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| **MODIFICATION PROPOSAL FORM** | | | | | |
| **Proposer**  *(Company)* | **Date of receipt**  *(assigned by Secretariat)* | | **Type of Proposal**  *(delete as appropriate)* | | **Modification Proposal ID**  *(assigned by Secretariat)* |
| **SEMO** | **5th October 2017** | | **Provisional** | | **Mod\_06\_17** |
| **Contact Details for Modification Proposal Originator** | | | | | |
| **Name** | | **Telephone number** | | **Email address** | |
| **Christopher Goodman** | |  | | **Christopher.Goodman@sem-o.com** | |
| **Modification Proposal Title** | | | | | |
| **Transitional Credit Cover Provisions** | | | | | |
| **Documents affected**  *(delete as appropriate)* | | **Section(s) Affected** | | **Version number of T&SC or AP used in Drafting** | |
| **T&SC Part A/Part B/Part C [TBC]**  **Agreed Procedures Part A/Part B [TBC]** | | **TBC** | | **Version 20** | |
| **Explanation of Proposed Change**  *(mandatory by originator)* | | | | | |
| *It is recommended to read the “Modification Proposal Justification” section of this proposal to provide the context for its submission prior to reading this section on the explanation of the proposed changes.*  **Objective of the Proposal**  This proposed change seeks to provide a workable solution to how credit cover will be managed during the transition from the TSC Part A (SEM) to the TSC Part B (I-SEM) arrangements. It seeks to clarify the timelines, activities, calculation methodologies and credit cover calculations for this transition.  The term ‘Transitional Credit Cover Provisions’ is used throughout this modification proposal to refer the transitional arrangements for credit cover.  The proposal aims to ensure:   * The appropriate levels of credit cover are maintained, in line with the full collateralisation principles of the SEM. * That practical and plausible implementation of the transitional arrangements is achieved given the timelines, effort and legal considerations. * Participants have a clear understanding of how transitional credit cover requirements will be determined, and what and when they will be need to do in order to meet these requirements.   Generally speaking the collateral requirement in the SEM will decrease as the SEM arrangements wind down[[1]](#footnote-1) and increase for I-SEM from the Initial Credit Cover Requirement (ICCR) at I-SEM go-live through to the first capacity settlement.  **Considerations**  There are a number of considerations in looking to define Transitional Credit Cover Provisions. The main ones are outlined below:  ***Legal***  Based on legal opinion, SEMO have been advised to avoid the “commingling” of collateral funds as an important safeguard for SEMO in fulfilling its duties as trustee under the TSC. In addition commingling raises concerns over the apportioning of collateral to SEM or I-SEM arrangements in the case of default. Therefore, Participants will be required to maintain separate letters of credit (LC) and/or cash collateral accounts for the SEM and I-SEM.  ***Entity Setup***  The mapping of participants in the SEM and I-SEM and therefore the assignment of financial obligations between I-SEM and SEM participants is not explicit, due to:   1. Parties amending their participant setup in the I-SEM either through forced changes due to the new I-SEM entity model, or through their own requested changes 2. Differences in Settlement Reallocation Agreements between Participants in the SEM and I-SEM arrangements meaning different financial obligations being present in each set of arrangements.   ***Systems and Process***  The systems and processes used for the calculation of credit cover for the SEM and I-SEM are separate and distinct. They both rely on different inputs and different systems for calculation and publication.  Attempting to merge these processes and arrive at combined credit cover requirement, for what is a short transitional period, is not seen as practical given the system, resourcing and increased risks of error in such an approach. This impact is likely to be applicable to both Participants and the Market Operator who will need to operate under both arrangements.  **Implications**  The implications are that Participants will need to:   1. Maintain their existing SEM LC’s or SEM cash collateral accounts for 13 months from the I-SEM go-live to cover the SEM collateral requirements (all be it at minimum fixed credit cover requirement (FCCR) levels) 2. Setup new LC’s or cash collateral accounts for the I-SEM in advance of the I-SEM go-live 3. Potentially look to transfer collateral from the SEM to I-SEM in an efficient way as the collateral requirements of the SEM decrease and those of the I-SEM increase.   This will require a number of activities to be performed by Participants, SEMO, and the SEM Bank in order to ensure credit cover requirements are met.  **Calculation of I-SEM Initial Credit Cover Requirements**  SEMO must calculate and provide each Participant with their Initial Credit Cover Requirement (ICCR) well ahead of the I-SEM go-live to ensure Participants have sufficient time to organize for the required collateral to be put in place.  