable. They argued that, because of this, Participants are required to remain over collateralized in the balancing market to avoid being required to post cash at short notice in the event of a collateral spike.

Another respondent stated that it is not always practical to update a Letter of Credit in 2 WD, depending on the internal approvals required as well as the Letter of Credit provider’s approvals.

Another respondent argued that there is a disjoint where Participants must respond to a CCIN in 2 WD, while SEMO have 5 WD to accept Letter of Credit changes and a further 5 WD to issue cash collateral refunds, and they firmly believe that this is a key driver behind over-collateralisation. This respondent pointed out that assuming a Participant posts a Letter of Credit but also posts cash collateral as a secondary action, and assuming that SEMO takes 5 WD to accept the Letter of Credit and another 5 WD to issue cash collateral refunds, the Participant is double-collateralised for 10 WD. This respondent also noted that paying an invoice early to close a CCIN is often not a sufficient option given the operation of the various markets and a Participant’s trading pattern, and that this is a key difference to the situation that pertained prior to the I-SEM arrangements.

EirGrid and SONI, on the other hand, stated that in their dealings with Participants, no specific issue on Letter of Credit approval timelines has been raised and processing of Letters of Credit has always been carried out promptly.

Changes that could be made to the current approval processes that would allow Letters of Credit to be approved more quickly

Some respondents stated they would support a review of the timelines for both CCINs and Letters of Credit and some stated they would support any effort that could be made by SEMO to either shorten the approval times for Letters of Credit or lengthen the time given to rectify a CCIN.

One respondent stated that from an administrative perspective it can be challenging to get additional Credit Cover approved and posted within the required time period and that they would support any modifications to market rules that could ease the administration challenge associated with this.

Another respondent argued that a reduction in the time taken for a Letter of Credit to be accepted and effective would make Participants more comfortable with lowering the headroom in their posted collateral. They therefore recommended that a Letter of Credit should be accepted and effective within 1 WD from when it is submitted, for both a new and an amended Letter of Credit, so that a Participant can potentially avail of this in the event of receiving a CCIN. They stated that this timeline should be reflected in an updated Agreed Procedure 9. They argued that these timelines would allow Participants more flexibility in dealing with high prices and market volatility.

Another respondent stated that the approval times for Letters of Credit could be shortened to assist with managing the collateral requirement and help reduce the margin of extra Credit Cover that may be posted by Participants. They argued that it should also be taken into consideration that the timeline for Letters of Credit also includes the time it takes for a Participant to agree the Letter of Credit with an eligible Credit Cover Provider and this may take several days, and that reducing the SEMO approval time would help to shorten the overall timeframe for a Letter of Credit to be put in place.

Another respondent stated that they would welcome a review of the conditions set out in Agreed Procedure 9 regarding timescales, and that in the interim there are changes that could be made to the current approval process in order to help Participants meet the timescales as they currently are.

This respondent argued that in order to speed up the process of banks on both sides issuing Letter of Credit details, Participants could escalate with their own banks and could provide copies of the amended Letter of Credit to SEMO immediately. They stated that being in receipt of this information earlier would allow SEMO's Finance team to start the due diligence and acceptance process much earlier. However, this respondent noted that this option is only workable if the correct team within SEMO reviews and approves the Letters of Credit.
This respondent also argued that it is vital that SEMO maintain a consistent approach with regards to Letter of Credit renewals. They stated that historically SEMO contacted Participants in advance of an upcoming expiry and request renewal, but this process has now stopped without any communication to Participants. They argued that it is imperative that SEMO are consistent in their approach and information communicated around expiry dates.

Another respondent stated that the approval process for Letters of Credit would be more reliable if the Market Operator's bank would agree to complete the final step of the Letter of Credit Amendment process in a timely manner. They stated that, on occasion, the specific wording within Letters of Credit can be prohibitively specific which can also slow the process. Ultimately, no change is effected until the Market Operator's bank electronically communicates acceptance of an amendment to the Participant's bank. They stated that this last step can take several weeks, and repeated requests to SEMO, and in their view these timeframes should be reconsidered.

On the other hand, EirGrid and SONI stated that they are opposed to changes to timings for the approval of Letters of Credit as they could not guarantee the documentation provided by Participants and their financial institutions would have all the correct details to allow the checking process to be reasonably and safely completed in less time than that already provided for by the Trading and Settlement Code. They were also of the view that it is unclear if a change to Letter of Credit timelines would assist in reducing the collateral held in the market.

EirGrid and SONI went on to state that they have concerns regarding the feasibility of a proposal to reduce timelines for approval of Letters of Credit and made the following points in this regard:

- The approval process for Letters of Credit is not automated.

- To ensure adherence with all the requirements of the Trading and Settlement Code, a number of control checks have to be carried out by the Market Operator and the process requires management sign off to approve a Letter of Credit. Incomplete documentation from Participants can lead to delays in this approval process.

- The process is not fully under the control of the Market Operator as it also includes an external dependency in dealing with various Participants' banking institutions.

- The Market Operator endeavours to respond to Letter of Credit requests within the assigned timelines; however, this is provided that the documentation submitted by the Participant's issuing bank meets all the requirements set for Credit Cover Providers in G.9.1.3 of the Trading and Settlement Code, Appendix A 'Standard Letter of Credit and Demand Guarantee' and Agreed Procedure 9 'Management of Credit Cover and Credit Default'. These include the bank's or insurance undertaking's licence to operate and their ability to meet the eligibility requirements such as their long-term rating; and their ability to provide same day payment by SWIFT payment services.

