Assessment Procedure Consultation Responses

P306 'Expanding the Definition of a 'Letter of Credit' to include regulated insurance companies'

This Assessment Procedure Consultation was issued on 25 July 2014, with responses invited by 15 August 2014.

What stage is this document in the process?

01 Initial Written Assessment

02 Definition Procedure

03 Assessment Procedure

04 Report Phase

Consultation Respondents

Respondent	No. of Parties/Non-Parties Represented	Role(s) Represented
Green Energy (UK) Plc	1/1	Supplier, MVRNA
GDF SUEZ	14/0	Generator, Supplier
Haven Power Ltd	1/0	Supplier
E.ON	4/0	Generator, Supplier, Interconnector User, Non Physical Trader
EDF Energy	11/0	Generator, Supplier
RWE npower	1/0	Supplier
SSE plc	8/0	Generator, Supplier, Interconnector User
Centrica	11/0	Generator, Supplier
IBM UK Ltd	9/0	Generator, Supplier, Distributor, ECVNA, Supplier Agent, MVRNA

Question 1: Do you agree with the Workgroup's view that the list of approved rating agencies under the definition of a 'Letter of Credit' should be expanded to include Fitch Ratings?

Summary

Yes	No	Neutral/No Comment	Other
9	0	0	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	Yes	Credit cover is a serious issue for smaller suppliers, and provides a serious barrier to entry. Any extension to the current definition of a 'Letter of Credit' would be applauded. We feel that suppliers who bank with an institution who fall on the wrong side of the current setup are unfairly marginalised. Cash reserves are clearly important to every company throughout the industry, but we would argue that they are especially vital to new and emerging suppliers who are not likely to have the balance sheet of the larger suppliers.
GDF SUEZ	Yes	As has been noted on page 15 of the Assessment Procedure Consultation document, Fitch is already an approved rating agency under the Treasury Report. In addition, Fitch, along with S&P and Moody's, have been recognised as External Credit Assessment Institutions whose ratings are eligible for Basel II purposes by all EU/EEA members.
Haven Power Ltd	Yes	We agree with the workgroup's view that the list of approved rating agencies under the definition of a 'Letter of Credit' should be expanded to include Fitch Ratings as this will increase the pool of qualified banks which gives more choice to parties and the possibility of lower associated costs. We note Fitch is already an approved rating agency under the Treasury Policy.
E.ON	Yes	We believe that by including Fitch Ratings in the definition this will sufficiently expand the pool of acceptable credit providers and help to increase competition.

Respondent	Response	Rationale
EDF Energy	Yes	Yes, Fitch is a significant and well established ratings agency, and as long as the equivalent rating is required where given by Fitch, as one from Standard & Poor's or Moody's, then this can increase choice and competition, without adding risk to other BSC Parties.
RWE npower	Yes	Given the fact 'Fitch' is a global leader in credit rating it would be sensible to include them as an approved rating agency which will open more options to the industry participants when selecting an eligible security provider.
SSE plc	Yes	Fitch Ratings are a globally recognised ratings agency, with an increasing presence in the corporate ratings market over recent years. As one of the Big Three global ratings agencies it is perhaps somewhat anomalous that Fitch are not currently approved. It is appropriate therefore to allow their inclusion as an approved agency under the BSC at this point in time.
Centrica	Yes	We are content that Fitch Ratings is added as an approved rating agency. We note Elexon's analysis that including Fitch would broaden the pool of qualified banks that could provide Letters of Credit under the BSC. Provided the qualified banks are required to maintain a sufficient credit rating (see our response to Question 2), we accept that broadening the pool of qualified banks could contribute to relevant objective (c). P306 is also proposing to allow insurance products with equivalent properties to a Letter of Credit (LC) as credit cover under the BSC. As such, the workgroup should consider whether insurance company focussed rating agencies should be added to the approved rating agencies. We suggest AM Best as an example of an insurance company focussed rating agency that could be added. We have reviewed the draft legal text for P306. The draft definition of "Approved Insurance Product" does not currently specify the approved rating agencies for awarding the required credit rating: ""Approved Insurance Product" means an insurance product which complies with the requirements set out in Annex M-4 of Section M and is provided by an insurance company regulated in the United Kingdom which has a long term debt rating of not less than a single A."

