P307 'Amendments to Credit Default arrangements'

This Modification proposes to extend the duration of the Query Period that is given to a participant prior to entering Credit Default from the present 24 hours to a period of at least 24 hours which must include a minimum of five consecutive Business Hours in a single Working Day.

This Report Phase Consultation for P307 closes:

5pm on **Tuesday 2 December**

The Panel may not be able to consider late responses.

The BSC Panel initially recommends **approval** of P307

This Modification is expected to impact:

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

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 is the P307 Draft Modification Report, which ELEXON is issuing for industry consultation on the BSC Panel's behalf. It contains the Panel's provisional recommendations on P307. The Panel will consider all consultation responses at its meeting on 11 December 2014, when it will agree a final recommendation to the Authority on whether or not the change should be made.

There are four parts to this document:

- This is the main document. It provides details of the solution, impacts, costs, benefits/drawbacks and proposed implementation approach. It also summarises the Workgroup's key views on the areas set by the Panel in its Terms of Reference, and contains details of the Workgroup's membership and full Terms of Reference.
- Attachment A contains the proposed redlined changes to the BSC for P307.
- Attachment B contains the full responses received to the Workgroup's Assessment Procedure Consultation.
- Attachment C contains the specific questions on which the Panel seeks your views. Please use this form to provide your responses to these questions, and to record any further views or comments you wish the Panel to consider.

Any questions?

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1 Summary

Why Change?

Parties need to keep their Credit Cover Percentage (CCP) below 80% otherwise they will trigger the Credit Default processes. If a Party does breach 80%, it is granted a 24 hour Query Period before any consequences are incurred; however the consequences of entering authorised Credit Default can be significant and severe.

If the CCP exceeds 90% then contract notifications can be refused and rejected at the end of the Query Period. The Party would also immediately enter Credit Default if its CCP is in excess of 100% at the end of the Query Period. There can be scenarios where the Query Period has no Business Hours included to allow the Party to lodge further Credit Cover, resulting in the Party needing to trade to remedy its position before the end of the Query Period. The Party can incur significant costs through this route.

These provisions adversely incentivise Parties to lodge higher amounts of Credit Cover to avoid the consequences of entering authorised Credit Default, particularly in the event where there are no Business Hours to resolve the issue.

Solution

P307 proposes to increase the duration of the Query Period to be a minimum of 24 hours which must include a minimum of five consecutive Business Hours in a single Working Day.

Impacts & Costs

P307 will impact the Energy Contract Volume Allocation Agent (ECVAA) and ELEXON. No effort is expected to be required from BSC Parties or Party Agents to implement P307, though BSC Trading Parties will see consequential impacts from the new arrangements.

The proposed solution will cost approximately £49k to implement, with approximately £10k per annum incurred in ongoing costs.

Implementation

The Panel recommends an Implementation Date of 25 June 2015 (June 2015 Release) if the Authority's decision is received on or before 12 February 2015.

Recommendation

The Panel unanimously believes P307 better facilitates Applicable BSC Objectives (c) and (d) and initially unanimously recommends that P307 is approved.

2 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, ELEXON has sufficient collateral available to pay off its debts. Otherwise the debts are 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 is appropriate.

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 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.

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.

Credit Default Guidance Note

More detail on Credit Default can be found in our Overview of Credit Default Guidance Note.

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. This information is also reported to all Parties in the ECVAA-I014 'Notification Report' flow.

Additionally, if a Party is in Level 2 Credit Default and its CCP is above 90%, 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. Contracts will stop being refused or rejected when the Defaulting Party's CCP falls below 90%.

A Party in Level 1 Credit Default whose CCP subsequently exceeds 90% will 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 removed from subsequent ECVAA-I014 flows.

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 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 between 17:00 on a Friday and Sunday morning, there can be a scenario where the Query Period has no Business Hours in which the Party can lodge further Credit Cover. If the CCP exceeds 90% 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 Business Hours to resolve the issue.

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

3 Solution

Proposed solution

P307 proposes to amend the Query Period to be a minimum of 24 hours which must include a minimum of five consecutive Business Hours[1] during a single Working Day. This will allow Parties sufficient time to lodge more credit upon breaching the 80% threshold. A consecutive period of five Business Hours would allow for Parties to carry out internal procedures for authorisation, payment processes and bank transfers in order to increase the level of Credit Cover following a credit threshold breach.

As a consequence of extending the Query Period, a Level 2 Cure Period could never be applied. A Level 2 Cure Period would only be granted if the participant had had less than two Business Hours within the Query Period. Under the proposed solution, the participant would always have at least five Business Hours in the Query Period. Therefore, the Level 2 Cure Period will be removed from the process.

All other aspects of the current Credit Default process would remain unchanged.

Legal text

The draft redlined changes to the BSC to deliver P307 can be found in Attachment A.

No respondents to the Assessment Procedure Consultation disagreed with the draft changes.

Are there any alternative solutions?

In its proposal, the Proposer also considered that the triggers and thresholds for entering Credit Default could be examined under P307, specifically with respect to the Cure Periods and the 80%, 90% and 100% thresholds. However, they left it open to the views of the Workgroup as to the most appropriate amendments to make, if any. They noted that the 2011 BSC Review looked at the rules for Credit Default (Panel 182/07), and considered that the Workgroup should look at the review's conclusions and proposed solutions as part of any revisions to the triggers or thresholds.

The Workgroup considered the 2011 BSC Review, and developed an Alternative Modification to progress wider reforms to the Credit Default process in line with the review's recommendations. The Workgroup proposed the following solution:

- There would be a single trigger, which would be set to 90%.
- If its CCP exceeds the 90% trigger, a Party would be given a Query Period which would end at 17:00 on the second full Working Day following notification of the breach[2].
- If at the end of the Query Period the CCP was at or below 90% then the process would end and no further action would be taken.

Timeline summaries

Summary diagrams illustrating the timescales for the current and proposed processes can be found in Appendix 1.

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.

[1] The BSC defines Business Hours as the period from 09:00 to 17:00 on a Working Day.

[2] A Working Day would count as a full Working Day only if the notification was deemed to be received prior to 09:00 on that day. If the notification is deemed to be received on or after 09:00 on a Working Day or at any time on a non-Working Day then the next Working Day would be deemed the first full Working Day.

- If at the end of the Query Period the CCP was above 90% then the Party would enter Credit Default. This would be announced on the BMRS and in the ECVAA-I014 flow and contracts would begin to be rejected and refused.
- Contracts would be rejected and refused only at times when the CCP is above 90%, and would stop should the CCP drop back to 90% or below. This would align with current practice and would lessen the impact on counterparties.
- Formal Section H proceedings would begin immediately if the Party's CCP:
  - was above 100% at the end of the Query Period;
  - breached 100% during the Query Period and was still above 90% at the end of the Query Period; or
  - breached 100% while in Credit Default.
- Once in Credit Default, the Party would automatically exit once its CCP drops back to 75% or below.

