

Stage 01: Initial Written Assessment

P307 'Amendments to Credit Default arrangements'

This Modification proposes amendments to the Credit Default arrangements, including adjusting the thresholds for entering Credit Default, extending the duration of the Query Period and reviewing the processes around the Cure Periods.



ELEXON recommends P307 is progressed to the Assessment Procedure for an assessment by a Workgroup

This Modification is expected to impact:

- BSC Parties
- The Energy Contract Volume Allocation Agent (ECVAA)
- ELEXON

What stage is this document in the process?

01 Initial Written Assessment

02 Definition Procedure

03 Assessment Procedure

04 Report Phase

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About This Document

This document is an Initial Written Assessment (IWA), which ELEXON will present to the Panel on 12 June 2014. The Panel will consider the recommendations and agree how to progress P307.



Any questions?

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1 Why Change?

What are the credit arrangements?

Under the BSC arrangements, payments by Trading Parties for Trading Charges arising on any particular Settlement Day are typically made 29 calendar days later. Thus, at any given time, Parties may have debts (or be due payments) for Trading Charges incurred over the previous 29 days. Each Party is required to lodge Credit Cover to cover this period, to ensure that, should it default, we have sufficient collateral available to pay off its debts. Otherwise the debts must be shared across all other BSC Parties.

The BSC does not stipulate the amount of Credit Cover that Parties must provide. Instead it is left to Parties to decide on the level of cover that they wish to provide.

We perform a credit check process every half hour to ensure that each Party's accumulated debt (their Energy Indebtedness) over the 29 day period does not exceed the amount of Credit Cover they have provided. If a Party has insufficient funds lodged to cover this debt, it will receive a default notice.

When does Credit Default occur?

The Credit Default process occurs when a Party's Credit Cover Percentage (CCP) (the ratio of their Energy Indebtedness compared to the level of Credit Cover lodged) exceeds 80%, at which point it receives a default notice by phone and email, and a 24 hour Query Period commences. This Query Period gives the Party an opportunity to investigate the default.

Where substantial evidence shows that the CCP does not give a true reflection of that Party's Energy Indebtedness it can claim Material Doubt. In this case ELEXON will recalculate the CCP taking into account the evidence. Where Material Doubt does not apply the Party may need to lodge more Credit Cover to bring its CCP down.

The next step depends on the Party's CCP at the end of the Query Period:

- If the CCP is below 80%, the Party exits the process and no further action is taken.
- If the CCP remains above 80%, the Party will be given a Level 1 Cure Period, whereby it must ensure its CCP falls below 75% for at least one Settlement Period before the end of the next Working Day. If this does not happen, the Party will enter Level 1 Credit Default.
- If the CCP is above 90%, but it has not exceeded 100% during the Query Period, and there has been less than two consecutive Working Hours during the 24 hour Query Period, the Party will be given a Level 2 Cure Period. If a Level 2 Cure Period is granted, the Party has until 12:00 on the Working day following the end of the Query Period to bring its CCP below 75%. If this does not happen or if the Party breaches 100% during the Level 2 Cure Period, the Party will enter Level 2 Credit Default.
- If the CCP is above 90% and the Party is not eligible for a Level 2 Cure Period, it will immediately enter Level 2 Credit Default.
- If the CCP is above 100%, the Party will immediately enter Level 2 Credit Default.



Credit Default Guidance Note

More detail on Credit Default can be found in our [Overview of Credit Default Guidance Note](#).

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The Level 1 and Level 2 processes run concurrently. It is therefore possible for a Party to enter Level 2 Credit Default while they are still working through a Level 1 Cure Period.

Once a Party enters Credit Default, it will automatically exit when its CCP falls below 75%.

What is the impact of being in Credit Default?

When a Party enters either Level 1 or Level 2 Credit Default, a notification is published on the Balancing Mechanism Reporting Service (BMRS) to this effect, and this information is also reported to all Parties in the ECVA-I014 'Notification Report' flow.

Additionally, if a Party is in Level 2 Credit Default, any Energy Contract Volumes Notifications (ECVNs) or Meter Volume Reallocation Notifications (MVRNs) that are submitted which would increase its Energy Indebtedness at any point in the future will be refused. Any existing ECVNs or MVRNs that would have the same effect will be rejected on a Settlement Period by Settlement Period basis, and the counterparty would have a very limited amount of time to amend its own position in response to the rejection. In each case the counterparty to the notification will be informed of the rejection.

A Party in Level 1 Credit Default whose CCP subsequently exceeds 90% can also have ECVNs and MVRNs rejected or refused in the same way.

When a Party exits Credit Default, the relevant notice(s) will be updated on the BMRS and its contracts, if they were, will stop being refused or rejected.

What is the issue?

The Proposer considers that the level of credit held across the energy industry is in some cases exceptionally high, above and beyond the actual risk that market participants are likely to incur. In particular, the BSC requires BSC Parties to lodge credit cover in excess of their maximum energy indebtedness, due to Parties needing to remain below the 80% threshold. If a Party does receive a default notice, it has a 24 hour Query Period before any consequences are incurred; however the consequences can be significant and severe.