Respondent	Response	Rationale
		We assume the approved rating agencies for the insurance companies are intended to be the same as for a LC, i.e. Moody's S&P and (prospectively) Fitch. The legal text should clarify this to avoid any ambiguity. We also note that the draft legal text for P306 continues to specify a minimum long term debt rating of "not less than single A". This does not reflect the Assessment Procedure Consultation, which proposes to cut the minimum long term debt rating to BBB. The draft legal text needs to be consistent with the modification proposal. See our response to Question 2 for our specific views on the proposal to cut the minimum credit rating.
IBM UK Ltd	Yes	Fitch's is an internationally recognised ratings agency and is regularly used in conjunction with Moody's and S&P. It makes sense to align the BSC with generally accepted practice.

Question 2: Do you agree with reducing the requited credit rating to expand the pool of banks able to provide a 'Letter of Credit'?

Summary

Yes	No	Neutral/No Comment	Other
5	4	0	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	Yes	We would be keen to see both Fitch Ratings included into the definition and a lowering of the required credit rating; however we feel that reducing the required credit rating is essential. We agree with the working group that the downgrade of many high street banks over the last few years has caused issues for many suppliers, not purely with the BSC but also with other codes requiring credit cover. As the UK government now owns shares in many of these banking institutions we feel that the BSC can have a certain level of confidence in their credit worthiness.
GDF SUEZ	No	While it is indeed the case that a number of banks have undergone ratings downgrades over the past few years, the proposal to lower the credit rating by three notches to 'BBB' raises the risk of Elexon being exposed to banks of substantially weaker credit quality. It would be more prudent to move the minimum credit rating to 'A-' (which is the industry standard in terms of the minimum acceptable rating when it comes to the provision of letters of credit).
Haven Power Ltd	Yes	We agree with reducing the required credit rating to expand the pool of banks able to provide a 'Letter of Credit' for similar reasons to Question 1. The increase in choice and associated possible cost savings in our opinion outweigh the possible increased risk.
E.ON	No	We believe that if Fitch Ratings are included in the definition and the credit rating is also reduced, this will introduce too much potential risk. It is sufficient to include Fitch Ratings in the definition of a 'Letter of Credit'.

Respondent	Response	Rationale
EDF Energy	No	No; we consider it important, given the reliance that would be placed in an event of default on these letters of credit, that they be highly robust. Given that P306 is making two major changes, adding insurers to those who can underwrite the equivalent of a letter of credit, and allowing ratings from Fitch, we don't believe that it is also necessary, or prudent, to lower the required ratings at this stage. We do believe there are sufficient well established and well rated letter of credit / bond providers, whether banks or insurers that meet the current rating test.
RWE npower	Yes	Given the current economic climate within Europe and the bank credit rating downgrades taken place in the recent past we welcome the proposal to lower the credit rating requirement of collateral providers. This would increase the pool of eligible security providers in the market which could promote competitive rates for suppliers when obtaining collateral.
SSE plc	Yes	SSE support the proposal to allow a reduction in the required credit rating in order to expand the pool of qualifying banks, as this will provide greater competition and pressure on price in providing these services which should result in more efficient costs to BSC Parties. At this point we would probably advocate being slightly more cautious than suggested in the consultation and drop the hurdle to the equivalent of BBB+ in the first instance, rather than BBB flat. We would not support a reduction to BBB-equivalent.
Centrica	No	We believe the proposal to cut the minimum credit rating by three notches (A > A- > BBB+ > BBB) is disproportionate and introduces unnecessary additional risk into the BSC arrangements. Further, we do not believe there is robust evidence from the last year or two of significant deterioration in banks' credit worthiness. There is therefore no justification for such a significant weakening of the minimum credit rating. We believe the proposal to move from A to BBB would be detrimental to relevant objective (c). However, we believe a more proportionate adjustment to the minimum credit rating could be regarded as striking a reasonable balance between cost and risk. We would be willing to support a

Respondent	Response	Rationale
		reduction in the minimum credit rating of one notch, from A to A-. This more proportionate change would be consistent with relevant objective (c). We also believe an adjustment to A- would better reflect industry standards in EFET/ISDA trading arrangements. As noted in our response to Question 1, the draft legal text for P306 continues to specify a minimum long term debt rating of "not less than single A". This does not reflect the Assessment Procedure Consultation, which proposes to cut the minimum long term debt rating to BBB. The draft legal text needs to be consistent with the modification proposal. For the avoidance of doubt, we believe the draft legal text should be amended to read "not less than A-", as opposed to "not less than BBB".
IBM UK Ltd	No	We support the current policy of placing a high bar on the level of institutions we accept to provide cover. While we recognise that the current economic climate has led to some 'a' rated banks losing that rating we feel that it is precisely those circumstances which mean we should only retain 'a' rated institutions.

