

# Transitional Credit Cover Provisions

# Background

- **Transition** from Part A (SEM) to Part B (I-SEM) arrangements
- Requires management of credit cover to **ensure principles** of full collateralisation are **maintained** throughout .....while **minimising duplication of credit cover**
- **Balance of risk and cost**
  - Risks: insufficient collateral to cover payment default leading to bad debt
  - Costs : peoples time, cost of having collateral in place (cash/LC), fees for cash collateral accounts and letters of credit setup and maintenance
- **Limited details in the Code** at present and some aspects can't work at all without amendment
  - e.g. Credit Assessment Price
- Looking for **workable solution** to Transitional Credit Cover Provisions

# Magnitude of the Transition

- Typical Required Credit Cover (RCC) for the Entire Market

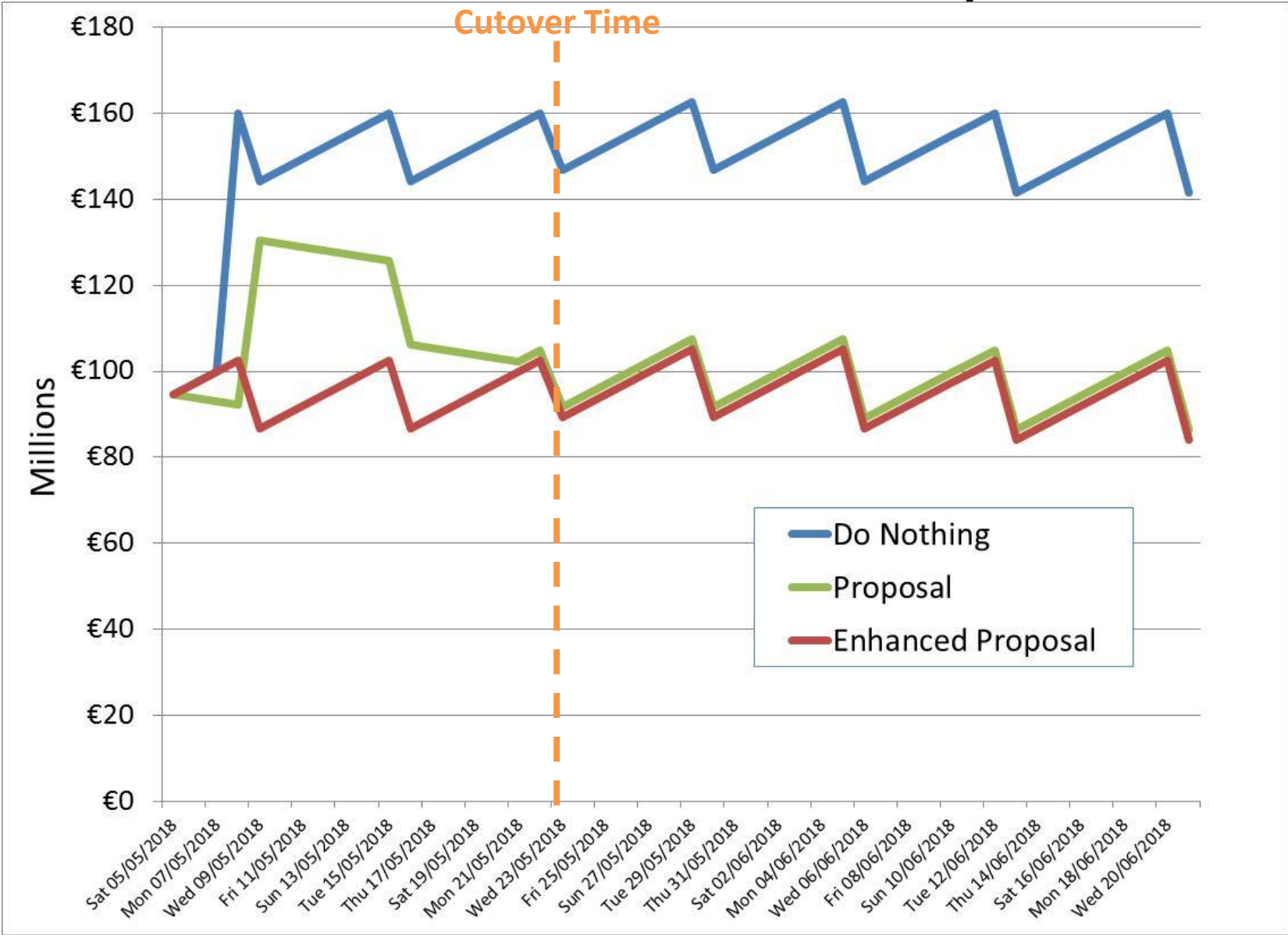
Credit Component	Typical %age	Total Market RCC
FCCR	~ 2%	~ 2 Million
Actual Exposure	~ 45%	~ 45 Million
UDE	~ 53%	~ 53 Million
<b>Total</b>	<b>100%</b>	<b>~ 100 Million</b>