Where the Query Period commences in the period following 17:00 on a Friday through to Sunday morning, there can be a scenario where the Query Period has no Working Hours in which the Party can lodge further Credit Cover. If the CCP exceeds 100% then ECVNs and MVRNs will be refused and rejected at the end of the Query Period until the CCP falls below 75%. The Party would therefore have no option other than to buy energy during the Query Period and notify energy contracts to reduce its CCP. This action can incur significant costs to the Party.

The provision whereby a default notice is issued should a Party's Credit Cover Percentage in any Settlement Period becomes greater than 80% adversely incentivises Parties to lodge higher amounts of Credit Cover to avoid the consequences of default, particularly in the event where there are no Working Hours to resolve the issue.

The Proposer believes that the Credit Cover that is lodged under the BSC appears to cover a large part of the "tail risk" where the largest losses occur but in terms of probability are very unlikely.

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Proposed solution

This Modification proposes to amend the timings, triggers and thresholds under BSC Section M in relation to Credit Default.

The Proposer seeks to amend the Query Period to include a minimum of five consecutive Working Hours during a single Working Day, to allow Parties sufficient time to lodge more credit upon breaching the 80% threshold. A consecutive period of five Working Hours would allow for internal procedures for authorisation, payment processes and bank transfers to take place in order to increase the level of Credit Cover following a credit threshold breach.

The Proposer also considers that the triggers and thresholds for entering Credit Default should be amended, specifically with respect to the Cure Periods and the 80%, 90% and 100% thresholds. However, they are open to the views of the Modification Workgroup as to the most appropriate amendments to make, but they note that the 2011 BSC Review looked at the rules for Credit Default ([Panel 182/07](#)), and consider that the Workgroup should look at the review's conclusions and proposed solutions as part of any revisions to the triggers or thresholds.

Applicable BSC Objectives

The Proposer considers that P307 would better facilitate **Applicable BSC Objective (c)**.

They believe that this Modification would allow BSC Parties to reduce the margin of credit provided under the BSC. An extension of the Query Period would reduce the risk of Credit Default consequences and contract refusal or rejection. Parties entering Credit Default over a weekend would have the option of providing additional funds to resolve the default. This reduction in credit would increase competition within the industry by reducing the costs incurred by participants, in particular smaller Parties, in lodging Credit Cover.

Interactions with P306 and P308

This Modification has been raised alongside two other Modifications relating to the credit arrangements. However, while these Modifications are all looking at the credit arrangements, each is looking at a different aspect of the process and proposing mutually independent solutions. To summarise, these three proposals are:

- [P306 'Expanding the definition of a 'Letter of Credit' to include regulated insurance companies'](#) proposes to allow individual Parties to obtain a Letter of Credit from a regulated insurance company that is capable of providing security of a similar level and form as that provided by a bank.
- [P307 'Amendments to Credit Default arrangements'](#) (this proposal) proposes to amend the timings, triggers and thresholds in relation to Credit Default, including adjusting the thresholds for entering Credit Default, extending the duration of the Query Period and reviewing the processes around the Cure Periods.



2011 BSC Review

The 2011 BSC Review carried out by ELEXON reviewed and proposed amendments to the current Credit Cover, Credit Default, Payment Default and Section H Default processes.



What are the Applicable BSC Objectives?

(a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence

(b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System

(c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity

(d) Promoting efficiency in the implementation of the balancing and settlement arrangements

(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators]

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- [P308 'Alternative security product for securing credit under the BSC'](#) proposes to introduce a centrally provided alternative security product as an alternative method for securing credit under the BSC, which Parties could use in place of the existing requirements to provide Credit Cover individually.

All three Modifications can be progressed and implemented independently of each other; P307 could be implemented both with and without P306 or P308, and the solution it proposes would not impact the solutions proposed by the others. Nevertheless, all three Workgroups should be mindful of the other proposed solutions when developing its solution.

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3 Areas to Consider

In this section we highlight areas which we believe the Panel should consider when making its decision on how to progress this Modification Proposal, and which a Workgroup should consider as part of its assessment of P307. We recommend that the areas below form the basis of a Workgroup's Terms of Reference, supplemented with any further areas specified by the Panel.

What is the appropriate duration for the Query Period?

The Proposer believes that the Query Period should be extended to include at least five consecutive Working Hours during a single Working Day. This would mean the Query Period would end after the longer of:

- 24 hours following commencement of the Query Period; or
- 14:00 on the first Working Day following commencement of the Query Period.

The Workgroup should consider if this is an appropriate duration for the Query Period.

What are the appropriate amendments to the triggers and thresholds?

The Proposer believes that the triggers and thresholds for entering Credit Default should be amended as highlighted in Section 2. However, the Proposer has left it open to the Workgroup as to the most appropriate amendments to make, but notes the 2011 BSC Review's conclusions should be considered as part of this.

The Workgroup should therefore agree what revisions, if any, should be made to the Cure Periods and the thresholds, and whether there are any other parts of the Credit Default process that should also be amended.