This process would remove the current two-level aspect of the process, replacing it with a single Credit Default status with a single trigger point. Participants would be given a longer Query Period, which would include at least two full Working Days, but there would be no subsequent Cure Period.

The Workgroup agreed that this solution would be a more robust long-term solution. However, members felt it would be better to implement the proposed solution first as a step-change towards wider reforms, and reconsider the alternative solution at a later date following implementation (if approved) of P307, P306 'Expanding the definition of a 'Letter of Credit' to include regulated insurance companies' and P308 'Alternative security product for securing credit under the BSC'. It therefore elected not to raise this solution at this time. The Workgroup's discussions on this solution and its proposed way forward can be found in Section 6.

In addition to the potential alternative solution detailed above, the Workgroup also considered two variants of the Proposer's proposed solution with different revised lengths for the Query Period. The Workgroup considered extending the Query Period to include either at least one full Working Day or at least two full Working Days. However, the Proposer elected not to amend the proposed Query Period duration from that which they originally put forward, and the Workgroup did not believe that the alternative revised durations to the Query Period would have a material impact on the benefits compared with the proposed extension, believing there would ultimately be more value in the wider, long-term changes set out above. Therefore, the Workgroup agreed not to progress either of these options for alternative Query Period durations as an alternative solution.

Overall, the Workgroup does not believe there are any other potential alternative solutions that would better facilitate the Applicable BSC Objectives at this time than the Proposer's proposed solution, but believes its potential alternative solution should be revisited at a later date following implementation of the proposed solution.

4 Impacts & Costs

Estimated central implementation costs of P307

The central implementation costs for the proposed solution will be around £49k, which consists of:

- £32k in ECVAA effort to make the relevant changes to the central systems; and
- £17k in ELEXON effort to implement the relevant document changes and to update the relevant day-to-day processes.

The proposed solution will also require an additional £10k per annum in ongoing ELEXON effort to manage the new processes.

Indicative industry costs of P307

Only a couple of respondents to the Assessment Procedure Consultation indicated any impacts in implementing P307, and these only to update their internal processes. No respondents noted any material costs required to implement P307. You can find the full responses from these participants in Attachment B.

P307 impacts

Impact on BSC Parties and Party Agents	
Party/Party Agent	Impact
BSC Trading Parties	No material impact is anticipated to implement this Modification. However, BSC Trading Parties will be indirectly impacted as a result of the extended Query Period, which may mean they can reduce their levels of Credit Cover.

Impact on Transmission Company
None anticipated.

Impact on BSCCo	
Area of ELEXON	Impact
Credit Arrangements	ELEXON will need to manage the new Query Period timescales for future Credit Defaults.

Impact on BSC Systems and process	
BSC System/Process	Impact
ECVAA	Changes will be required to implement the proposed solution.

Impact on Code	
Code Section	Impact
Section M	Changes will be required to implement the proposed solution. You can find the proposed changes in Attachment A.
Section X Annex X-1	

Impact on Code Subsidiary Documents	
CSD	Impact
BSCP301	Changes will be required to implement the proposed solution. These will be prepared as part of the implementation project should P307 be approved.
ECVAA Service Description	Changes may be required to implement the proposed solution. These will be prepared as part of the implementation project should P307 be approved.
ECVAA User Requirements Specification	

Other Impacts	
Item impacted	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.

5 Implementation

Recommended Implementation Date

The Workgroup recommends an Implementation Date for P307 of:

- **25 June 2015** (June 2015 Release) if the Authority's decision is received on or before 12 February 2015; or
- **5 November 2015** (November 2015 Release) if the Authority's decision is received after 12 February 2015 but on or before 25 June 2015.

These dates are based on the 19 week lead time that would be required to implement the central system changes to deliver the proposed solution.

All respondents to the Assessment Procedure Consultation agreed with this approach.

What is the most appropriate duration for the Query Period?

The Workgroup considered the Proposer's suggestion that the Query Period should be extended to include a minimum of five Business Hours, and asked why this particular time period had been suggested. The Proposer believes that participants who have entered the Query Period should be able to carry out any actions required to reduce their CCP in the space of one morning. If a Party enters the Query Period over the weekend, it would be notified of this immediately. The relevant people at that organisation would then be able to come in on Monday morning knowing what they needed to do to resolve the situation.

It was also noted that in ELEXON's experience any money lodged in such a situation will generally arrive before 13:00 on that Monday. The proposed extension to include five Business Hours would also allow ELEXON time to manage the subsequent default processes inside Business Hours should the Party's CCP still be above 80% when the Query Period ends at 14:00.

One Workgroup member considered that this Modification would help to distinguish defaults that would cause genuine risk to other participants from those caused by administration errors or insufficient collateral which would pose little risk to others. However, giving too long would allow the exposure of a genuine risk to grow. Nevertheless, the purpose of the Query Period is to assess whether the default is genuine, and the key question is whether this period should include Business Hours.

It was highlighted that some smaller participants do not operate 24-hour operations and may not be able to trade over the weekend to manage their positions. Equally, banks are not open outside of Business Hours to allow participants to lodge more cover. Some Workgroup members had little sympathy with the former argument, noting that it was entirely the participant's choice whether or not to trade outside of Business Hours. However, the Workgroup did sympathise with the latter argument, as this would apply to all participants.

One member flagged that overnight risk is not unique to the BSC. They also noted that the Workgroup would need to ensure everyone is protected, as all participants face the costs if a defaulting Party is unable to pay its bills. They noted the example of a Party triggering the Credit Default process on a Friday evening, and having to trade out its position in the imbalance market in order to manage its CCP, which increases the exposure of other Parties accordingly in the event the Party goes on to default on its payments.

When is industry notified of a Credit Default?

The Proposer noted that the incentive behind P307 is to reduce the need for Parties to 'over secure' their positions by lodging significant sums in Credit Cover to avoid facing the risks discussed above. However, several members noted that this was not the only driver behind Parties over securing, and that another reason was the reputational damage that could arise from entering authorised Credit Default.

One Workgroup member queried when the wider industry would become aware of a Party entering Credit Default. This depends on the severity of the breach, but will never be before the end of the Query Period. If the participant's CCP is over 100% at this point then the industry would be immediately notified. Conversely, if the CCP remains below 90% then it can take a couple of days for the Level 1 Cure Period to expire before a notification is issued, allowing the participant further time to remedy the situation.

The member considered that if the participant is unable to trade out or otherwise remedy its position over a weekend then allowing time on the Monday morning to lodge more money before the wider industry becomes aware of the situation would be good. Parties understand the implications of reputational risk, and the member did not think the wider industry should be falsely notified when the Party was legitimately in control of the situation. However, another member countered that if a Party breaches the 80% trigger threshold then it is likely it would breach the 100% threshold shortly after.

