# Consultation on changes to reduce collateral requirements in the balancing market

## SEM Committee Consultation

## Power NI Response

8 June 2022

## Introduction

Power NI welcomes the opportunity to respond to the SEM Committee (SEMC) consultation regarding changes to reduce collateral requirements in the balancing market. The increased collateral burden has proved challenging, particularly given the current market volatility that participants are facing.

## Specific Questions

Within the Consultation Paper the SEMC posed a number of specific questions. Power NI has, as requested within the paper, responded to each in turn:

***Q1: 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?***

***Power NI response***:

Power NI are supportive of the proposal to amend the Single Suspension Delay Period to 5 days and reduce the Undefined Exposure period to 7 days.

***Q2: Do you agree that an increased risk of bad debt in the balancing market is an acceptable trade-off when weighted against the reduced collateral burden on all Participants in the market on an ongoing basis?***

***Power NI response:***

Power NI feel the risk of increased bad debt is minimal and significantly outweighed by the benefit of reducing the Undefined Exposure Period, and as a result supplier collateral requirements.

A reduction in the collateral burden, should assist in reducing the likelihood of a business facing financial difficulties, further mitigating the risk of bad debt.

It should also be recognised that the cost of collateral is ultimately paid by customers and therefore over collateralisation is an avoidable cost.

***Q3: 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?***

***Power NI response:***

Power NI considers over-collateralisation to be driven by a combination of market volatility, the limited time to remedy a CCIN and SEMO taking the maximum number of days to issue cash collateral refunds.

As a market participant, Power NI proactively forecast credit cover and post additional collateral during volatile periods to avoid a CCIN. Once a CCIN is issued, the current steps within Agreed Procedure 9 of the Trading and Settlement Code are onerous and automatically leads to over-collateralisation. Participants have 2 working days to remedy a CCIN, whilst SEMO have 5 working days to accept LoC changes and a further 5 working days to issue cash collateral refunds requests. As there is no guarantee the LoC will be accepted in time to close the CCIN; participants are left in a situation where they in effect must post cash until the LoC is formally accepted. Participants subsequently request return of the cash collateral which SEMO have 5 working days to process.

Power NI's experience is, despite confirming the refund request on Day1, SEMO wait until the 5th working day to issue the refund. From the beginning of the process, participants have double collateral for a period of 10 working days due to the acceptance and refund periods.

Power NI would welcome clarification on why collateral refunds are not issued in a timely manner i.e., within one or two working days, particularly when much larger sums of money are involved. Previous experience has shown that SEMO can issue same day refunds.

Power NI's view is that if the disjoin between the timescales for CCINs and LoCs was to be reviewed and refined, it could potentially reduce a large amount of extra credit cover being posted.

***Q4: 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?***

***Power NI response:***

Power NI strongly believes and has experienced the above statement to be correct. As stated above, there is a disjoin where participants must respond to a CCIN in 2 working days, SEMO have 5 working days to accept LoC changes and a further 5 working days to issue cash refunds. This is a key driver behind over-collateralisation.

Whilst Participants must respond to a CCIN within 2 working days, there is no guarantee the LoC will be accepted in time; therefore, participants are forced to take secondary action by posting cash. 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. This is a key difference to the situation prior to the I-SEM arrangements.

Assuming SEMO take 5 working days to accept the LoC and another 5 working days to issue cash collateral refunds, this is 10 working days those participants are double collateralised. In Power NI's experience the 5 working day acceptance window of the LoC can result in LoCs being rejected if they are no longer valid for 12 months depending on when SEMO review them.

Power NI would welcome further engagement around review of timelines for both CCIN and LoC.

***Q5: What are your views on the approval times for Letters of Credit generally? Are there any changes that could be made to the current market 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)?***

***Power NI response:***

Approval times are challenging and are having the biggest impact on credit cover. Whilst Power NI would welcome a review of the conditions set out in Agreed Procedure 9 regarding timescales, in the interim there are changes that could be made to the current approval process in order to meet the timescales as they currently are.

As SEMO is aware, it is common that banks on both sides can be slow to issue LoC details. In order to speed this process up, participants can escalate with their own banks and can provide copies of the amended LoC immediately. Being in receipt of this information earlier would allow SEMO's Finance team to start the due diligence and acceptance process much earlier. However, it is worth nothing that this option is only workable if the correct team reviews and approves the LoCs.

It is also vital that SEMO maintain a consistent approach with LoC renewals. Historically SEMO would have contacted participants in advance of an upcoming expiry and request renewal, but this process has now stopped, without any communication to participants. It is imperative that SEMO are consistent in their approach and information communicated around expiry dates.