While there are rules for classifying Participants as ‘New’ or ‘Adjusted’ Participants under the TSC Part B (I-SEM), in order to calculate ICCR the equations are reliant on the existence of historical imbalance prices to determine the applicable Credit Assessment Price (CAP). Because there is no historical basis for the Imbalance Price a methodology for determining the initial CAP is needed.  **Proposed Approach**  The proposed approach, with broad timelines indicated, is provided below.  **Appendix A** accompanying this Modification Proposal provides a more detailed draft of the timeline proposed for the activities related to the Transitional Credit Cover Provisions. This is provided as indicative only and is subject to confirmation with the SEM Bank and other parties involved. The intention would be to include this timeline as part of the published Transitional Registration Plan in order to provide Participants with a clear indication of the timelines they would need to adhere to.  **Modifications to make Credit Cover Requirements work during the Transitional Period**  The following provides a description of the elements of the proposal that look to amend - temporarily - the enduring TSC provisions to make them implementable as Transitional Credit Cover Provisions.  These elements include:   * A methodology for determination of the Credit Assessment Price * A methodology for determination and use of Forecast Volumes * A procedure for the transfer of collateral from SEM to I-SEM Cash Collateral Accounts   ***Methodology for Determination of Credit Assessment Price***  As mentioned, there will be no historical Imbalance Prices to use for the determination of the Credit Assessment Price, although all other inputs to the Credit Assessment Price should be known by February 2018.  Calculation of a forecast Imbalance Price is an extremely subjective topic and one that could be debated for many months or years. However, the proposal looks at a pragmatic approach which utilises the existing SEM Shadow Price information as a basis for the calculation of forecast Imbalance Prices. This is based on the premise that shadow prices could be considered a defacto for the incs and decs that are to be used in the I-SEM balancing market as they are both based on a Bidding Code of Practice.  The suggested methodology is described below and entails using historical shadow prices to forecast imbalance prices from the I-SEM Cutover Time, then applying the standard methodology in the TSC to determine a Credit Assessment Price, and then using this Credit Assessment Price for the first 100 days of the I-SEM to provide stability and certainty to Participants on their credit cover requirements. The specific steps are:   1. Using previous years (Oct 2016 to Sept 2017) daily average historical Shadow Price curve determine the normalized curve for a year based on available ‘to date’ information for the current year to Feb 2018 (Oct 2017 to Feb 2018). 2. Based on this obtain a forecast daily average shadow price curve for the period for the 100 days (Historical Assessment Period) up to the planned 23rd May I-SEM go-live date. 3. Use this forecast daily average price curve to determine the relevant daily average Imbalance Prices while setting any values above the strike price equal to the strike price. 4. Calculate the Credit Assessment Price PCAg (with its associated safety factor) based on G 14.2.5 5. Calculate the Combined Credit Assessment Price CCAPg using the PCAg values and other related inputs, including: Capacity Payment/Charge Price, Residual Error Volume Charge, Imperfections Charge Price and the Currency Cost Charge based on G 14.2.6 6. Apply the Combined Credit Assessment Price for the duration of the first 100 days of the I-SEM until a full historical assessment period (currently set at 100 days) has elapsed.   ***Methodology for Determination of Forecast Volumes***  Given the nature of the I-SEM design the use of historical volumes for the determination of ICCR is not considered practical and/or appropriate. For example, I-SEM Generator standard credit cover calculations for the future exposure are based on historical ‘daily amounts’. These relate to the SEM where all volumes are going through the Ex-Post market. However, for the I-SEM the volumes going through the TSC settlement will only be for balancing actions or imbalance settlement. Hence reliance on the ‘daily amounts’ from the SEM is not appropriate.  Therefore, it is seen as appropriate for simplicity, transparency and efficiency to classify all units as ‘new’ for the I-SEM and request forecast volumes from Participants that can be used for calculation of the ICCR and also for the initial period of the I-SEM until sufficient historical information is available.  ***Procedure for Transfer of Collateral from SEM to I-SEM Cash Collateral Accounts***  To aid in the efficient use and transition of collateral from the SEM to I-SEM arrangements, SEMO are proposing to provide an interim facility to assist in these transfers. This will remove the need for Participants to request cash collateral refunds to go into their own bank accounts (which can take up to 5WD) and then in turn transfer this same money into their I-SEM cash collateral accounts (which typically can take up to 2WD to lodge). The proposal is that Participants could provide a formal written instruction to SEMO that any refunds they request (once approved) are moved into the corresponding I-SEM Cash Collateral Account directly.  