ELEXON flagged that the majority of events begin at 23:00 on a Friday due to several days' worth of Interim Information Settlement Run (II) data entering the Credit Cover calculations in place of estimated data. The Workgroup felt that that there was a strong justification to change the Query Period due to too much uncertainty in the calculations. However, the Workgroup considered that it would be beneficial to examine the impacts that the revised Query Period duration would have had on historical events to gauge the materiality of the change. The analysis concluded that there would have been little difference historically to the number of Parties that entered Credit Default under the proposed solution compared to the current process, although this analysis was not able to take into account any potential behavioural changes that may have occurred with the extra hours. The full analysis on this can be found in Appendix 2.

One member felt that counterparties would need as much notice as possible should an ECVN or MVRN that they are party to was about to be rejected or refused. Currently, these participants would be informed of a rejection or refusal only at the point of rejection or refusal, which can give them a very small window of time in which to trade out the subsequent imbalance on their own position. The Workgroup elected to seek the views of the industry as part of the Assessment Procedure Consultation on how much warning participants would realistically need of a counterparty entering Credit Default and that ECVNs and MVRNs may be rejected or refused.

Respondents to the consultation were generally of the view that as much notice as possible should be provided, especially if the impact would be more significant. However, one respondent also noted that the wider industry should not be falsely notified of a default where the Party is legitimately in control of the situation and would be able to lodge any additional Credit Cover required as soon as they were able to. You can find the full responses received in Attachment B.

Should ELEXON be obligated to monitor participants' CCPs?

The Workgroup considered a comment received in the Assessment Procedure Consultation that ELEXON should be obliged to monitor participants' CCPs. It was noted by members that, although not required to do so, ELEXON does monitor all participants' Credit Cover and, where possible, gives participants early warning if it is felt that their CCP is rising too fast or reaching the 80% threshold. The Workgroup was satisfied with this approach. One Workgroup member felt that obliging ELEXON to perform this monitoring would not be appropriate, as it is for participants to ensure that their levels of Credit Cover are suitable.

In addition, an array of tools is available through the ELEXON Portal that would facilitate participants in actively monitoring their own positions. In particular, there is a feature that allows a participant to receive an email notification should its CCP exceed a threshold of its choosing, or to receive an alert every half an hour of its latest CCP. The site also provides a participant with the background data to its current indebtedness position. The Workgroup believed it would be beneficial if participants were to make use of these tools, and asked ELEXON to ensure these are highlighted to the wider industry.

When are ECVNs and MVRNs rejected or refused?

One Workgroup member asked whether the rejection or refusal of ECVNs and MVRNs was optional. Any ECVNs and MVRNs that would increase the participant's CCP will be rejected or refused at any point while the participant is in authorised Credit Default and its CCP is over 90%, as summarised in Section 2. However, any ECVN or MVRN that would reduce the CCP would still be accepted. This process would stop when the participant's CCP returned to 90% or below, but would resume if the CCP subsequently exceeded 90% again. This is not optional, and is hard-wired into the rules around Credit Default and in the ECVAA systems. However, this will only happen if the participant has been formally placed into authorised Credit Default (i.e. not during the Query Period), which will only happen when ELEXON gives the ECVAA permission to set this status. Should material doubt or other such just reason apply, ELEXON will withhold this authorisation.

When does the participant enter Section H Default?

The Workgroup discussed the thresholds for a participant in Credit Default subsequently entering Section H Default. One member noted that there have been scenarios where a participant has persistently entered and subsequently exited authorised Credit Default, but not for long enough to trigger a Section H Default. It was queried whether the thresholds for entering Section H Default should be tightened.

It was noted that the Panel's powers in such a scenario are limited, and will usually need approval from the Authority for the action it takes. Even then, the Authority's powers can be limited should the organisation not be in administration. It was noted that being in breach of the BSC could also be deemed to be in breach of the participant's licence, which can allow for enforcement powers to be used. Nevertheless, a participant could not be expelled from the BSC or have its licence revoked by the Authority without due process being followed, as the Authority would need to consider the impacts and potential harm on consumers as a result of any actions.

Although the Workgroup considered the issues around Section H Default in response to a Credit Default, it was noted that this was not in the scope of P307 as the Proposer was not proposing changes to that part of the process. Therefore, the Workgroup is not proposing any changes to the Section H Default thresholds or processes as part of P307.

What reforms were suggested in the 2011 BSC Review?

The Workgroup accepted the Proposer's suggestion to look at the conclusions from the 2011 BSC Review in respect of the Credit Default process. The Proposer had stated that, while the intent of P307 is to extend the duration of the Query Period, they were not adverse to the Workgroup developing a wider solution as an Alternative Modification as long as a longer Query Period was included in that solution.

The Workgroup noted the BSC Review's proposal to replace the existing two-level process with a single process and a single entry threshold. It was believed that while the two levels have different outcomes, Parties treat the severity of both the processes equally due to the potential reputational consequences of being in authorised Credit Default irrespective of the level. Therefore, participants would see the 80% CCP threshold for the Level 1 processes to be just as urgent as the 90% and 100% thresholds under the Level 2 processes.

The Workgroup considered that any single threshold should be set to somewhere between 90% and 100%. There was concern about whether the process should be initiated before the participant's entire security has been used up. One member felt that the threshold should in theory be set to 100%, but noted that a period for administration was required which would necessitate a lower value. It was considered that this would come down to a trade-off between early warnings and a simpler process.

One member noted that ELEXON, while not obligated to do so, does follow good working practice in actively monitoring all participants' Credit Cover and giving any participant early warning if it is felt that its CCP is rising too fast or getting too close to the 80% threshold. Obligations only apply once the participant has hit the threshold and triggered the Credit Default processes. It was also noted that participants are not obligated to submit Credit Cover at all if they are never indebted to the BSC (i.e. they are consistently long), and it was felt that participants should not be obligated to submit more Credit Cover until they have used up their existing cover. The member did not want to lose the early warning but equally did not want to place additional obligations on ELEXON or participants in the process. Another member noted that a lower threshold would cause participants to continue to lodge more Credit Cover, which would be counter to the aims of P307.

A member asked how many participants' CCP exceeded 80% in the last 12 months. ELEXON noted that the number is not large. There are around five to six breaches per month on average, but only one a year tends to go on to enter authorised Credit Default, and none have done so in the past 12 months. A typical cause for breaching the 80% threshold is due to changes in participants' Credit Assessment Load Factor (CALF) or Generation or Demand Capacity (GC/DC) values at the start of each BSC Season, which impacts the Credited Energy Indebtedness (CEI) part of the Credit Cover calculations. It was also considered that the contract rounds that take place on 1 April and 1 October can also cause issues due to participants' portfolios changing without the ability to amend CALF or GC/DC values in response. However, this was one of the reasons why the material doubt process was originally introduced.

Overall, the Workgroup felt that a threshold of 90% would be the most pragmatic value to propose. The Workgroup also felt that, once in authorised Credit Default, the 75% exit threshold should remain unchanged, as the incentive should be to avoid entering Credit Default in the first place.

The Workgroup noted that the BSC Review suggested a two Working Day Query Period with no subsequent Cure Period. Members felt that this duration would be appropriate to allow participants the time to manage their position. The Workgroup initially proposed that this Query Period should end at close of Business Hours (17:00) on the second full Working Day, and considered whether this should be earlier, such as 15:00, to allow both ELEXON and any counterparties some Business Hours in which to react.

