Prepay Power

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**RE: SEM-22-024 Consultation on changes to reduce Collateral Requirements in the Balancing Market.**

Dear Karen,

PrePayPower welcomes the opportunity to respond to the SEM Committee's consultation paper on reducing SEMO collateral requirements. It is a positive development that the Regulatory Authorities and Market Operator are examining the burden of credit cover costs for market participants. During the recent peaks in commodity prices prior to Christmas 2021 and between January and April 2022, suppliers were required to post significant amounts of collateral across both ex-ante and balancing markets. We estimate that a supplier with 10% of the retail market would have required approx. €20m in credit cover to remain trading during recent months. Gas and ISEM electricity Prices remain elevated today and are likely to remain high for some time. Even with gas prices dipping towards 100 c/th recently we are still seeing extremely high spark spreads in ISEM (averaging €40/MWh) so power prices have remained extremely high relative to historical norms. In that regard, any moves to reduce collateral requirements are welcome. Our specific comments to each of the questions are below.

**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?**

We agree with and welcome the proposal to reduce the Single Suspension Delay Period by 2 days. We would also like to raise again and support the point made by EAI in their paper on security of supply earlier this year where they highlight the unnecessary double collateralisation of the SEM wholesale markets. Since Participants are expected to collateralise the Single Electricity Market Operator (SEMO) in the Balancing Market, and the European Commodity Clearing (ECC) in the Ex-Ante Markets, this duplicates the collateral requirements. Removing this double exposure in its entirety or partially would substantially reduce supplier collateral requirements. We believe it would be useful for the SEMC and SEMO to also investigate this potential change.

**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?**

We agree the change is an acceptable trade off, however we would note that the risk lies with the Regulatory Authorities / SEMOs ability to meet the 5-day deadline to invoke the SoLR.
We think that 5 working days would be sufficient to make a decision on this basis assuming sufficient resources were dedicated to the matter.

**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?**

Before considering the reasons for carrying increased credit cover, it important to consider the significance of collateral management for market participants. A potential breach of credit cover is a very serious event that carries significant if not terminal reputational damage for a participant within the ISEM, or any commodity market for that matter. Management of credit cover requires an investment in time 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.

We believe there are 3 main reasons for carry additional credit cover, the first two - the LOC approval times, and the deadline for rectifying a CCIN – have been addressed in questions 4 and 5 below. The third reason is that is extremely difficult to calculate the required credit cover. Even when following the Trading and Settlement Code formulae, SEMO training slides, and worked examples, we have not been able to reproduce the values in our daily credit reports. Prior to the increase in electricity prices, it may not have been as important for a Participant to be able to calculate their credit cover requirement as it was relatively stable, however, with increased prices and increased volatility in the market, the need for reasonable forecasts of future exposure is extremely important. Since it is difficult to calculate our current exposure, we are reliant on credit reports, and thus cannot forecast as accurately as desired when an increase in collateral may be required.
It is also worth making the point that it has been difficult for us to assess accurately the monetary value of decreasing the Undefined Exposure Period for the purpose of responding to this consultation paper – except to say that it will decrease the credit cover requirement.
We do not believe we are alone in finding it difficult to forecast credit cover requirements and believe that more help should be provided by SEMO in assisting the market in this task.

**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?**

We agree that the approval times for LOCs is one of the main reasons why Participants are posting excess credit cover. The challenging timelines mean that if a Participant waits to receive a CCIN before amending an LOC to increase credit cover, it is possible that the LOC will not be approved on time. Failing to meet the terms of the CCIN is a very serious event for a Participant and has severe implications for their reputation. For this reason, Participants will likely favour posting excess collateral, rather than risk receiving a CCIN.

**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)?**

We would support any effort that can be made by SEMO to either shorten the approval times for Letters of Credit, or lengthen the time given to rectify a CCIN.

Best Regards,

Colm mac Oireachtaigh,

Head of Forward Trading,
PrePayPower