There are in excess of 150 cash collateral accounts in the SEM at present. However, approximately 40 of these relate to Suppliers who are most likely to have excess cash collateral once the SEM starts to wind down. Generator only Participants are not expected to be able to avail of this facility to the same degree as they will only have posted the FCCR for the SEM which would still need to be held in place for 13 months after the I-SEM Cutover Time.  Given the numbers involved, SEMO are proposing to include interim arrangements for the 2 weeks either side of the I-SEM Cutover Time where weekly batches of refunds (or transfers to I-SEM cash collateral accounts if instructed) are processed.  The Participant would have to previously provided written instructions to transfer any refunds to the associated I-SEM cash collateral account. Participants would then submit a refund request stating the amount they wish to have refunded by 5pm each Wednesday (after the credit report has been issued and invoice payments have been made for the week). SEMO would then validate, approve and transfer the requested amount within 5WD at the latest (potentially earlier). This would reduce the time to transfer amounts between SEM and I-SEM cash collateral accounts by at least 2WD.  Similar arrangements are proposed for Letter of Credit (LC) cancellations or reductions in LC value.  Participants would submit the request to change or cancel a LC via the normal process, but for the interim arrangements - for the 2 weeks either side of the I-SEM Cutover Time - these requests would be batched up. Any requests submitted by 5pm each Wednesday (after the credit report has been issued and invoice payments have been made for the week) would be validate and approve within 2WD at the latest (potentially earlier). | | | | | |
| **Legal Drafting Change**  *(Clearly show proposed code change using* ***tracked*** *changes, if proposer fails to identify changes, please indicate best estimate of potential changes)* | | | | | |
| The following provides a summary of the modifications needed to the TSC to accommodate the proposed Transitional Credit Cover Provisions.  Once the general principles are agreed, a detailed drafting of the legal drafting changes will be undertaken.  The majority of changes are expected to be included in TSC Part C Transitional Arrangements, although as part of the formal legal drafting further consideration to the placement of the changes will be made. This may include updates to the TSC Part A/B and/or Part A/B Agreed Procedures.  The identified changes are:   1. Wind down of Undefined Exposure Period (UDE) for SEM collateral calculations the I-SEM Cutover Time is approached. [Potentially to go in TSC Part A Section 8 Transitional Arrangements]. 2. Wind down to have the last Energy Week and Capacity Month end on the day before the I-SEM Cutover Time, with invoicing and payments for these performed within 2 weeks - in line with the Energy settlement calendar (meaning the last Capacity Period would be billed early than normal as it is only for a partial month). [Potentially to go in TSC Part A Section 8 Transitional Arrangements]. 3. SEMO to publish timeline for transitional credit cover activities in Transitional Registration Plan. 4. The ICCR for I-SEM Cutover Time needs to use forecast volumes for both generators and suppliers. [References to negate for the transition G.14.7.3 for Suppliers using metered demand and G.14.7.6 for generators using ‘historical amounts’]. 5. Ability for SEMO to reject the forecast volumes if they are deemed to be unrealistic and cannot be substantiated by the Participant submitting them, and to determine substitutes for these forecast volumes where this occurs. 6. Provision to use same calculation of ICCR as is used for ‘new’ Participants [to make it explicit that Participants that are joining the I-SEM arrangement will be classified as ‘new’ . 7. Define 14 weeks from I-SEM Cutover Time as the date SEMO will aim to publish ICCR, assuming all inputs e.g. relevant charges are approved etc.. 8. Explicit timelines for having I-SEM collateral posted (based on the normal 10 WD deadline as used in the normal process of establishing collateral as a new Participant). 9. Methodology for calculation of initial Capacity Assessment Price given lack of historical Imbalance Prices. 10. Add the ability to request that refunds of collateral go to an I-SEM cash collateral account rather than back to the ‘normal’ bank account of the Participant, once SEMO are provided with formal instruction to do so. 11. Rules in place for the cutover period to batch up requests for refunds of cash collateral during the period 2 weeks before I-SEM Cutover Time until 2 weeks after I-SEM Cutover Time – with one batch per week. This is to avoid ~40 requests each and every working day needing to be processed by SEMO. Suggestion is that requests need to be in by Wednesday 5pm (after credit report has been issued and invoice payments in have been made). Transfers executed within 5 WD [as defined under AP9 Section 3.4 Step 14] 12. Rules in place for the cutover period to batch up request for refunds of LC’s or amendments to values during the period 2 weeks before I-SEM Cutover Time until 2 weeks after I-SEM Cutover Time – with one batch per week. This is to avoid ~40 requests each and every working day needing to be processed by SEMO. Suggestion is that requests need to be in by Wednesday 5pm (after credit report has been issued and invoice payments in have been made. LC amendments or cancellations executed within 2 WD [as defined under AP9 Section 3.4 Step 8 & 11 | | | | | |