The Workgroup consulted upon its potential alternative solution as part of the Assessment Procedure Consultation. Members noted that a majority of respondents were in favour of the alternative option over both the proposed solution and the current baseline, but that some participants were cautious in their support, feeling that it would be better implemented at a later date following implementation of the P307 proposed solution. You can find the full responses received in Attachment B.

The Workgroup agreed that this alternative approach would be the most pragmatic to take. One member agreed that an extension to the Query Period would be a good first step, and would make people aware of the changes. They felt that P307 and the other credit-related Modifications, P306 and P308, should be implemented (if approved), and the effects of these changes observed, after which these further revisions to the Credit Default process should be revisited. Another member agreed, feeling that more analysis would be needed on the impacts of the potential alternative option, but that the proposed solution had benefits and should be implemented now.

The Workgroup concluded that its potential alternative solution could be beneficial in the long term, but felt that now was not the time to take it forward, preferring instead to implement P307's proposed solution as a first step. It therefore agreed not to raise the potential alternative solution as a P307 Alternative Modification.

Will participants' behaviour change in response to P307?

The Workgroup noted that P307 would only have benefits if participants were to change their behaviour in response by reducing the levels of excess Credit Cover that they currently lodge, something its historical analysis of Credit Default events was not able to take into account. As part of its consideration of P307, the Workgroup has looked at the level of reduction in Credit Cover that could be realised should participants be willing to hold a CCP closer to the 80% threshold, knowing that they would be guaranteed at least five Business Hours in which to remedy a breach. Its analysis suggests that should participants be willing to breach once per year around half the current level of Credit Cover across all Parties could be removed, rising to two thirds if participants are willing to breach 10 times a year. The full analysis results can be found in Appendix 2.

The Workgroup sought the views of respondents to the Assessment Consultation on whether they would change their behaviour in response to the solutions proposed by P307, and in particular whether they would reduce the amount of Credit Cover they lodge.

Some respondents considered that they would change their behaviour, highlighting that they would receive additional time in which to lodge more Credit Cover should they breach the 80% threshold. However, other respondents believed that they would not change their behaviour. One such respondent noted that they already had models and forecasts in place to ensure enough Credit Cover had been posted, but considered that smaller participants may benefit the most from the extra time. Another felt that a longer period still would be required before they would change their behaviour, considering that at least one full Working Day, and preferably two, would be needed. The Workgroup had previously discussed these options but had decided not to take either suggestion forward, for the reasons described in Section 3, and members did not change their minds in response to this comment. You can find the full responses received in Attachment B.

Workgroup's final views against the Applicable BSC Objectives

The Workgroup unanimously believes that P307 **would better facilitate Applicable BSC Objectives (c) and (d)** for the reasons given below. The Workgroup therefore unanimously recommends that P307 should be **approved**.

Applicable BSC Objective (c)

The Workgroup unanimously believes that P307 would better facilitate Applicable BSC Objective (c) as:

- reducing the levels of excess Credit Cover that participants would need to lodge, and the costs associated with doing so, would better facilitate competition; and
- it proposes a more pragmatic approach than the current process for smaller Parties in responding to a Credit Default event, as the current process is not the most optimal.

Applicable BSC Objective (d)

The Workgroup unanimously believes that P307 would better facilitate Applicable BSC Objective (d) as:

- allowing more time to manage a Credit Default and the removal of the Level 2 Cure Period would better facilitate efficiency in the BSC arrangements; and
- it would help to reduce some of the complexity in the Credit Default processes.

Assessment Procedure Consultation respondents' views

All eight respondents to the Assessment Procedure Consultation agreed with the Workgroup that P307 would better facilitate Applicable BSC Objectives (c) and (d). The reasons put forward were broadly in line with those expressed by the Workgroup, and no new arguments were raised. You can find the full responses received in Attachment B.

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]

(f) Implementing and administrating the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation

Panel's views on P307

The Panel felt that the proposed solution was a sensible and pragmatic solution, and was a step in the right direction for the credit arrangements. Panel Members believed that taking too radical a step too quickly, such as the more wide ranging measures of the potential Alternative Modification considered by the P307 Workgroup, could result in unintended consequences. They therefore agreed with the Workgroup's decision not to progress its potential Alternative Modification at this time, noting that if this wider long-term solution was deemed beneficial then a Modification would be raised by a BSC Party when it considered the time was right.

One Panel Member requested that ELEXON monitor the effect of the extended Query Period going forward, in order to assess the impacts it was having on BSC Trading Parties' behaviour. This will be accomplished as part of ELEXON's usual monitoring of Parties' credit positions and the credit processes.

Panel's initial recommendations

Applicable BSC Objectives

The Panel unanimously agrees that P307 **would better facilitate Applicable BSC Objectives (c) and (d)** for the same reasons given by the Workgroup in Section 7.

The Panel therefore initially unanimously recommends that P307 should be **approved**.

Legal text

The Panel unanimously agrees that the draft redlined changes to the BSC in Attachment A deliver the intention of P307.

Implementation Date

The Panel unanimously agrees with the Workgroup's recommended Implementation Date put forward under Section 5.

Report Phase Consultation Questions
Do you agree with the Panel's initial unanimous recommendation that P307 should be approved? *Please provide your rationale with reference to the Applicable BSC Objectives.*
Do you agree with the Panel that the redlined changes to the BSC deliver the intention of P307? *Please provide your rationale.*
Do you agree with the Panel's recommended Implementation Date? *Please provide your rationale.*
The Panel invites you to give your views using the response form in Attachment C

9 Recommendations

The BSC Panel initially recommends to the Authority:

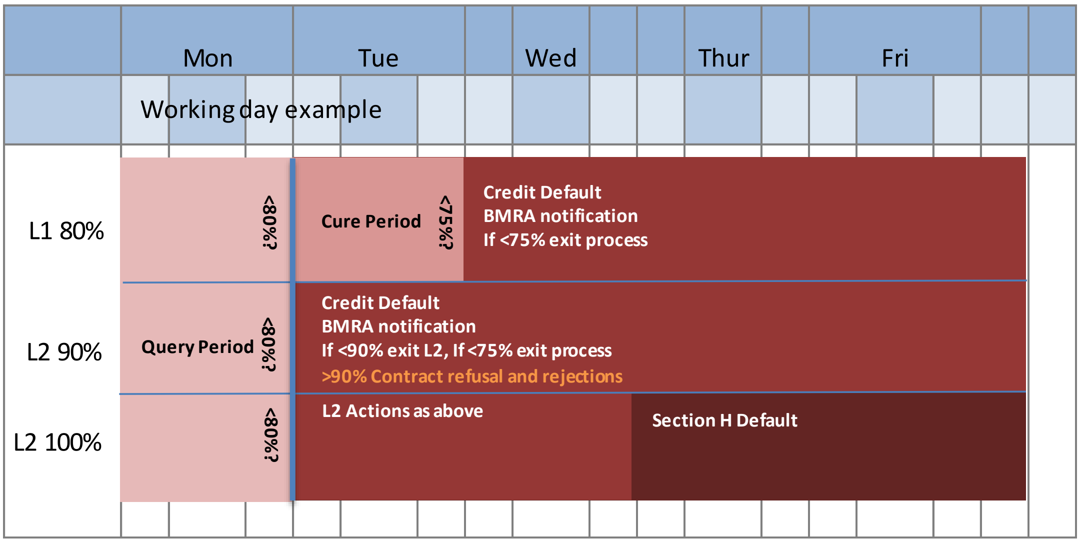
- That P307 should be **approved**;
- An Implementation Date for P307 of:
    - 25 June 2015 if an Authority decision is received on or before 12 February 2015; or
    - 5 November 2015 if an Authority decision is received after 12 February 2015 but on or before 25 June 2015; and
- The draft BSC legal text for P307.