Question 3: Do you agree with the Workgroup's view that funds claimed through an insurance product should be released within 3 working days of the claim being made? (*If not, would you prefer a longer timescale accepting the risk that all Parties may need to cover bridging funds via payment of funding shares?)*

Summary

Yes	No	Neutral/No Comment	Other
8	0	1	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	Yes	No rationale provided.
GDF SUEZ	Yes	No rationale provided.
Haven Power Ltd	Neutral	We agree with the Workgroup's view that funds claimed through an insurance product should be released within 3 working days of the claim being made. A longer timescale increases the risk the industry may need to accept that bridging funds might be needed while claims are made (which would be delivered via levying funding shares on market participants.) The requirement to provide bridging funds should be avoided and would be particularly difficult for small suppliers and independent generators to cope with.
E.ON	Yes	The three working day timescale is a reasonable requirement and is in line with the current arrangements. This approach also avoids the introduction of any complications surrounding the administering of funds.
EDF Energy	Yes	Yes, current default and claiming processes under the BSC are based on release of funds by a letter of credit provider within 3 working days of being claimed. We wish to maintain this standard for the new equivalent insurance product, whilst allowing new insurance providers, to meet it, in the interests of competition.
RWE npower	Yes	We would want any funds relating to an insurance product to be released within 3 working days. Otherwise rest of the industry participants would be exposed to an unnecessary risk.

Respondent	Response	Rationale
SSE plc	Yes	SSE support the work group's conclusions that an insurance backed product should ideally pay out within 3 working days, to provide an equivalent level of assurance to that provided by a Letter of Credit currently. If it is not viable to source an insurance product that meets this criterion at a reasonable cost, then SSE would be prepared to further consider a longer period of payment, with the subsequent implications for bridge funding. However, we would need to have more information on the likely time period needing to be bridged before giving a definite view.
Centrica	Yes	We believe the insurance product should operate in the same way as a LC, to ensure the robustness of the BSC credit arrangements is maintained whichever product is used as credit cover. Practically, this means both products should be released within the same timeframe.
IBM UK Ltd	Yes	3 days provides a suitable balance, allowing these new products to be utilised without adding undue burden onto other Parties.

Question 4: Will P306 impact your organisation?

Summary

Yes	No	Neutral/No Comment	Other
3	6	0	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	Yes	As a supplier we are affected by credit cover, a relaxation of the current definition would give us more options to satisfy the cover demands.
GDF SUEZ	No	There will be no impact on my organisation.
Haven Power Ltd	No	No rational provided.
E.ON	Yes	If insurance products become an acceptable form of credit, this may be considered as an alternative to Letters of Credit in the future.
EDF Energy	Yes	We hope that the implementation, based on allowing a new equivalent insurance product, and allowing new ratings from Fitch, yet requiring the same rating level, will improve competition and choice, without increasing the risk of loss to others arising from any given firm's default. We therefore, on the basis of this definition of the modification, anticipate beneficial effects, without detriment.
RWE npower	No	We do not anticipate any direct impacts as a result of this implementation.
SSE plc	No	There are no systems nor process impacts on SSE, given that use of the additional product is optional. Potentially. SSE would be likely to utilise an insurance backed product if it can be procured at a competitive rate in comparison to a Letter of Credit, and provide equivalent assurance in transferring risk.
Centrica	No	No comments.
IBM UK Ltd	No	No rationale provided.

Question 5: Will your organisation incur any costs in implementing P306?

Summary

Yes	No	Neutral/No Comment	Other
0	9	0	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	No	No rationale provided.
GDF SUEZ	No	My organisation will not incur any costs in implementing P306.
Haven Power Ltd	No	No rationale provided.
E.ON	No	Existing arrangements will not be affected; therefore we do not anticipate incurring any costs.
EDF Energy	No	No, none.
RWE npower	No	We do not anticipate any direct cost impacts as a result of this implementation.
SSE plc	No	Utilising an insurance backed security product is optional for each participant. Any cost incurred through transferring an extant security instrument to an insurance backed product is likely to either be delayed until expiry of the current instrument, or offer sufficient cost savings to justify the expense. There are potential indirect costs if the insurance backed product proves to be inadequate and leads to greater levels of default funding arising from bad debts. It is crucial therefore that Elexon's Treasury Policy safeguards that the terms of any product are sufficiently robust to avoid a significant increase in the risk of default, and that Elexon have the right to refuse to accept a product as security if the legal wording of the product cannot be agreed upon.
Centrica	No	No comments.
IBM UK Ltd	No	No rationale provided

Question 6: Do you agree with the Workgroup's initial unanimous view that P306 does better facilitate the Applicable BSC Objectives than the current baseline?

