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## Issue 106 Workgroup Meeting 5 Summary

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### Summary

#### 1. Meeting Objectives

The Chair welcomed attendees and presented the meeting objectives:

- Objective 1: Recap on the Issue 106 discussion
- Objective 2: Review the potential outcomes
- Objective 3: Agree on closing Issue 106

#### 2. Issue 106 Recap

2.0 2.1 Elexon started by summarising why Issue 106 was raised, the feedback received and the discussion in the previous meetings.

#### 3. Review of the proposed Credit Cover Calculation

3.0 Elexon then recapped the discussions around the proposed New Credit Cover Calculation. Elexon explained that this solution lays down the principles and concepts to design a new calculation. The solution needs to be refined through a Modification Assessment Procedure, emphasising how the solution will work for each type of party (Supplier, Generators, Embedded Generators, etc.) and under its interaction with other ongoing Changes like P415.

3.1 Then, the Issue Group (IG) voted if they agreed with the proposed solution:

- Yes – 45% (4 votes)
- No – 0% (0 votes)
- Neutral – 55% (5 votes)

3.2 Elexon asked if any of the Parties in the meeting would be interested in raising the change. A Party expressed interest offline to Elexon in raising this change. Given the dependencies with MHHS, work will not start on this Modification until 2024. Of those that voted neutral (which equates to a vote for no change, not better than the current baseline) the reasons given were that it was not their area of expertise, or that it was not yet clear if the new calculation would be any better than the existing calculation, although there was a sense it should be, especially for flexible generators.

#### 4. Further Analysis of the Credit Default Proposal and Removal of Cure Period

4.0 Elexon presented a further analysis of the Credit Default Proposal, which aims to delay the rejection/refusal of any ECVNs & MVRNs after a Party has entered authorised Level 2 Default. The Proposal's overall impact on the BSC is low. It represents a small risk compared to the benefits of delaying the rejection of ECVNs for liquidity in trading between counter Parties.

4.1 The process is doing what was intended in that the incentive to resolve the Default promptly is there. The measure of incentive is instances of where Parties have avoided entering Credit Default.

4.2 The threat of entering Credit Default level 2 is prominent and by delaying the rejection of ECVNs by one further Settlement Period will bring benefits to Counter Parties as it allows greater control and opportunity to terminate ECVN's with any Defaulting Party that may impact their own position.

4.3 There is also a big difference to the many BSC Parties that utilise the power exchanges and the benefits of increased competition in short term trading and for Counter parties to reduce risk of exposure.

4.4 The Issue group unanimously voted to recommend the progression of this Proposal as a Modification, and a Party expressed interest offline to Elexon in raising this change.

- 4.5 Elexon noted that after reviewing the Proposal to remove the Cure Period (presented at the second workgroup meeting -WG), there are more benefits in leaving the arrangements than modifying them. These included allowing Parties additional time to lodge credit collateral during business hours. This will help if Parties have entered a Query period over the weekend and for international payments to clear in time.
- 4.6 This was evidenced by the number of parties entering Level 2 Default compared to the number of Credit Breaches over the same period, showing the Cure Period is an effective tool to avoid entering Credit Default
- 4.7 The Issue group unanimously voted not to progress with the Proposal of removing the Cure Period for the reasons given by Elexon.

## **5. Analysis and review of risk based approach to Credit Cover**

- 5.0 Elexon expanded on the Proposal to develop risk criteria by which Parties with a high risk of defaulting would have to lodge more collateral than those with a better Credit rating.
- 5.1 The Proposal was explained at a high, conceptual level and, if moved forward, needs to be fully developed as part of a Modification Assessment Procedure.
- 5.2 Elexon presented the case that there is a high level of complexity in developing a scoring system and calculation to determine a risk factor. The resource and time to define a process of this nature is a great deal when asking Parties to lodge a sum of collateral relative to the size of the Party, particularly for most parties where there isn't a lot of risk and lodging collateral as cover which just isn't palatable.
- 5.3 There is complexity Vs value point to consider with this approach as there will be further work required to determine what further criteria could feed into the overall risk assessment and the overall risk profiles, and what the value of this is compared to amounts required to be held as cover.
- 5.4 It will require a fixed approach that aligns with Ofgem and their processes around Parties fit for purpose to enter the Market. We've identified a need for financial resilience which is part of the wider Ofgem criteria piece of Parties fit to enter the market.
- 5.5 An IG member noted that adding extra collateral would work as a barrier to market entry, and without a clear definition of 'risk' it is not possible to assess the Proposal's implications. It was also noted that since the last energy crisis, Ofgem has been working on its financial requirements for market entry and which should go some way to mitigate the risk of new entrants with insufficient capital entering the market resulting in payment defaults.
- 5.6 Then, the IG voted if they agreed with the proposed solution:
- Yes – 13% ( 1 vote)
  - No – 75% (6 votes)
  - Neutral – 13% (1 vote)
- 5.7 Therefore, the WG is not recommending this Proposal as its additional complexity and effort to operate and maintain and it would be difficult to get the criteria to reflect the risk. Moreover, it risked creating a barrier to entry, which no-one was able to justify

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## **Actions – Next Steps**

- After an internal review, Elexon will circulate the Issue 106 Report to the Issue Group members for review on W/C 27 November.
- Then, the final Report is aimed to be tabled at the December BSC Panel Meeting.
- During the next business quarter, a Non-Physical Trader will raise a Modification to implement the Credit Default Proposal.
- During the second business quarter of 2024, a Generator will raise a Modification to implement the New Credit Cover Calculation. Even when the solution needs to be deployed after the MHHS go-live date, since the Proposal requires an exhaustive Assessment Procedure, Elexon believes there will be value in starting the Change Process next year.