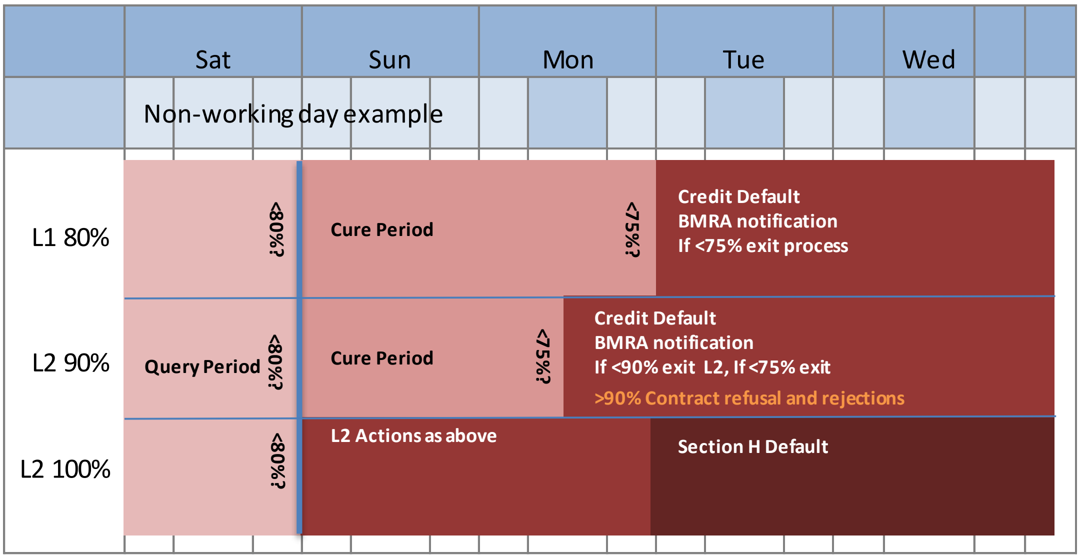
Appendix 1: Summary of Credit Default Timelines

The below timelines shows the current Credit Default process timescales compared to the proposed solution outlined in Section 3. The illustrations have been repeated to show the difference between what would happen on a Working Day and a non-Working Day. For illustration purposes the initial breach time has been set to 12:01 on a Monday for the Working Day example and a Saturday for the non-Working Day example. In reality, a breach usually happens in the early hours of the day when the II Settlement Run is updated and when Parties have a lower number of contracts to offset against the CEI calculation.

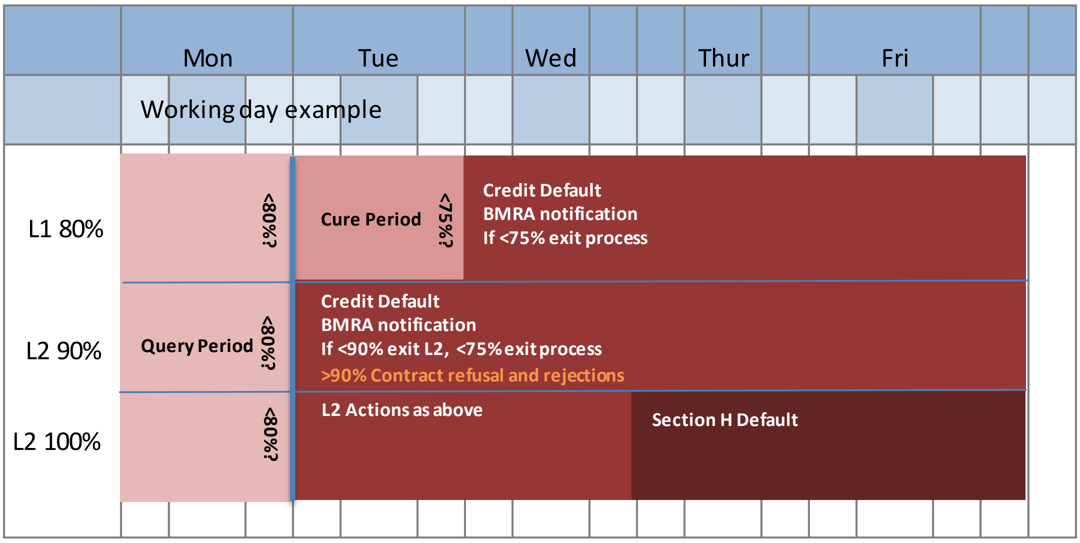
A vertical blue line indicates the end of the current Query Period.

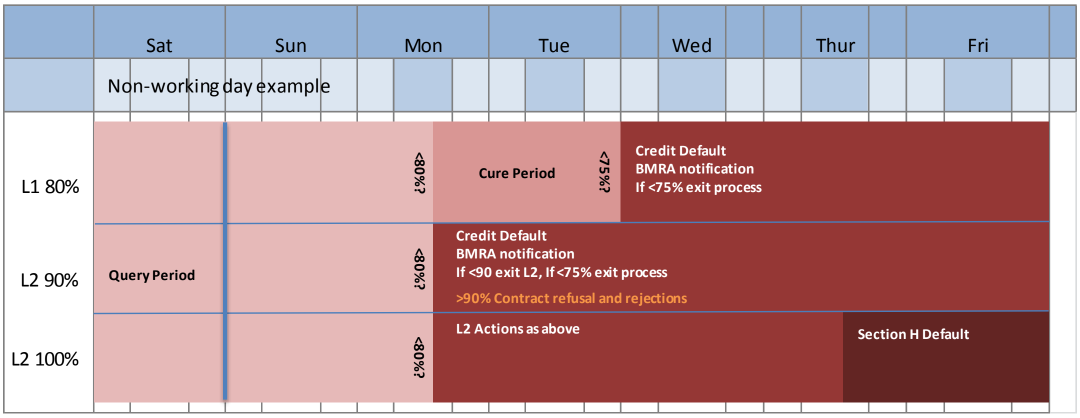
Current arrangements





Proposed solution





Appendix 2: Workgroup's Analysis

This Appendix summarises the results of the analysis undertaken by ELEXON on behalf of the Workgroup to assess the impacts of P307.

