Energy for generations

ESB Generation and Trading's Response to the SEM Committee's Consultation on Changes to Reduce Collateral Requirements in the Balancing Market

(SEM-22-024)

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1. INTRODUCTION

ESB Generation and Trading (GT) welcomes the opportunity to respond to the SEM Committee (SEMC) consultation paper on 'Changes to Reduce Collateral Requirements in the Balancing Market' (SEM-22-024)[1]. Increases in electricity pricing which has been caused by volatility in the fuel markets, has led to an increase in collateral requirements on participants. Given this volatility, it is appropriate to review processes which can help reduce this exposure and ease the burden on participants of covering the cost of this extra Credit Cover. The below response includes an executive summary of ESB GT's views along with answers to the 5 questions in the consultation paper.

2. EXECUTIVE SUMMARY

ESB GT welcomes the SEMC's review on collateral requirements in the BM and agrees with the SEMC's proposals of reducing the Single Suspension Delay Period (SSDP) to 5 days from 7, which will in-turn reduce the Undefined Exposure Period by 2 days to 7 days. Over the past year external factors, outside of the control of participants, have caused volatility in the fuel markets and an increase in electricity prices which resulted in significant increases in Credit Cover. The reduction in the SSDP would be a beneficial step towards reducing the Credit Cover that is required to be posted by market participants. Without these amendments, high collateral requirements will continue to be an excess burden on participants as they face additional costs to put this Credit Cover in place.

Reducing the timeframe by 2 days does present an additional challenge of increasing the risk of bad debt in the BM. While reducing this timeframe by 2 days is welcomed and is acknowledged that this can lead to an increased risk of bad debt, this challenge should not be left un-mitigated. In order to address this risk, assurance from the Regulatorily Authorities that timeframes will be committed too by them and not leave generators exposed to bad debt is required.

The paper also seeks views on the reasoning behind participants posting extra Credit Cover above their requirements. While comments cannot be made on behalf of other participants experiences, volatility in the fuel markets as well of approval times for Letters of Credit are certainly potential factors in any decisions made. Volatility has caused substantial swings in Credit Cover Requirements over the past year and participants may look to ensure an adequate margin of cover is put in place to ensure compliance in this dynamic landscape. Sharp increases in collateral requirements, due to the volatility, can happen at an expediated rate and if Letters of Credit are not approved within a timeframe to meet this requirement, then participants may risk being non-compliant and in accordance with Agreed

[1] SEMC-22-024 Consultation on changes to reduce BM collateral.pdf (semcommittee.com)

Procedure 9[2], Management of Credit Cover Requirements (Step 8), be issued with a Default Notice and steps for Suspension initiated (Procedure 18).

A potential solution would be the tightening of the approval procedure for Letters of Credit. Currently in Agreed Procedure 9, there is a timeframe of 4 working days to submit a Letter of Credit, with evidence of eligibility, prior to the period that the Letter of Credit is required for. While this timeframe may seem like a short process, it should also be taken into consideration that it may also take several days prior to this to agree a Letter of Credit with an eligible Credit Cover Provider

3. RESPONSES TO CONSULTATION 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?

Yes, ESB GT would agree with the SEMC's proposals to amend the Single Suspension Delay Period to 5 days. This would be a beneficial step towards reducing the Undefined Exposure Period which in turn will help reduce the Credit Cover that is needed during this volatile period of fuel prices. However, this 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 5 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?

Unfortunately, participants are not in the position to determine the trade off as the information isn't available to do the assessment. In the recent year there have been a number of suppliers who have left the market[3]. Would the Regulatory Authorities been able to meet the 5 or 7 day requirement during these events and if not what would the bad debt exposure be to the market?

An increase of risk on any participant is something that should never be taken lightly and should be mitigated against wherever possible. While it can be agreed that reducing the timeframe by 2 days is a welcomed outcome and is acknowledged that this has the potential to increase the risk of bad debt, it should be done so alongside preventative measures. Any additional risk that is caused by reducing

[2] https://www.sem-o.com/rules-and-modifications/balancing-market-modifications/market-rules/Part-B-Agreed-Procedure-9-Management-of-Credit-Cover-and-Credit-Default.docx

[3] Third energy supplier pulls out of Irish market - Independent.ie

time periods should be adequately mitigated against through assurances from the Regulatory Authorities that timeframes will be committed too by them and not leave generators exposed to bad debt.

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?"

A view on why participants may be posting extra Credit Cover may be due to the volatility experienced in the fuel markets. This volatility has caused substantial swings in Credit Cover Requirements for electricity market participants over the past year. As these large increases have been experienced, participants may look to ensure an adequate margin of cover is put in place to ensure compliance in this dynamic landscape.

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?"

While comments cannot be made on behalf of other participants experiences, it is certainly a potential factor that may lead to participants requiring extra headroom. Sharp increases in Credit Cover due to the volatilities in the fuel markets can happen at an expediated rate and if Letters of Credit are not approved within a timeframe to meet this requirement, then participants may risk being non-compliant and in accordance with Agreed Procedure 9, Management of Credit Cover Requirements (Step 8), be issued with a Default Notice and steps for Suspension initiated (Procedure 18).

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)?"

The approval times for Letters of Credit could be shortened to assist with managing the collateral requirement and help reduce the margin ("headroom") of extra Credit Cover that may be posted by participants. Currently in Agreed Procedure 9, there is a timeframe of 4 working days for a Letter of Credit to be approved after submission and prior to the period that the Letter of Credit is required for.

While this timeframe may seem like a short process, it should also be taken into consideration that it may take several days prior to this to agree a Letter of Credit with an eligible Credit Cover Provider. Reducing this approval time would help to shorten the overall timeframe for a Letter of Credit to be put in place.