Summary

Yes	No	Neutral/No Comment	Other
7	1	0	1

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	Yes	No rationale provided.
GDF SUEZ	Yes	The proposed solution will offer BSC Parties greater flexibility in terms of the credit support providers they will be able to use. This may help to reduce the cost of providing credit support as this should increase competition among LC issuers. P306 will therefore better facilitate Objective c.
Haven Power Ltd	Yes	We agree with the Workgroup's view.
E.ON	Yes	P306 promotes effective competition by offering greater flexibility and additional options for BSC Parties to lodge Credit Cover under the BSC. This will enable them to provide collateral on their liabilities and lower the barriers for entering the market. It will also improve efficiency as adding additional options for lodging Credit Cover should result in less instances of default
EDF Energy	Conditional yes (depends on form of mod, as per main reply)	If the mod is developed based on allowing a new equivalent insurance product, and allowing new ratings from Fitch, yet requiring the same rating level, we believe that it does better facilitate Applicable BSC Objective C than the current baseline, as it will improve competition and choice of credit securitisation, without increasing the risk of loss to others arising from any given firm's default. Thus the mod would, in this form, promote effective competition by offering greater flexibility and additional options for BSC Parties to lodge Credit Cover under the BSC. We therefore, on the basis of this definition of the modification, anticipate some beneficial effects, without detriment. However, if the mod were to permit a lower credit rating level from the providing entity, then we consider it would meet the applicable objectives less well than baseline. This version of the mod would

Respondent	Response	Rationale
		increase the risk to parties from others' default, would create undue risk, and increase the risk and cost-of-capital of operating as a party.
RWE npower	Yes	We believe this change proposal would increase competition by offering both flexibility and additional options for BSC parties to provide credit cover under the BSC in a cost effective way without exposing industry to unnecessary risks.
SSE plc	Yes	The proposed solution would offer BSC Parties increased choice of security instruments available to underwrite credit obligations, at competing costs. Greater choice, and the ensuing potential to reduce costs and redeploy capital, supports competition in the generation and supply of electricity and therefore better facilitates objective c). In addition, we agree with the working group view that there are likely to be marginal positive benefits in the administration of the BSC, noting that Elexon already monitor Fitch Ratings for other purposes, and therefore support the conclusion that the change would better facilitate objective d).
Centrica	No	We believe the proposal to cut the minimum credit rating by three notches (A > A- > BBB+ > BBB) is disproportionate and introduces unnecessary additional risk into the BSC arrangements. Further, we do not believe there is robust evidence from the last year or two of significant deterioration in banks' credit worthiness. There is therefore no justification for such a significant weakening of the minimum credit rating. We believe the proposal to move from A to BBB would be detrimental to relevant objective (c). However, we believe a more proportionate adjustment to the minimum credit rating could be regarded as striking a reasonable balance between cost and risk. We would be willing to support a reduction in the minimum credit rating of one notch, from A to A-. This more proportionate change would be consistent with relevant objective (c). We also believe an adjustment to A- would better reflect industry standards in EFET/ISDA trading arrangements.
IBM UK Ltd	Yes	Objective c will be better served by allowing smaller Parties to be able to source credit cover from a wider pool of companies, encouraging new entrants and increasing competition.

Question 7: Do you agree with the Workgroup that the draft legal text in Attachment A delivers the intention of P306?

Summary

Yes	No	Neutral/No Comment	Other
7	2	0	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	Yes	The only alteration we wish to see is to the definition of letter of Credit in Glossary X-1. We believe this should be changed to show the required credit ratings are BBB at Standard & Poor's, BAA at Moody's or BBB by Fitch. Currently this still says the rating has to be single A.
GDF SUEZ	Yes	The draft legal text delivers the intention of P306.
Haven Power Ltd	Yes	No rationale provided.
E.ON	Yes	The draft legal text takes into consideration the proposed change to the definition and looks to maintain clarity and consistency of interpretation.
EDF Energy	Yes	Yes, and it is flexible to how the mod is developed. We wish to see the same (the existing) minimum rating level maintained for both new and existing providers of letters of credit and their insurance equivalent.
RWE npower	No	We feel that under Annex X-1: General Glossary, the definition of 'Approved Insurance Product' needs to reflect the amended credit requirements of the 'Letter of Credit' definition below with regard to the requirement for a formal credit rating of at least an A (or equiv) from the three main rating agencies or there might be a credit mismatch from the amended acceptable credit providers. Currently it refers to only a 'long term debt rating' which is not in line with that which is required for banks issuing letters of credit.
SSE plc	Yes	No rationale provided.