- The documentation submitted can vary from one banking institution to another. The type and quality of data provided is not always standardised and is often incomplete making the review process more complex and lengthy. In addition, even when a Participant requests a Letter of Credit update from an institution that is already on the list of approved Credit Cover Providers, the ability to meet the eligibility requirements has to be tested on a regular basis to demonstrate that no change has occurred that would affect the status of the relevant institution.

Finally, EirGrid and SONI argued that the current approval is robust in ensuring that the Market Operator as a prudent Market Operator carries out the appropriate level of due diligence and checks on new Letters of Credit and amendments in all circumstances, and it is already very tight in situations where documentation is incomplete or incorrect.

Another respondent was of the view that approval times for raising or amending Letters of Credit are based on the internal controls and processes in place at both the issuing banks and at the businesses being supported and expediting the timelines of banks, if it could be agreed, would potentially be at the expense of due diligence which would not benefit industry and potentially raises more risk for consumers. Banks usually assess each company based on their creditworthiness and assessment of items such as credit ratings, key ratios and market environment. The banks then decide how much they are willing to insure and at what cost with their primary objective being to accurately price the risk they are taking on. This respondent does not believe that Credit Cover Providers / banks issuing Letters of Credit have any incentive to reduce timelines and ultimately for SEM those timelines currently work to protect consumers against the risk of bad debt.

Other comments

One respondent requested that a wider variety of providers be allowed to provide Letters of Credit.

One respondent specifically welcomed the approval of Mod_01_22 Balance Surety_Demand Guarantee, stating that this modification intends to diversify the types of parties that can be underwriters for Letters of Credit. They were of the view that this modification will assist participants with the challenge of providing collateral.

EAI members also wished to acknowledge and welcome the approval of Mod_01_22 Balance Surety Demand Guarantee. EAI members consider this modification will go some way to assisting participants with the challenge of providing collateral to such an extent in this market.

3.4 SEM Committee comments

The SEM Committee would like to thank respondents for providing their views as to why Participants are posting extra Credit Cover.

The SEM Committee notes that the majority of respondents agreed that the approval times for Letters of Credit is one of the main reasons why Participants are posting excess Credit Cover in the balancing market, and that the challenging timelines mean that if a Participant waits to receive a CCIN before amending a Letter of Credit to increase their Credit Cover, it is possible that the Letter of Credit will not be approved on time to rectify the CCIN.

The SEM Committee also notes that some respondents would support a review of the timelines for both CCINs and Letters of Credit and some would support any modifications to market rules that could ease the administration challenges involved. However, the SEM Committee acknowledges that it is not entirely within the Market Operator's gift to shorten these timelines as there are external dependencies involved, for example dependencies around Credit Cover Providers and their internal controls and processes.

The SEM Committee agrees that the approval process for Letters of Credit should be robust and that the Market Operator should carry out the appropriate level of due diligence in all circumstances, as not doing so would increase the risk of bad debt.

However, the SEM Committee notes the inconsistency between the timeframe for meeting a CCIN and the Letter of Credit turnaround time and encourages Participants and the Market Operator to work together to identify areas where efficiency improvements could be made. The SEM Committee suggests that Participants raise changes to such areas in the form of Trading and Settlement Code Modifications as appropriate, noting that a Participant has already raised Mod_01_22 Balance Surety_Demand Guarantee, which was approved and implemented, and which diversified the forms of acceptable collateral.

The SEM Committee has raised the issue of cash collateral refunds with SEMO, who have stated that such refunds are paid out as quickly as possible after due diligence is carried out, and that this timeline is also dependent on the relevant Participant supplying the correct information in their request. SEMO also stated that the timing of a cash collateral refund will depend on the day of the week that the request is submitted as SEMO do not want to put a Participant in a position whereby they obtain a refund only for the next credit report to put them in breach. For example, it is impractical for SEMO to review and approve a cash collateral refund on a Friday morning before the Settlement Documents have been published, and it is more reasonable to wait until after they have been published and review the Participant's credit report after publication. If the balance remaining is on the low side it is of benefit to the Participant for SEMO to wait until Monday afternoon after the credit report has been issued (there is only one on a Monday) to issue the cash collateral refund, as this takes into consideration the trades of the weekend. This ensures that the Participant is not put in a breach position after the credit report has been completed.

The SEM Committee has also raised with SEMO the issue of contacting Participants in advance of an upcoming Letter of Credit expiry and requesting renewal. SEMO stated that they do usually contact Participants, as a courtesy reminder, in advance of upcoming expirations of Letters of Credit but there were a number of occasions recently, due to an administrative oversight, where the reminder emails did not issue. While the reminder emails will continue to be issued, SEMO considers the overall monitoring of upcoming Letter of Credit expiries is the responsibility of the Participant.

The SEM Committee will consider introducing a KPI around the issues discussed in this section for consultation as part of the next SEMO Price Control process.

4. Next Steps

The SEM Committee decision to reduce the Undefined Exposure Period to 7 days will be given effect via a determination from the Regulatory Authorities that the Single Suspension Delay Period is to be amended to 5 days. 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 SEM Committee will keep this matter under review and the Undefined Exposure Period will continue to be consulted upon annually as part of the Trading and Settlement Code parameters consultation.

Regarding the approval times for Letters of Credit, the SEM Committee encourages Participants and the Market Operator to work together to identify areas where efficiency improvements could be made, and suggests that Participants raise changes to such areas as Trading and Settlement Code Modifications as appropriate.