

Response to SEM-22-024

CONSULTATION ON CHANGES TO REDUCE COLLATERAL REQUIREMENTS IN THE BALANCING MARKET

EirGrid and SONI Response
08th June 2022



Introduction

EirGrid holds licences as independent electricity Transmission System Operator (TSO) and Market Operator (MO) in the wholesale trading system in Ireland, and is the owner of SONI Ltd (SONI), the licensed TSO and MO in Northern Ireland. Together, EirGrid and SONI act as the Single Electricity Market Operator (SEMO), and operate the Single Electricity Market on the island of Ireland.

Both EirGrid and SONI, have been certified by the European Commission as independent TSOs, and are licenced as the transmission system and market operators, for Ireland and Northern Ireland respectively. EirGrid also owns and operates the East West Interconnector, while SONI acts as Interconnector Administrator for both of the interconnectors that connect the island of Ireland and GB.

EirGrid and SONI, both as TSOs and MOs, are committed to delivering high quality services to all customers, including generators, suppliers and consumers across the high voltage electricity system and via the efficient operation of the wholesale power market. EirGrid and SONI therefore have a keen interest in ensuring that the market design is workable, will facilitate security of supply and compliance with the duties mandated to us and will provide the optimum outcome for customers.

EirGrid and SONI have duties under licence to advise the Commission for Regulation of Utilities (CRU) and the Utility Regulator (UR) respectively on matters relating to the current and expected future reliability of the electricity supply. We have also been allocated responsibility for administering the Capacity Market Code through our TSO licences. This response is on behalf of EirGrid and SONI in their roles as TSOs and MOs for Ireland and Northern Ireland.

EirGrid and SONI Views on the Consultation Topic

EirGrid and SONI in their role as System Operators (SO) and Market Operator (MO) have considered the questions raised in the consultation paper SEM-22-024¹, in relation to ‘Changes to Reduce Collateral Requirements in the Balancing Market’.

EirGrid and SONI recognise the impact on the Market from the unprecedented international circumstances and will collaborate with the industry where possible to apply changes that would be considered beneficial.

Having reviewed the Consultation Paper, the following extract would need to be clarified:

It is the SEM Committee’s understanding that once an SOLR direction is issued, then the Metered Quantity of the supplier concerned is set to zero from midnight on the date that the direction is issued regardless of when the relevant MPRNs are actually moved from the exiting supplier to the SOLR. Any consumption associated with these MPRNs after this time then sits within the Residual Error Volume until resettlement at M+4 / M+13 when it is settled by the SOLR. SEMO has confirmed that this is their understanding also.

The affected Supplier ceases to be liable for any Metered Quantity recorded from midnight following an Supplier of Last Resort (SOLR) direction. The SOLR instead will take on the liability for such consumption going forward, but the transfer of metering by the relevant Meter Data Provider (MDP),

¹ <https://semcommittee.us13.list-manage.com/track/click?u=35760ee9da0c8ccdadfbaa4c8&id=32ee2f4326&e=8c58ed4d26>

might take longer to complete. The affected Metered Quantity will not be included in the Residual Error Volume as stated in the extract above. Until the MDP completes the transfer of all affected customers to the SOLR, the Supplier exiting the market will continue to receive regular Settlement Reports and Settlement Documents up to M+13 for any Metered Quantities relating to timelines prior to the effective date of exiting the market. If the Supplier cannot honour payments, then the Credit Cover in place would be drawn down; when a credit note is issued that would be offset against any outstanding debt before being paid out. Should the Credit Cover in place be insufficient to cover the liabilities of the Supplier, then the amounts will be socialised according to the rules of Shortfall and Unsecured Bad Debt as per G.2.7 of the Trading and Settlement Code (T&SC).

The Supplier would also continue to receive Indicative and Initial Settlement Documents for any Metered Quantities not yet been transferred post SOLR direction and, similarly to the above process, if insufficient Credit Cover is in place, any resulting invoiced amount will also be socialised. This, however, is a temporary measure because the SOLR is liable for those quantities from the point of the RAs decision and when the transfer of a customer is complete, it can be charged for them, therefore the previously socialised Unsecured Bad Debt can be repaid as laid out in paragraph G.2.7.10 of the T&SC. This could take up to M+4 or M+13 depending on the affected Supplier's customers numbers and type. In that regard it is correct to state that any final correction will take place at M+4 or M+13 as per the consultation extract.

The Undefined Exposure period (UDE) provide a buffer period for the Supplier to try and avoid defaulting and triggering an SOLR process.

Notwithstanding the Market moving away from the aspiration of full collateralisation, the MO systems and processes in place allow some flexibility in adjusting the UDE as proposed in the consultation paper, while the scope for change with regards to the process of approval of a Letter of Credit is less adaptable.

More details will be provided below in the responses to the individual questions raised in the consultation paper.

EirGrid and SONI's response to questions 1 and 2:

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?

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?

The Undefined Exposure Period (UDE) in the SEMO Settlement Systems, is a parameter that feeds into the calculation of the Credit Cover Requirements for Participants. The Market Operator (MO), is mandated to provide an analysis of Credit Cover Parameters, including UDE, on an annual basis. This is to allow the Regulatory Authorities (RAs) to evaluate whether the value is achieving the intended balanced approach of providing adequate protection to the market without resulting in excessive over-collateralisation.