- Typical Posted Credit Cover for the Entire Market ~ 200 Million

# Constraints

- Maintaining principle of **full collateralisation**
- **Apportioning** participant collateral to SEM and I-SEM arrangements in case of **bad debt**
- **Separate systems** for calculation of SEM/I-SEM credit cover
- **Differences in the entity models** between SEM/I-SEM and mapping Participants in SEM to I-SEM
- **Timelines for transfer** of money

# Entire Market (SEM + I-SEM) Required Credit Cover based on Option



# Do Nothing

- ✓ **Maintains SEM principles** of full collateralisation
- ✓ **Maintains physical split** of SEM and I-SEM moneys for **bad debt** scenarios
- ✓ **Duplication of credit cover** (~60% increase)
- ✗ **Long timelines for transfer** of cash collateral from SEM to I-SEM due to physical movement of monies
- ✗ Will receive **separate credit cover reports for SEM and I-SEM**
- ✗ **Significant effort in setup** of I-SEM specific collateral accounts, deeds of charge and Letters of Credit (LC) for Participants and SEMO
- ✗ **Separate Cash Collateral Accounts** for SEM/I-SEM
- ✗ **Separate LC** needed for SEM/I-SEM
- ✗ **Fixed Credit Cover Requirement duplicated**

# Modification Proposal

- ✓ **Maintains SEM principles** of full collateralisation
- ✓ **Maintains physical split** of SEM and I-SEM moneys for **bad debt** scenarios
- ✓ **Removes most of duplication of credit cover** except prior to Cutover Time
- ✗ **Long timelines for transfer** of cash collateral from SEM to I-SEM due to physical movement of monies
- ✗ Will receive **separate credit cover reports for SEM and I-SEM**
- ✗ **Significant effort in setup** of I-SEM specific collateral accounts, deeds of charge and Letters of Credit (LC) for Participants and SEMO
- ✗ **Separate Cash Collateral Accounts** for SEM/I-SEM
- ✗ **Separate LC** needed for SEM/I-SEM
- ✗ **Fixed Credit Cover Requirement duplicated**

# Emerging Thinking

An 'Enhanced' Proposal.....

- Has emerged between submission of the modification for Transitional Credit Cover Provisions [5<sup>th</sup> October] and today [19<sup>th</sup> October]
- **Uses the modification proposal as the basis** for transitional credit cover provisions
- **Mitigates duplication of collateral** with some additional interim arrangements around UDE and FCCR
- **Identifies ways to transfer collateral quickly** between the SEM and I-SEM while maintaining the manageability
- **Reduce the overheads of the transition** in terms of administration and operational effort for Participants and SEMO

*Note: Enhanced Proposal is subject to further legal consideration....but initial legal discussions indicate this is possible.*