Scenarios considered under this analysis

The Workgroup has considered three scenarios as part of this analysis:

- the current arrangements;
- the proposed solution as outlined in Section 3; and
- the potential alternative solution as outlined in Section 3.

History of Credit Defaults

Currently most Parties who enter Credit Default will resolve the issue in the Query Period or Cure Period. This would normally be done by lodging further cash to their Credit Cover. We have reviewed the Credit Default notices issued since November 2009, and the table below shows the instances that occurred and would have occurred under each scenario.

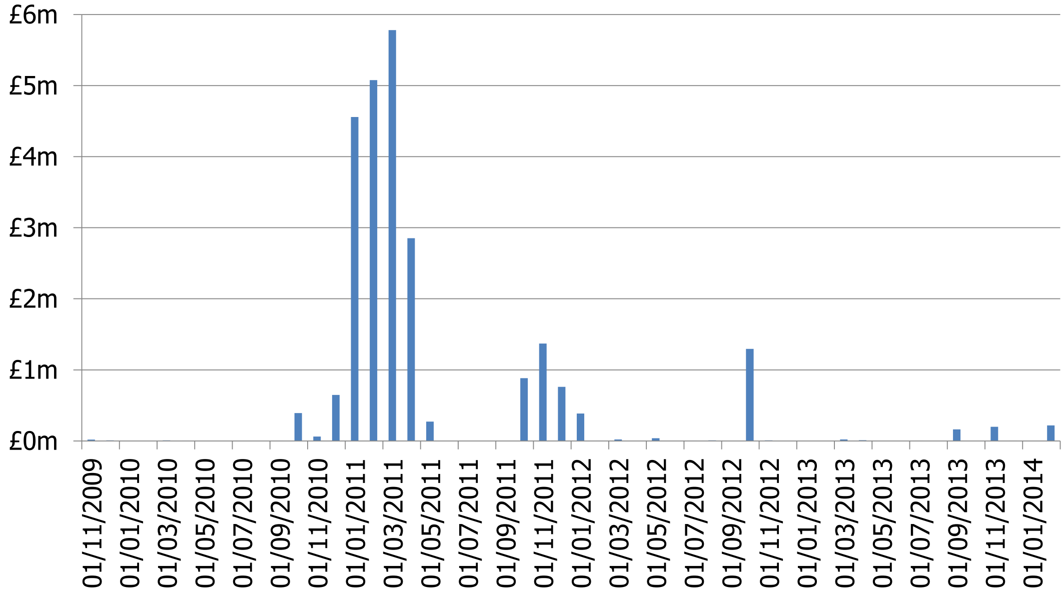
History of Defaults			
Scenario	No. of Default Notices since Nov 09	Excluding Material Doubt	CCP above threshold after Query Period and entered authorised Credit Default
Current Scenario – participant breaches 80%	166	132	74
P307 Proposed Scenario – participant breaches 80%	166	132	74
P307 Alternative Scenario – participant breaches 90%	113	16	16

Based on the above results there would have been no difference historically to the number of Parties that entered Credit Default under the proposed solution compared to the current process. However, this analysis does not take into account the potential behavioural changes that may have occurred with the extra hours. With the alternative solution, some Parties would not have had a Default Notice at all as they had not yet reached a 90% CCP.

Examples of real defaults and exposure

Credit Cover is lodged to protect the industry from Parties who are not able to or do not pay their trading charges, assuming the CCP calculation is reflective of their exposure. Should a Party's charges exceed 100% of its Credit Cover, other BSC Parties may be exposed to these charges. Looking at the 100% Credit Default notices that have occurred since November 2009 (excluding material doubt cases), the below graph shows the amount of exposure or Trading Charges that were in excess of the available Credit Cover.

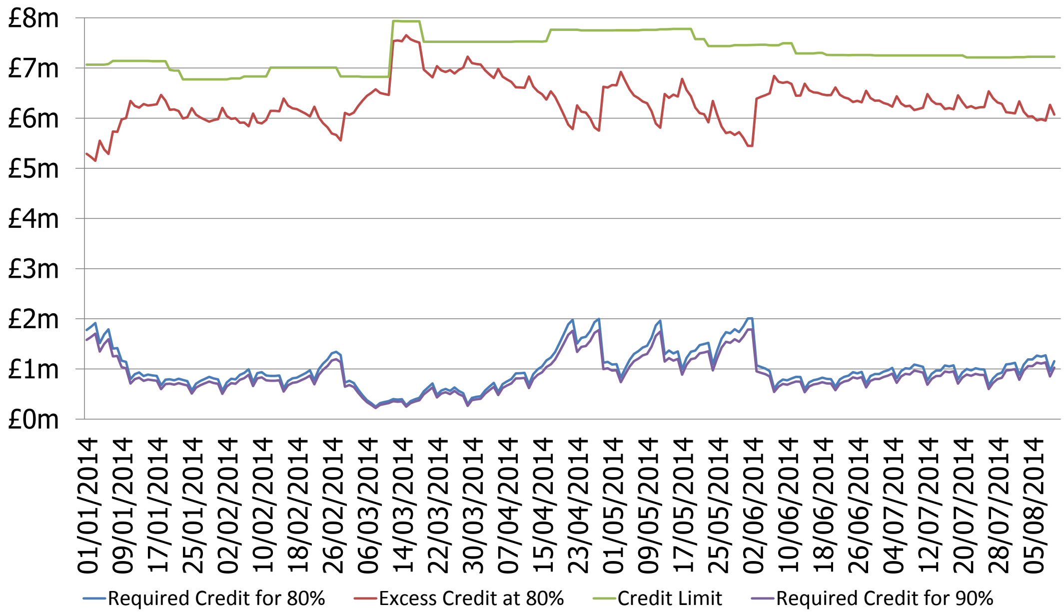
There are two significant breaches during this period. The highest exposure was for £249,188 which was from a single Party on 29 January 2011 and the other for £230,225 on 4 November 2011. Both were in authorised Credit Default for a number of days and were escalated to the Panel. In both cases the Parties would still have been escalated to the Panel under either of the proposed solutions.



Excess credit

As of 25 August 2014, there is a total of £353,266,965 lodged as Credit Cover. If the credit beach level of 80% was increased to 90% and Parties reacted by reducing their Credit Cover by 10% the industry would lodge £35,326,696.50 less than it currently does.

The below chart represents the amount of credit needed to achieve an 80% and a 90% CCP compared to the total credit lodged. There is also a mark to show how much excess credit there is based on these factors.