To date the value of UDE, which has been set to nine days since the beginning of the SEM, has not changed. The conditions of the market remained generally stable and the processes that drive the decision to invoke the Supplier of Last Resort (SOLR) also remained largely unchanged, therefore the value didn't require any adjustments. The most recent analysis from SEMO on UDE, available in the report 'Recommended Values for SEM Credit Cover Parameters 2022', refers to data up to June 2021, showing that large over-collateralisation only happens briefly after periods of short and isolated price spikes; while under-collateralisation occur in periods before such price spikes. When prices follow a constant upward or stable trend, the estimated Undefined Exposure used in collateral calculation is closely comparable to the realised Undefined Exposure calculated ex post with actual settlement data². This means that the collateralisation of the market to date has achieved that balance between over and under collateralisation correctly adapting to the market prices.

Of the nine days of the UDE, two are fixed by design because they refer to Metered Generation that has been consumed but not yet settled (on any given day this is the energy of the current and previous day). The remaining seven days relate to the Suspension Delay Period (SDP) for both Generators and Suppliers and should be sufficiently long to allow Participants to rectify their financial situation where possible and at the same time allow the RAs to prepare for the potential recourse to the SOLR. The longer the SDP the higher the burden to Participants but higher the protection offered to the market; vice versa the lower the SDP, the lesser financial requirements for a Participant but the market risks of default increases.

EirGrid and SONI are satisfied that the value so far has been adequately set, but if directed by the RAs, a change to this parameter could be easily achieved with immediate effect by updating the relevant editable UDE field in the settlement system.

In view of a potential change to the UDE and the trade off with potential increase in the risk of default, the following should be considered by the RAs:

- Whether the market is overcollateralised and therefore putting an unnecessary burden on Participants or whether the overcollateralisation is within an acceptable tolerance to provide adequate protection to the market in consideration of the aim of full collateralisation. As per SEMO's report 'Recommended Values for SEM Credit Cover Parameters 2022', large overcollateralisation has not been a significant feature up to 2021 and periods of undercollateralisation have been short lived and within expected parameters;
- Whether reducing the SDP would mean a departure from the principle set in the I-SEM Market Design of aspiring to full collateralisation;
- Whether this is a temporary measure in response to a specific context and current market conditions due to the sudden increase of fuel prices and security of supply, and under what criteria would it be reversed;
- Whether this change is signalling a perceived potential for default in the SEM and if that could result in a more cautious approach to trading reducing liquidity in the market;

² Reference to figure 4 in the report 'Recommended Values for SEM Credit Cover Parameters 2022' : <https://www.semcommittee.com/sites/semc/files/media-files/SEM-21-067a%20Recommended%20Values%20for%20SEM%20Credit%20Cover%20Parameters%202022.pdf>

- Whether reducing the UDE would actually hinder the chances of a Participant to rectify its financial situation as they would have less time at their disposal to rearrange their finances and discuss their situation with the RAs as required by the process;
- Whether an increase in the level of bad debt would become a burden on SEMO's resources and SEMO's ability to meet its timelines;

The MO has no issues in carrying out the potential changes as proposed in Q1 and with regards to Q2 have no strong position other than the concerns for consideration by the RAs highlighted above.

EirGrid and SONI's response to questions 3, 4 and 5:

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?

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?

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)?

EirGrid and SONI in their role as MO do not have the insights into Participant's reasons for posting excess Credit Cover necessary to express a view on Questions 3 and 4. In our dealing with Participants, no specific issue on timelines has been raised and processing of Letters of Credit (LOC) has always been carried out promptly.

With regards to Question 5 on reducing timelines for approval of LOC, the MO would have concerns of the feasibility of such a proposal. This is not an automated process. To ensure adherence with all the requirements of the T&SC, a number of control checks have to be carried out, and the process requires management sign off to approve an LOC. Incomplete documentation from participants can lead to delays in this approval process.

In addition, this is not a process that is fully under the control of the MO because the process also includes an external dependency in dealing with various participants' banking institutions.

The MO endeavours to respond to LOC requests within the assigned timelines; however, this is provided that the documentation submitted by the Participant's issuing bank meets all the requirements set for Credit Cover Providers in G.9.1.3 of the T&SC, Appendix A 'Standard Letter of Credit and Demand Guarantee' and Agreed Procedure 09 'Management of Credit Cover and Credit Default'. These include the bank's or Insurance Undertaking's licence to operate and their ability to meet the Eligibility Requirements such as:

- their long term rating;
- their ability to provide same day payment by SWIFT payment services;

The documentation submitted can vary from one banking institution to another. The type and quality of data provided, is not always standardised and often incomplete making the review more complex and lengthy. In addition, even when the Participant requests an LOC update from an institution that is already on the list of approved Credit Cover Providers, the ability to meet the eligibility requirements has to be tested on a regular basis to demonstrate that no change has occurred that would affect the status of the relevant institution.

The current approval is robust in ensuring that the MO as a prudent Market Operator carry out the appropriate level of due diligence and checks on new LOC and amendments in all circumstances, and it is already very tight in situations where documentation is incomplete or incorrect.

EirGrid and SONI are opposed to changes to timing of approval of LOC as it could not guarantee the documentation provided by Participants and their financial institution would have all the correct details to allow the checking process to be reasonably and safely completed in less time than that already provided for by the T&SC. It is also unclear if a change to letter of credit timelines would assist in reducing the collateral held in the market.