# Enhanced Proposal

- ✓ Maintains SEM principles of **full collateralisation**
- ✓ **Maintains a ~~physical~~ **accounting split**** of SEM and I-SEM monies for **bad debt** scenarios
- ✓ **Removes ~~most of the~~ duplication** of collateral requirements
- ✓ **Removes the need to open **duplicate collateral accounts or LCs****
- ✓ **Minimises workload** for Participants/SEMO in managing collateral during transition
- ✓ **Faster ~~Longer~~ Timelines for transfer** of collateral from SEM to I-SEM
- ✗ Will receive **separate credit cover reports for SEM and I-SEM** [*same as other options*]
- ✗ May require some **effort** from Participants to **amend/resubmit existing documents** to cover both Parts A and B of TSC. [*still less than other options though*]
  - ✗ Currently references are only to Part A of the Code
    - For example:
      - ✗ Deeds of Charge
      - ✗ Letters of Credit
      - ✗ Authorisation instructions to assign collateral to I-SEM Participant or vice versa
- ✗ **Resourcing implication** for SEMO to allow for extra workload before and during transition [*still less than other options though*]

**Green** – additions from mod proposal  
**Black** – unchanged from mod proposal  
**Red** – removals from mod proposal

# Enhanced Proposal – Details 1

- Use agreed methodology to determine Credit Assessment Price (given lack of historical Imbalance Prices)
- Treat all Participants as ‘new’ and use forecasts of net imbalance volumes (generators), forecasts of future metering (suppliers)
- Initial Credit Cover for I-SEM communicated months in advance of Cutover Time
- ~~Post I-SEM credit cover at D-10WD as if ‘new’ participant~~
- ~~Wind Down Period for UDE~~ Maintain UDE in SEM until Cutover Time and then drop SEM UDE to zero and set I-SEM UDE to full at Cutover Time to minimise duplication of credit cover

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# Enhanced Proposal – Details 2

- Transfer credit cover from ~~separate~~ SEM to I-SEM using accounting rather than physical transfers ~~collateral accounts~~ at the most beneficial times and in a manageable way
  - Removes duplication of cash collateral and letters of credit
  - Batched transfers of collateral by next working day as only accounting transfer ~~5WD to process~~
    - First transfer: End of Day 22<sup>nd</sup> May 2018 based on:
      - SEM Posted Credit Cover – (FCCR + Actual Exposure + Traded not Settled)
    - Three further accounting transfers of credit cover after each “payment in” cycle from SEM to I-SEM
      - 23<sup>rd</sup> May, 30<sup>th</sup> May, 6<sup>th</sup> June 2018 based on SEM PCC – (FCCR + AE)
  - Must have instructions from SEM Participant to allow this, otherwise need to post new I-SEM collateral on D-10WD as for new Participants.