Potential reduction in excess credit

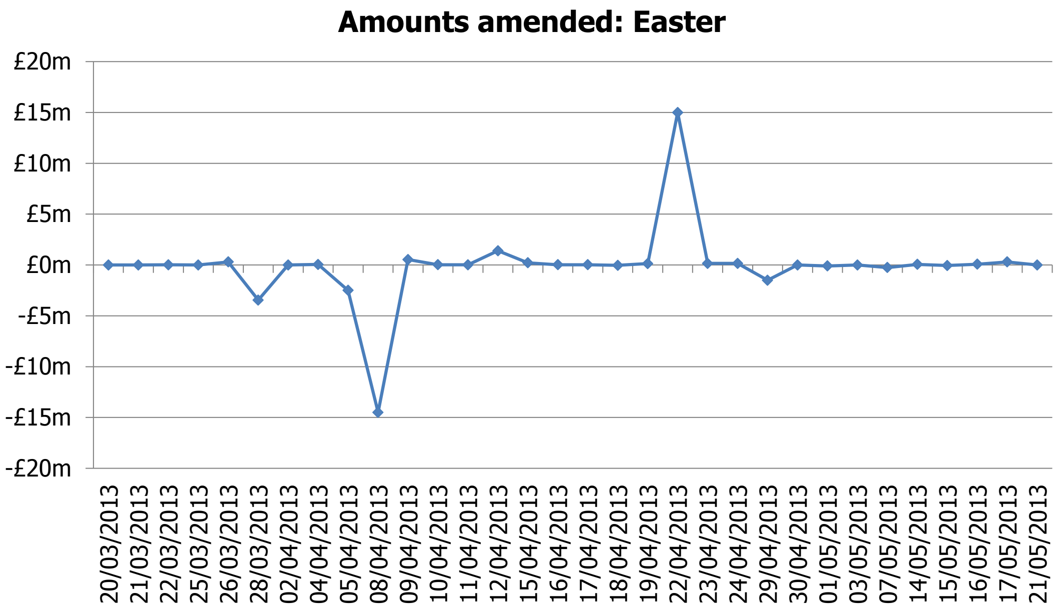
The guaranteed Business Hours in a Query Period may result in Parties changing their behaviour. They may manage their CCP with a shorter margin and be willing to breach the initial threshold occasionally. This analysis assumes that the Party is willing to breach a number of times per year. It can then resolve the breach in the guaranteed Business Hours within the Query Period. This would be subject to administration and transaction time and costs to amend Credit Cover.

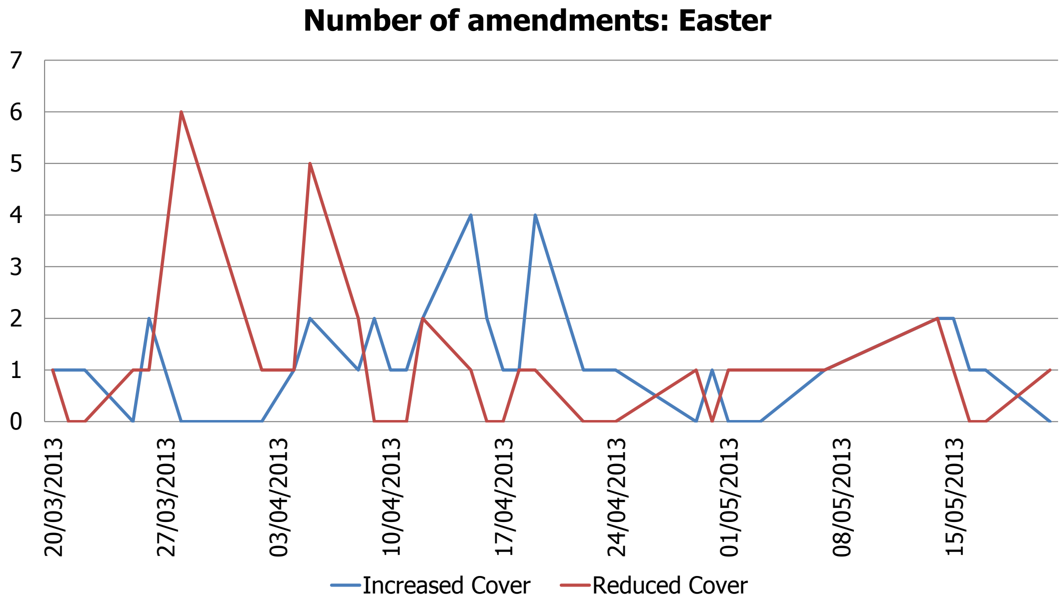
If all Parties are willing to exceed a CCP of 80% once a year as a result of the new Query Period durations, the market could remove approximately £175m in Credit Cover (this is approximately 49% of the total Credit Cover currently lodged). Assuming a willingness to breach the 80% threshold 10 times per year, and hence reducing the margin much further, this analysis suggests that £230m of excess Credit Cover could be removed (approximately 65% of the total Credit Cover currently lodged).

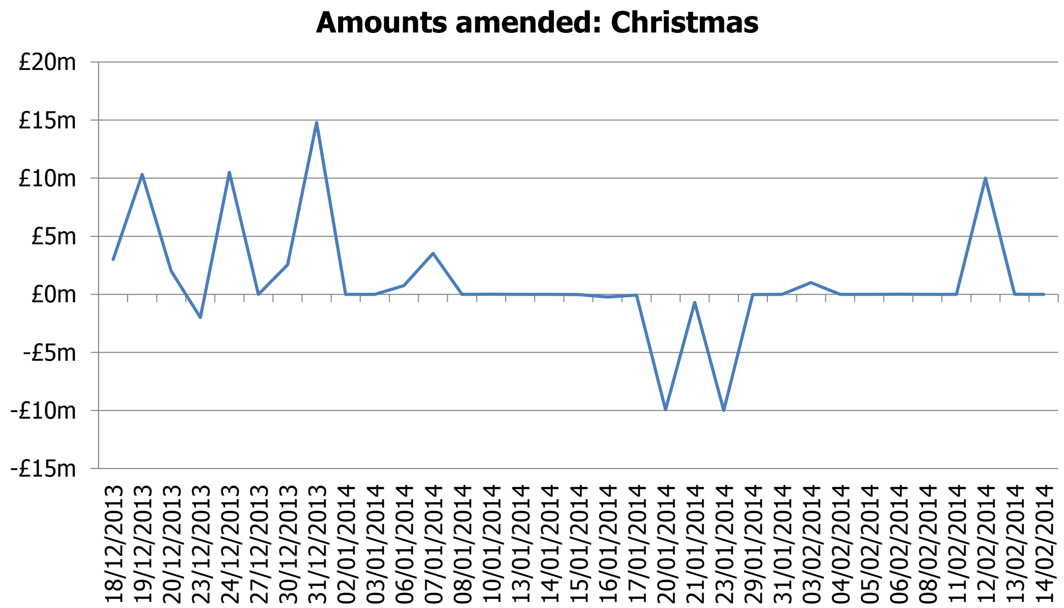
Credit Cover behaviour

Historically, when there is a Bank Holiday, Parties amend the Credit Cover that they have lodged. This is mostly because the Credit Cover calculation changes with what is included in the total 29 days calculation. The CEI, which usually covers the first five Working Days of the calculation, can increase up to 12 calendar days in the week following a Bank Holiday. The increased number of days particularly affects Suppliers where the CEI is based on a BM Unit’s contractual position at Gate Closure compared to an estimated Metered Volume. The estimated Metered Volume is based on the CALF and the expected maximum demand and consumption over the BSC Season (DC).