Areas to consider

The table below summarises the areas we believe a Modification Workgroup should consider as part of its assessment of P307:

Areas to Consider
What is the appropriate duration for the Query Period?
What amendments, if any, should be made to the triggers for entering the Credit Default process?
What amendments, if any, should be made to the Cure Periods?
Are there any other parts of the arrangements for entering or exiting Credit Default that should be amended and if so what amendments should be made?
What changes are needed to BSC documents, systems and processes to support P307 and what are the related costs and lead times?
Are there any Alternative Modifications?
Does P307 better facilitate the Applicable BSC Objectives than the current baseline?

4 Proposed Progression

Next steps

We recommend that P307 is progressed to the Assessment Procedure for assessment by a Workgroup.

Workgroup membership

We recommend that the Workgroup membership should be formed of experts on the credit processes and any other relevant experts and interested parties.

Timetable

We recommend that P307 undergoes a five month Assessment Procedure, with the Assessment Report being presented to the Panel at its meeting on 13 November 2014.

We believe that the Workgroup will need to undertake the activities shown in the table below, which includes a central systems impact assessment as well as a 15 Working Day Assessment Procedure consultation. The timetable below allows for both of these and for the Workgroup to fully develop the proposed solutions outlined in Section 2 and fully consider the areas highlighted in Section 3.

The BSC allows the Panel to set an Assessment Procedure timetable which is longer than three months where the Panel believes this is justified by "the particular circumstances of the Modification Proposal (taking due account of its complexity, importance and urgency)", (Section F2.2.9), and provided the Authority does not issue a contrary direction.

We note that, should the Workgroup progress quicker than anticipated, we would seek to bring the Assessment Report back to the Panel at an earlier meeting.

Proposed Progression Timetable for P307	
Event	Date
Present Initial Written Assessment to Panel	12 Jun 14
Workgroup Meeting	W/B 30 Jun 14
Central Systems Impact Assessment	18 Jul 14 – 01 Aug 14
Workgroup Meeting	W/B 11 Aug 14
Assessment Procedure Consultation	29 Aug 14 – 19 Sep 14
Workgroup Meeting	W/B 06 Oct 14
Present Assessment Report to Panel	13 Nov 14
Report Phase Consultation	14 Nov 14 – 02 Dec 14
Present Draft Modification Report to Panel	11 Dec 14
Issue Final Modification Report to Authority	12 Dec 14

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5 Likely Impacts

Impact on BSC Parties and Party Agents

Party/Party Agent	Potential Impact
BSC Parties	No material impact is anticipated to implement this Modification. However, BSC Parties will be indirectly impacted as a result of the changes to the triggers and thresholds around entering Credit Default. This may mean they can reduce their levels of Credit Cover.

Impact on Transmission Company

None anticipated.

Impact on BSCCo

Area of ELEXON	Potential Impact
Credit Arrangements	ELEXON will need to manage the new timescales and triggers for future Credit Defaults.

Impact on BSC Systems and processes

BSC System/Process	Potential Impact
ECVAA	Changes may be required to implement the proposed solution.

Impact on Code

Code Section	Potential Impact
Section M	Changes will be required to implement the proposed solution.
Section X Annex X-1	Changes may be required to implement the proposed solution.

Impact on Code Subsidiary Documents

CSD	Potential Impact
BSCP301	Changes will be required to implement the proposed solution.

Other Impacts

Item impacted	Potential Impact
Credit Default Guidance Note	Changes will be required as a result of this Modification.
Credit Cover Guidance Note	Changes may be required as a result of this Modification.

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6 Recommendations

We invite the Panel to:

- **AGREE** that P307 progresses to the Assessment Procedure;
- **AGREE** the proposed Assessment Procedure timetable;
- **AGREE** the proposed membership for the P307 Workgroup; and
- **AGREE** the Workgroup's Terms of Reference.

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Appendix 1: Glossary & References

Glossary of defined terms

Acronyms and other defined terms used in this document are listed in the table below.

Glossary of Defined Terms	
Acronym	Definition
BMRS	Balancing Mechanism Reporting Service
BSCP	Balancing and Settlement Code Procedure (<i>Document</i>)
CCP	Credit Cover Percentage (<i>Parameter</i>)
ECVAA	Energy Contract Volume Allocation Agent (<i>BSC Agent</i>)
ECVN	Energy Contract Volume Notification
IWA	Initial Written Assessment (<i>Document</i>)
MVRN	Metered Volume Reallocation Notification

External links

A summary of all hyperlinks used in this document are listed in the table below.

All external documents and URL links listed are correct as of the date of this document.

External Links		
Page(s)	Description	URL
3	Credit Default Guidance Note	http://www.elexon.co.uk/reference/credit-pricing/credit/
5	2011 BSC Review (Panel 182/07)	http://www.elexon.co.uk/meeting/bsc-panel-182/
5	P306 webpage	http://www.elexon.co.uk/mod-proposal/p306/
5	P307 webpage	http://www.elexon.co.uk/mod-proposal/p307/
6	P308 webpage	http://www.elexon.co.uk/mod-proposal/p308/

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