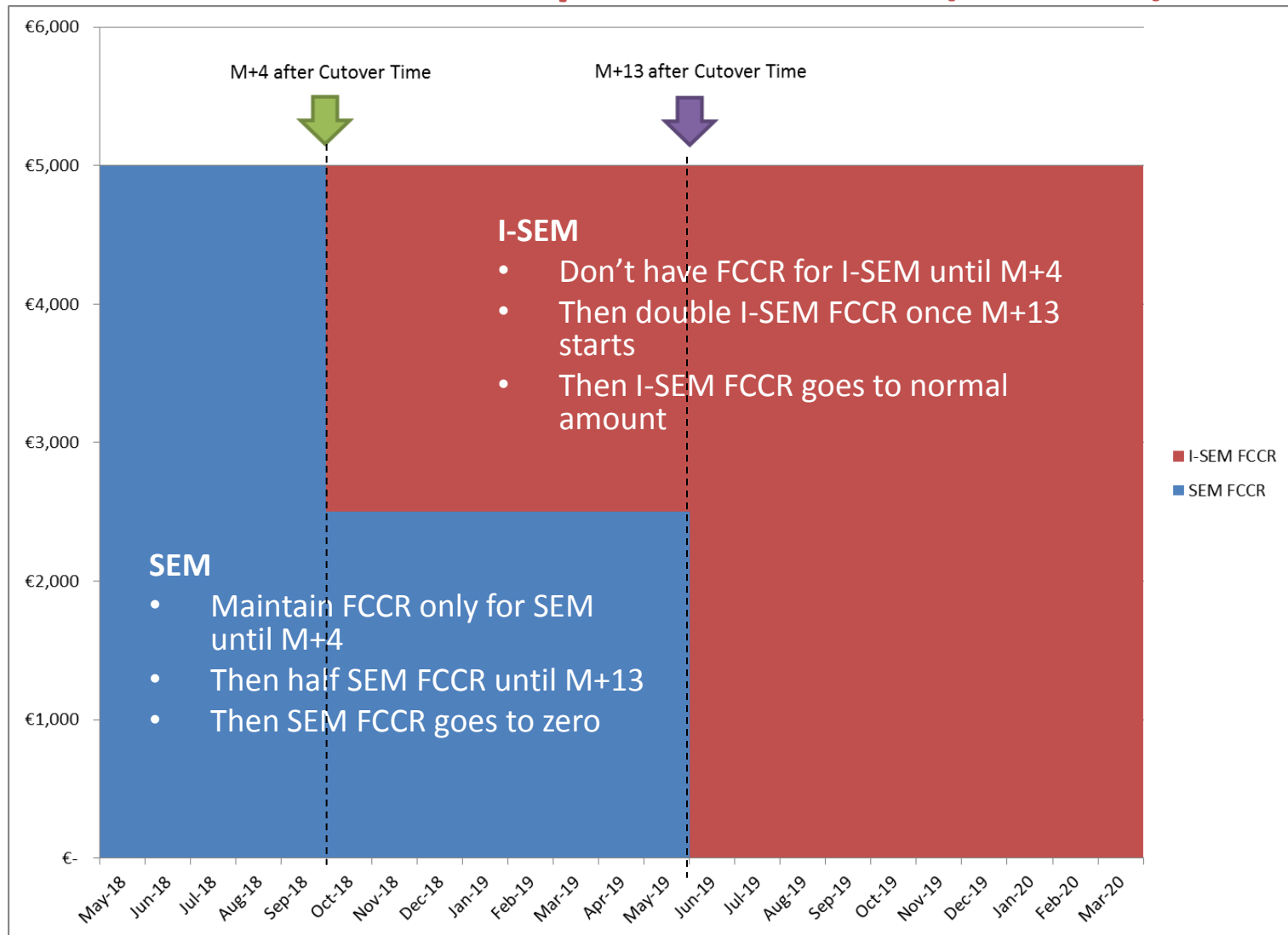
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# Enhanced Proposal – Details 3

- Rules in place to use other arrangements (SEM/I-SEM) credit cover in bad debt scenario
  - only if the other arrangements are not in bad debt as well.
- Use of Credit Cover Increase Notices where Initial Credit Cover for I-SEM is insufficient (normal process)

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# Enhanced Proposal – Fixed Credit Cover Requirement (FCCR)



# Enhanced Proposal - Timelines

Dec '17

- Enhanced **Modification Approved**

Jan to Mar  
'18

- **Submit Forecast volumes**
- **Calculate the Initial Credit Cover Requirements** a minimum of two months ahead of I-SEM Cutover Time
- **Deeds and Letter of Credit updates** make (if needed)
- **Instructions from SEM Participant** to allow transfers of surplus collateral to I-SEM Participant (and vice versa)

May to June  
'18

- SEMO to provide a facility on an interim basis to **perform accounting transfers of surplus** cash collateral or LC amounts **from SEM to I-SEM posted credit cover**