Respondent	Response	Rationale
Centrica	No	As noted in our responses to Questions 1 and 2, we believe the draft legal text needs to be amended in two respects to deliver the intent of P306. 1. The draft definition of "Approved Insurance Product" does not currently specify the permitted rating agencies for awarding the required credit rating: ""Approved Insurance Product" means an insurance product which complies with the requirements set out in Annex M-4 of Section M and is provided by an insurance company regulated in the United Kingdom which has a long term debt rating of not less than a single A." We assume the permitted rating agencies for the insurance companies are intended to be the same as for a LC, i.e. Moody's S&P and (prospectively) Fitch. The legal text should clarify this to avoid any ambiguity. 2. The draft legal text for P306 continues to specify a minimum long term debt rating of "not less than single A". This does not reflect the Assessment Procedure Consultation, which proposes to cut the minimum long term debt rating to BBB. The draft legal text needs to be consistent with the modification proposal. For the avoidance of doubt, we believe the draft legal text should be amended to read "not less than A-", as opposed to "not less than B".
IBM UK Ltd	Yes	No rationale provided.

Question 8: Do you agree with the Workgroup's recommended Implementation Date?

Summary

Yes	No	Neutral/No Comment	Other
9	0	0	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	Yes	We feel that this should be implemented as soon as possible, 10 working days following an Authority decision seems reasonable.
GDF SUEZ	Yes	No comments.
Haven Power Ltd	Yes	No rationale provided.
E.ON	Yes	An Implementation Date for P306 of 10 Working Days following an Authority decision, if the decision is made to approve P306, is sufficient.
EDF Energy	Yes	The Workgroup are recommending an Implementation Date for P306 of 10 Working Days following an Authority decision. A similar mod has been implemented in CUSC space since 7th July 2014; we can see no need for a long lead period prior to implementation, provided that the mod is well-defined enough for Grid's credit department, and users' credit departments, to be able to operate it effectively from that date.
RWE npower	Yes	We agree with Workgroup's recommended time scales for implementation as we are not anticipating any significant impacts due to this modification.
SSE plc	Yes	There is no systems impact, so the lead time is appropriate
Centrica	Yes	We agree that P306 expands options but should not create disruption to BSC parties. As such, 10 working days following an Authority decision is a reasonable timeframe for implementation.
IBM UK Ltd	Yes	No rationale provided.

Question 9: Do you agree with the Workgroup that there are no other potential Alternative Modifications within the scope of P306 which would better facilitate the Applicable BSC Objectives?

Summary

Yes	No	Neutral/No Comment	Other
9	0	0	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	Yes	No rationale provided.
GDF SUEZ	Yes	No comments.
Haven Power Ltd	Yes	No rationale provided.
E.ON	Yes	Although there are currently similar modifications being worked on (P307 and P308), we believe that each of these Modification Proposals stands alone and can therefore be implemented without reliance on the others.
EDF Energy	Yes	Yes, we have nothing to propose here
RWE npower	Yes	We believe this change proposal would enable to meet the specific BSC objectives (as listed in the original assessment consultation document v1.0) without exposing industry to unnecessary risks.
SSE plc	Yes	No rationale provided.
Centrica	Yes	We believe there are two potential alternatives to P306 which would better facilitate the relevant objectives than the current proposal (specifically, relevant objective (c)). Of the two, we believe Option 2 would best facilitate the relevant objectives. **Option 1:** Adjust the minimum credit rating by one notch, from A to A-, rather than three notches as proposed by the Workgroup. **Option 2:** Adjust the minimum credit rating by one notch, from A to A-, rather than three notches as proposed by the Workgroup. Include AM Best as a permitted rating agency in addition to Fitch Ratings.
IBM UK Ltd	Yes	No rationale provided.

Question 10: Do you have any further comments on P306?

Summary

Yes	No	Neutral/No Comment	Other
1	8	0	0

Responses

Respondent	Response	Rationale
Green Energy (UK) Plc	No	n/a
GDF SUEZ	No	n/a
Haven Power Ltd	No	n/a
E.ON	No	n/a
EDF	Yes	The insurance product needs to be truly equivalent to a letter of credit, not only in terms of time to pay, but also, in particular, in terms of it being irrevocable (so that there is true transfer of risk onto the insurer), unconditional and truly payable-on-demand.
RWE npower	No	n/a
SSE plc	No	n/a
Centrica	No	n/a
IBM UK Ltd	No	n/a