| **Modification Proposal Justification**  *(Clearly state the reason for the Modification)* | | | | | |
| **Why is the Modification being raised?**  With the focus on the completion and approval of the main body of the TSC Part B (I-SEM arrangements) combined with, at the time, a lack of clarity on the transitional arrangements for credit cover, there is limited detail provided in the TSC on how SEM credit cover requirements will be managed during the transition from the TSC Part A (SEM) to TSC Part B (I-SEM) arrangements.  In addition there are certain elements of the enduring TSC that do not cater, without amendment or addition, for the initial start of the I-SEM arrangements when certain information may not be available. For example, use of historical Imbalance Prices for the calculation of the Credit Assessment Price.  Participants have also become increasingly interested in what the Transitional Credit Cover Provisions are going to be in order to allow planning, preparation and compliance with the requirements.    This modification provides a proposal to clarify the timelines, activities, calculation methodologies and credit cover calculations over the transitional period.  **Why a Provisional Modification?**  This modification has been raised as a “provisional” modification to enable the confirmation of the principles proposed for the Transitional Credit Cover Provisions before a detailed drafting of the TSC changes is made.  This is in a similar vein to the plain English documents used as a tool for the development of the I-SEM TSC.  The modifications intention is to ensure:   * clarity of the principles to be used without getting bogged down in the detailed legal wording * efficient use of resources to avoid time and effort being wasted on detailed drafting before the principles are agreed. | | | | | |
| **Code Objectives Furthered**  *(State the Code Objectives the Proposal furthers, see Section 1.3 of T&SC for Code Objectives)* | | | | | |
| This Modification proposal aims to further the Code Objectives under the T&SC , specifically the elements shown in bold below.  (1) to **facilitate the efficient discharge** by the Market Operator of the obligations  imposed upon it by its Market Operator Licences;  (2) to **facilitate the efficient, economic and coordinated operation**, administration  and development of the Single Electricity Market **in a financially secure**  **manner;**  (5) to **provide transparency in the operation** of the Single Electricity Market; | | | | | |
| **Implication of not implementing the Modification Proposal**  *(State the possible outcomes should the Modification Proposal not be implemented)* | | | | | |
| The implications of not implementing transitional arrangements include:   1. Participants will need to maintain SEM collateral at levels higher than what is actually needed 2. The I-SEM may not be collateralized appropriately (given Credit Assessment Prices will not be able to be calculated as historical Imbalance Prices are not available) leading to increased risks of bad debt to Participants 3. Participants having limited time to put in place Initial Credit Cover Requirements for the I-SEM arrangements | | | | | |
| **Working Group**  *(State if Working Group considered necessary to develop proposal)* | | | **Impacts**  *(Indicate the impacts on systems, resources, processes and/or procedures; also indicate impacts on any other Market Code such as Capacity Marker Code, Grid Code, Exchange Rules etc.)* | | |
| In order to provide clarity and certainty to Participants about the Transitional Credit Cover Provisions, and allow sufficient time for Participants to prepare financing and account setups, it is proposed that the focus be on using this proposal as a basis for the final modification. As such, we suggest that any amendments made to the proposal should be done via direct interaction at the Modifications Committee, rather than progressing via a separate working group which may take considerably more time and effort. | | | Based on the proposal, there may be impacts during the transitional period requirements around managing collateral, requesting and processing refunds or transfer. Although some of these may appear as negative impacts, the alternative options are less palatable.  Impacts may include:   * SEMO and Participant processes and procedures * SEMO and Participant resourcing | | |
| ***Please return this form to Secretariat by email to*** [***modifications@sem-o.com***](mailto:modifications@sem-o.com) | | | | | |