The next four graphs show the changes in Credit Cover over the most recent Easter and Christmas & New Year periods.




Number of amendments: Easter
7
6
5
4
3
2
1
0
20/03/2013
27/03/2013
03/04/2013
10/04/2013
17/04/2013
24/04/2013
01/05/2013
08/05/2013
15/05/2013
Increased Cover
Reduced Cover


Amounts amended: Christmas
£20m
£15m
£10m
£5m
£0m
-£5m
-£10m
-£15m
18/12/2013
19/12/2013
20/12/2013
23/12/2013
24/12/2013
27/12/2013
30/12/2013
31/12/2013
02/01/2014
03/01/2014
06/01/2014
07/01/2014
08/01/2014
10/01/2014
13/01/2014
14/01/2014
15/01/2014
16/01/2014
17/01/2014
20/01/2014
21/01/2014
23/01/2014
29/01/2014
31/01/2014
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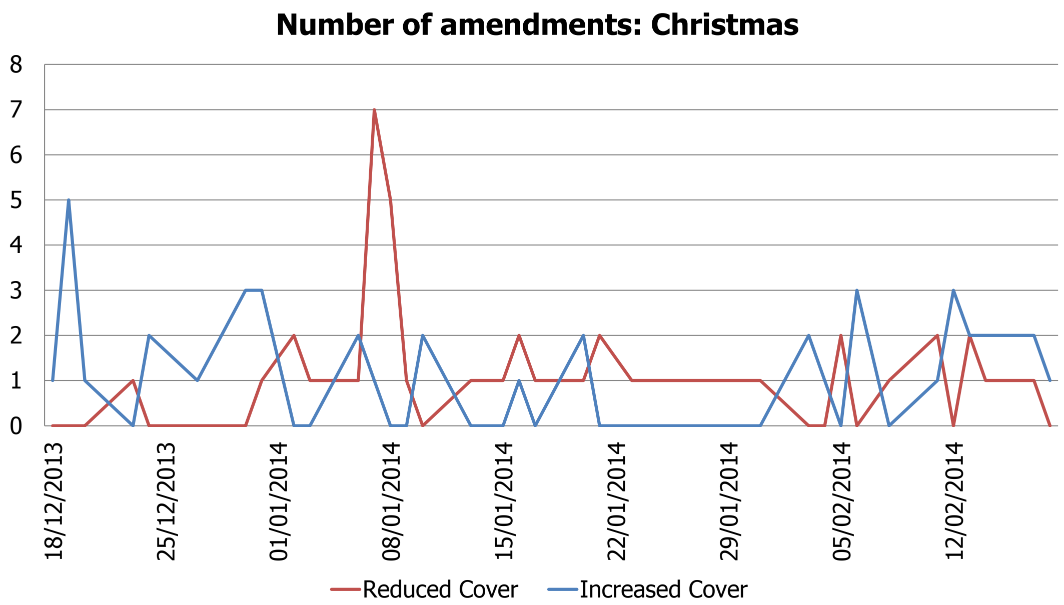
08/02/2014
11/02/2014
12/02/2014
13/02/2014
14/02/2014


Number of amendments: Christmas
8
7
6
5
4
3
2
1
0
18/12/2013
25/12/2013
01/01/2014
08/01/2014
15/01/2014
22/01/2014
29/01/2014
05/02/2014
12/02/2014
Reduced Cover
Increased Cover

Appendix 3: Workgroup Details

Workgroup's Terms of Reference

Specific areas set by the BSC Panel in the P307 Terms of Reference
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 unintended consequences could arise from the changes proposed by P307 and how can any such risks be managed?
What amendments would need to be made to the credit monitoring processes to account for the changes proposed by P307?
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?

Assessment Procedure timetable

P307 Assessment Timetable	
Event	Date
Panel submits P307 to Assessment Procedure	12 Jun 14
Workgroup Meeting 1	03 Jul 14
Central Systems Impact Assessment	24 Jul 14 – 13 Aug 14
Workgroup Meeting 2	28 Aug 14
Assessment Procedure Consultation	12 Sep 14 – 10 Oct 14
Workgroup Meeting 3	22 Oct 14
Panel considers Workgroup's Assessment Report	13 Nov 14

Workgroup membership and attendance

P307 Workgroup Attendance				
Name	Organisation	03 Jul 14	28 Aug 14	22 Oct 14
Members				
Talia Addy	ELEXON *(Chair)*	✓	✓	✗
Dean Riddell	ELEXON *(Chair)*	✗	✗	✓
David Kemp	ELEXON *(Lead Analyst)*	✓	✓	✓
Leonida Bandura	E.ON *(Proposer)*	✓	✓	✓
Andy Colley	SSE	✓	✓	✓
Karl Maryon	Haven Power	✓	✓	✓
Gary Henderson	IBM	✗	✓	✗
Dimuthu Wijetunga	Npower	☎	✓	✓
Lisa Waters	Waters Wye Associates	✗	✓	✗
Tryfon Tzelis	E.ON	✓	✗	✓
Attendees				
Beth Connew	ELEXON *(Design Authority)*	✓	✓	✓
Roger Harris	ELEXON *(Design Authority)*	✓	✓	✓
Tina Wirth	ELEXON *(Lead Lawyer)*	✗	✗	✗
Matthew Woolliscroft	ELEXON	✗	✗	✓
Graham Knowles	Ofgem	✓	☎	☎
Joseph Gildea	Ofgem	✗	✗	☎
Peter Bolitho	Waters Wye Associates	✓	✗	✓

Appendix 4: Glossary & References

Acronyms

Acronyms used in this document are listed in the table below.

Glossary of Defined Terms	
Acronym	Definition
BMRS	Balancing Mechanism Reporting Service
CALF	Credit Assessment Load Factor *(parameter)*
CCP	Credit Cover Percentage
CEI	Credited Energy Indebtedness
DC	Demand Capacity *(parameter)*
ECVAA	Energy Contract Volume Allocation Agent *(BSC Agent)*
ECVN	Energy Contract Volume Notification *(contract notification)*
GC	Generation Capacity *(parameter)*
II	Interim Information *(Settlement Run)*
MVRN	Metered Volume Reallocation Notification *(contract 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
-	P307 page on the ELEXON website	http://www.elexon.co.uk/mod-proposal/p307/
4	Credit page on the ELEXON website (for the Credit Default guidance note)	http://www.elexon.co.uk/reference/credit-pricing/credit/
6	BSC Panel 182 page on the ELEXON website (for the 2011 BSC Review)	http://www.elexon.co.uk/meeting/bsc-panel-182/
7	P306 page on the ELEXON website	http://www.elexon.co.uk/mod-proposal/p306/
7	P308 page on the ELEXON website	http://www.elexon.co.uk/mod-proposal/p308/
12	ELEXON Portal	https://www.elexonportal.co.uk/