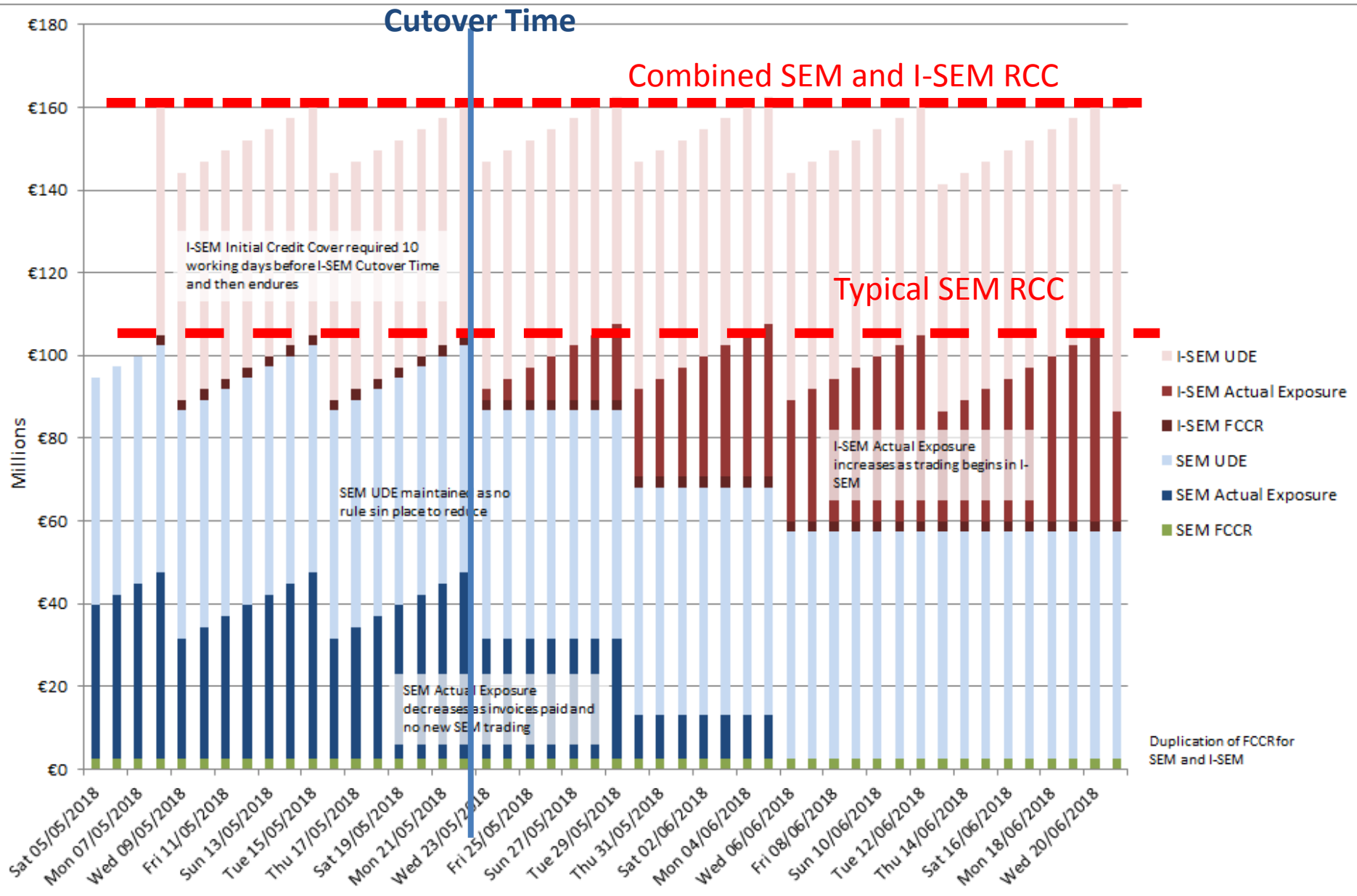
# Next Steps

- Agreement on Principles (today)
- Legal Drafting of Enhanced Proposal (Nov)
- Approval of Enhance Proposal (Nov/Dec)
- Implementation (Jan-May)