Apprendix A: Activities and Timelines

The table below provides the proposed timeframes and deadlines for completion of tasks related to the transitional collateral provisions.

|  |  |  |  |
| --- | --- | --- | --- |
| **Timing** | **Activity** | **Owners** | **Notes** |
| 20th Oct 2017 | Confirm application forms and supporting information with SEM Bank | SEMO and SEM Bank |  |
| 1st Nov 2017 | Issue timeline for I-SEM Transitional Collateral plan | SEMO |  |
| 1st Nov 2017 | Publish I-SEM cash collateral opening form, and deed of charge template (from TSC), and template for instructions to transfer collateral refunds from SEM to I-SEM cash collateral accounts. | SEMO |  |
| 15th Jan 2018 | Submit I-SEM cash collateral opening forms and supporting information to SEMO | Participants |  |
| 15th Jan 2018 | Deeds of Charge completed and submitted to SEMO | Participants | 150+ deeds potentially |
| 30th Jan 2018 | Deeds of Charge validated and approved | SEMO | 150+ deeds potentially |
| 1st Feb 2018 | SEMO complete submission of I-SEM cash collateral opening forms to SEM Bank | SEMO | 150+ accounts may need opening |
| 1st Feb 2018 | Deadline for submission of updated balancing market forecast volumes | Participants |  |
| 15th Feb 2018 | All required tariffs for payments and charges approved | Regulatory Authorities | Includes:  Imperfections, Residual Error Volume, Currency Cost, Capacity Payment/Charge Price.  + Exchange Rate |
| 15th Feb 2018 | SEMO confirm Credit Assessment Price based on Imbalance Price forecast methodology and other approved tariff values | SEMO |  |
| 28th Feb 2018 | Publishing to Participants of their calculated ICCR | SEMO | Would also provide estimates of increase in collateral requirements over the subsequent weeks/months recommendation would be to consider this collateral rather than receiving a Credit Cover Increase Notice (CCIN) on the first data of the I-SEM |
| 1st Mar to ~9th May 2018 | Obtain financing for ICCR | Participants |  |
| 30th Mar 2018 | Cash collateral accounts opening complete and notified to Participants | SEM Bank, SEMO | 150+ accounts may need opening [143 in SEM at present] |
| 13th April 2018 | Deadline for submission of instructions to transfer excess SEM cash collateral to the equivalent I-SEM | Participants |  |
| 27th April 2018 | Instructions for transfers of cash collateral validated and approved | SEMO |  |
| 8th May 2018 | SEM collateral requirements start to reduce. | SEMO | SEM collateral starts to reduce as Undefined Exposure Period (UDE) starts to decrease to zero for I-SEM go-live |
| 8th May to ~ 7th June | Requests to refund SEM collateral as requirements reduce (and transfer to I-SEM – where instructions to do so are already confirmed) | Participants | Suggestion is transitional rules in place to allow SEMO to batch these requests in to weekly rather than daily requests [existing timelines 5WD cash collateral refund, 2WD Letter of Credit reduction in value] |
| 11th May 2018 | 10WD before I-SEM go-live, Participants must have submitted and had approved I-SEM collateral to cover their ICCR | Participants | Minimum of 2WD to validate LC  Minimum of 1 WD to lodge cash collateral |

Notes: Dates related to SEM Bank timelines still subject to confirmation

**Notes on completing Modification Proposal Form:**

1. **If a person submits a Modification Proposal on behalf of another person, that person who proposes the material of the change should be identified on the Modification Proposal Form as the Modification Proposal Originator.**
2. **Any person raising a Modification Proposal shall ensure that their proposal is clear and substantiated with the appropriate detail including the way in which it furthers the Code Objectives to enable it to be fully considered by the Modifications Committee.**
3. **Each Modification Proposal will include a draft text of the proposed Modification to the Code unless, if raising a Provisional Modification Proposal whereby legal drafting text is not imperative.**
4. **For the purposes of this Modification Proposal Form, the following terms shall have the following meanings:**

**Agreed Procedure(s): means the detailed procedures to be followed by Parties in performing their obligations and functions under the Code as listed in either Part A or Part B Appendix D “List of Agreed Procedures”. The Proposer will need to specify whether the Agreed Procedure to modify refers to Part A, Part B or both.**

**T&SC / Code: means the Trading and Settlement Code for the Single Electricity Market. The Proposer will also need to specify whether all Part A, Part B, Part C of the Code or a subset of these, are affected by the proposed Modification;**

**Modification Proposal: means the proposal to modify the Code as set out in the attached form**

**Derivative Work: means any text or work which incorporates or contains all or part of the Modification Proposal or any adaptation, abridgement, expansion or other modification of the Modification Proposal**

**The terms “Market Operator”, “Modifications Committee” and “Regulatory Authorities” shall have the meanings assigned to those terms in the Code.**

**In consideration for the right to submit, and have the Modification Proposal assessed in accordance with the terms of Section 2 of Part A or Chapter B of Part B of the Code (and Part A Agreed Procedure 12 or Part B Agreed Procedure 12) , which I have read and understand, I agree as follows:**

**1. I hereby grant a worldwide, perpetual, royalty-free, non-exclusive licence:**

* 1. **to the Market Operator and the Regulatory Authorities to publish and/or distribute the Modification Proposal for free and unrestricted access;**
  2. **to the Regulatory Authorities, the Modifications Committee and each member of the Modifications Committee to amend, adapt, combine, abridge, expand or otherwise modify the Modification Proposal at their sole discretion for the purpose of developing the Modification Proposal in accordance with the Code;**
  3. **to the Market Operator and the Regulatory Authorities to incorporate the Modification Proposal into the Code;**

**1.4 to all Parties to the Code and the Regulatory Authorities to use, reproduce and distribute the Modification Proposal, whether as part of the Code or otherwise, for any purpose arising out of or in connection with the Code.**

**2. The licences set out in clause 1 shall equally apply to any Derivative Works.**

**3. I hereby waive in favour of the Parties to the Code and the Regulatory Authorities any and all moral rights I may have arising out of or in connection with the Modification Proposal or any Derivative Works.**

**4. I hereby warrant that, except where expressly indicated otherwise, I am the owner of the copyright and any other intellectual property and proprietary rights in the Modification Proposal and, where not the owner, I have the requisite permissions to grant the rights set out in this form.**

**5. I hereby acknowledge that the Modification Proposal may be rejected by the Modifications Committee and/or the Regulatory Authorities and that there is no guarantee that my Modification Proposal will be incorporated into the Code.**

1. The “wind down” referred to in the SEM is due to the SEM future exposure decreasing to zero up to the I-SEM go-live and the collateral needing to be held also decreasing further as invoices are paid. Within 2 weeks of the I-SEM go-live participants’ collateral requirements for the SEM arrangements will reduce down to the Fixed Credit Cover Requirement (FCCR) which covers the resettlement for M+4 and M+13. This FCCR will need to be maintained for the SEM arrangements until M+14. [↑](#footnote-ref-1)