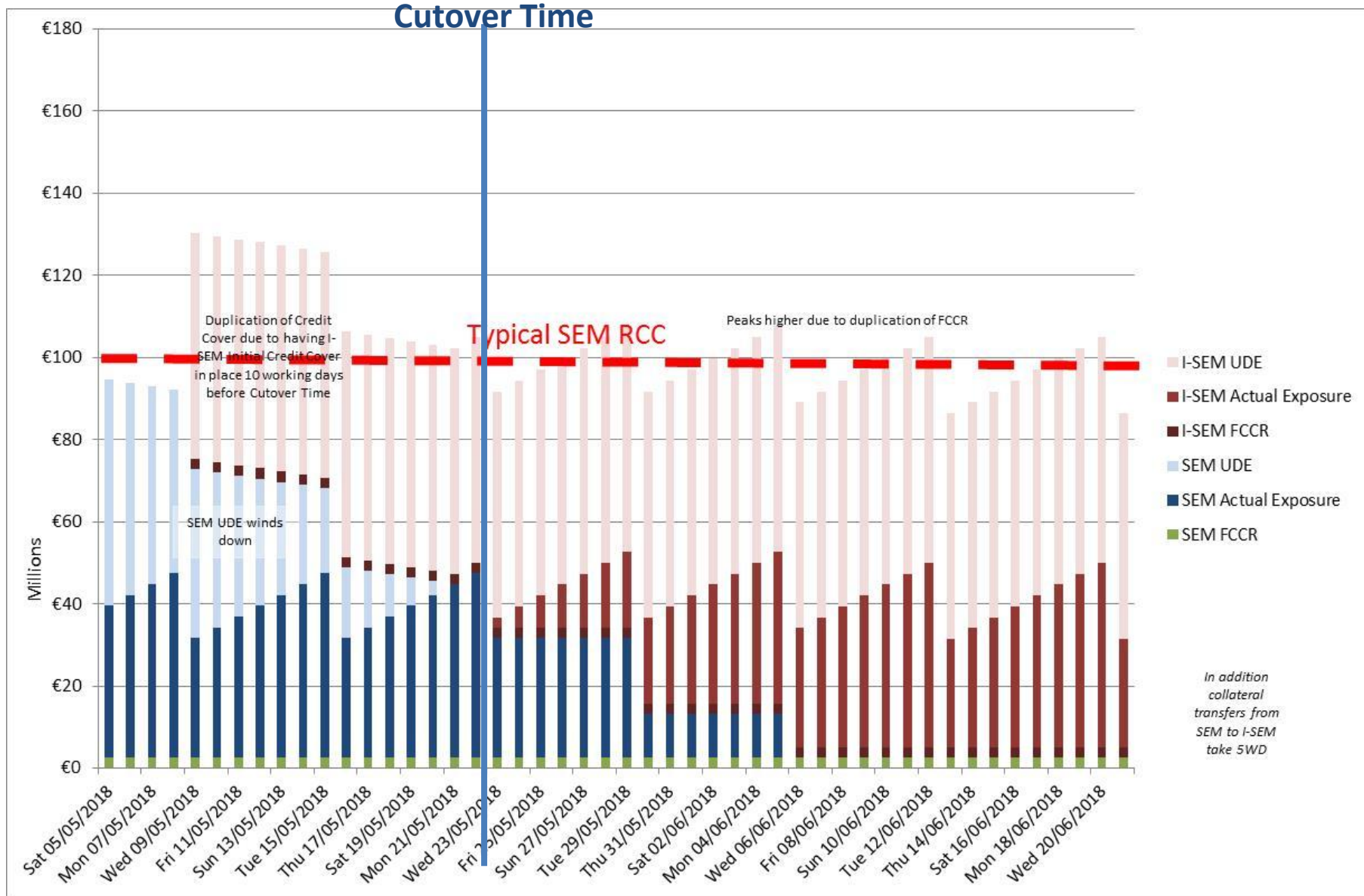
# Appendices



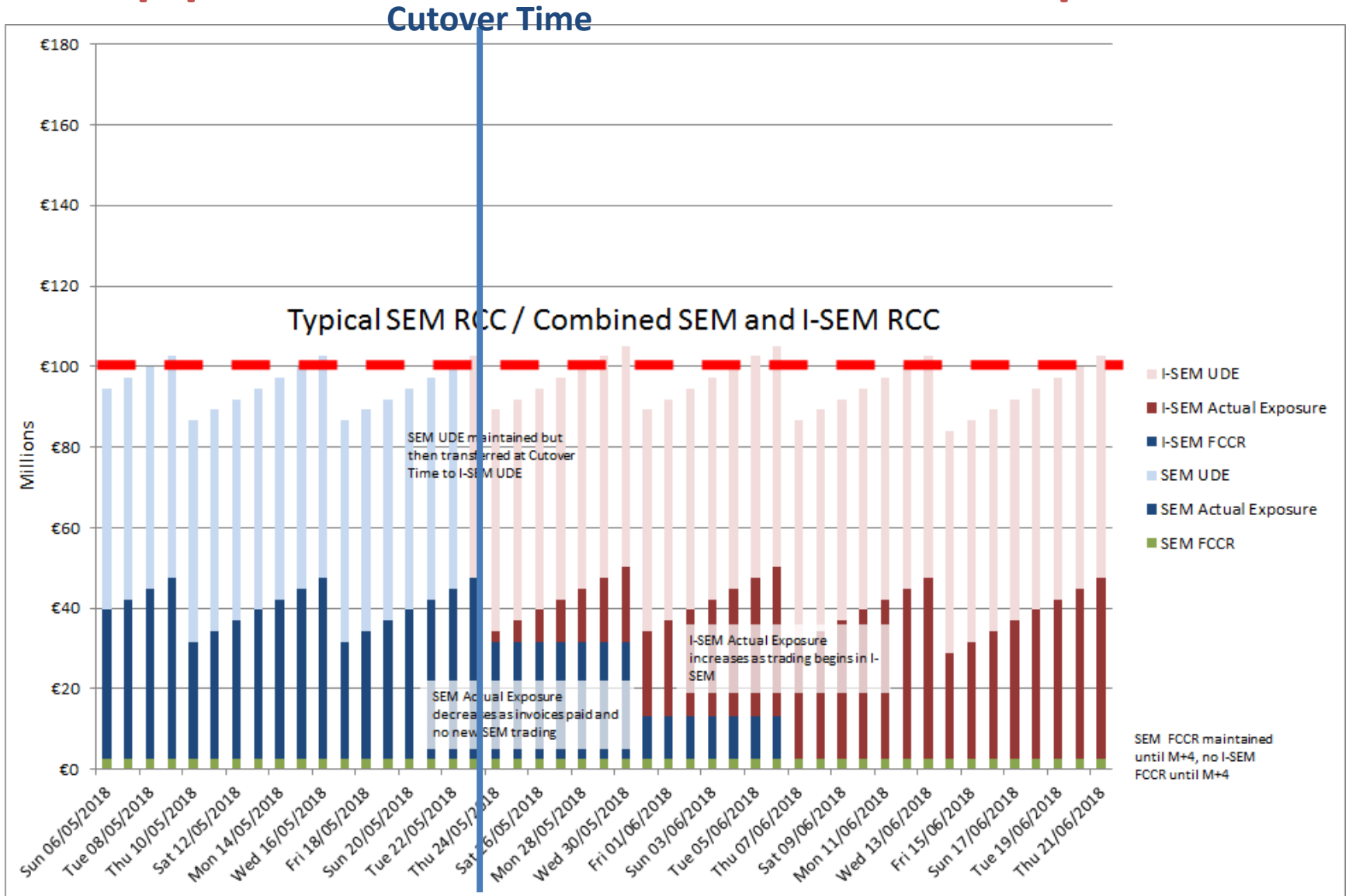
# Appendix A: If we do nothing...



# Appendix B: Modification Proposal



# Appendix C: Enhanced Proposal



# Appendix D: Modification Proposal - Details

- Use **agreed methodology** to determine **Credit Assessment Price** given lack of historical Imbalance Prices
- **Treat all Participants as 'new'** and use forecasts of net imbalance volumes (generators), forecasts of future metering (suppliers)
- Initial Credit Cover for I-SEM communicated a number of months in advance of Cutover Time
- Post **I-SEM credit cover at D-10WD** as if 'new' participant
- **Wind Down Period for Undefined Exposure Period (UDE)** to minimise duplication of credit cover
- **Transfer collateral** from separate SEM to I-SEM collateral accounts at the most beneficial times and **in a manageable way**
  - Batches and 5WD to process