

## 4.7 Issue Form

<b>Issue Form - BSCP40/04</b>	<b>Issue 106</b> <i>(mandatory by BSCCo)</i>
<b>Issue Title</b> <i>(Mandatory by originator)</i>  Review of BSC Credit Cover Arrangements	
<b>Issue Description</b> <i>(Mandatory by originator)</i>  There is a direct link between market prices for electricity and Credit Cover requirements. As such, as market prices fluctuate, the amount of credit to be lodged with the BSC fluctuates too. Further, as the market goes through a period of change to meet future consumer needs, such as changes being introduced as part of Market-wide Half Hourly Settlement (MHHS), now is a good time to review whether BSC credit arrangements remain fit for purpose.	
<b>Justification for Examining Issue</b> <i>(Mandatory by originator)</i>  Existing Credit Cover arrangements have not been sufficient to cover outstanding Trading Charges in most market failures in the past. This has led to debt mutualisation of over £71m through the Default Funding Share accumulated over the last five years. These arrangements do not consider the additional BSC Trading Charges that collateral may be required to cover if a Supplier has not sufficiently balanced their Settlement position.  The credit arrangements were designed to estimate imbalance volumes and BSC Trading Charges for traditional Suppliers and Generators during a period of market stability and where market failure was uncommon. The arrangements have not been reviewed to see if they remain fit for purpose when there are a large number of suppliers exiting the market through the SoLR process.  Concern has been raised regarding the accuracy and role of the Credit Assessment Price (CAP) and the inaccuracy in parts of the Credit Cover Calculation where there is a lack of reliable data. There currently is a degree of offset between inaccuracy in the CAP, and inaccuracy in estimated indebtedness.  The way the electricity market operates in Great Britain has been changing as we move towards a Half-Hourly Settled net-zero market. We have seen new roles emerging such as Virtual Lead Parties (VLPs) and the Distribution System Operator (DSO). The Credit Cover arrangements may need to adapt to changes to the balancing and Settlement arrangements in a way that encourages responsible trading and reduces the market's exposure to mutualised charges.  Therefore, the Credit Committee has requested an Issue Group review of Credit Cover to identify any suitable changes to the existing Credit Cover mechanism, to ensure it is fit for purpose whilst being more flexible and robust for the future.	

**Potential Solution(s)** *(Optional by originator)*

The Issue Group will re-evaluate what the Credit Cover arrangements should achieve and whether they are achieving that goal. The aim is to identify areas for improvement to the existing mechanism. This will be a complete end-to-end review, including compliance and implications thereof. The Issue Group will assess and prioritise any identified improvements before recommending any potential Changes to the BSC.

In addition, the Issue Group will consider changes to the market arrangements due to take place in the next few years. They will consider the objectives of the Credit arrangements needed to support the efficient operation of this future market, as far as possible, based on what is known or expected.

The Issue Group will be organised around at least six meetings, subject to review by the Issue Group at its first meeting. The Work Group aims to identify quick wins within the first 2-3 months of the review, and conclude the review within 6-9 months. Modification and Change Proposals are intended to be raised in parallel as the Issue Group defines potential solutions to the identified problems. The following work streams are proposed and will be reviewed by the Issue Group at its first meeting. They will consider these questions and any related solutions:

1. Why do we need Credit Cover? Current arrangements and pain points.
2. How is indebtedness calculated? How should credit be lodged?
3. Compliance, Enforcement and Risk Mitigation

A more detailed breakdown of these work streams can be found in Annex A at the end of the form. Before the first meeting, Elexon will issue a survey to collect Industry views about their pain points around Credit Cover. This will allow us to tailor the meetings to Industry needs. Other issues may be added –or removed by the Issue Group as the review progresses.

**Proposer's Details*****Name***

Tirath Maan

***Organisation***

Elexon

***Email Address***

Tirath.Maan@elexon.co.uk

***Telephone Number***

0207 380 4372

***Date***

13 January 2023

## 4.8 Annex A

### Work stream 1:

- Why do we need Credit? Current arrangements and pain points
  - What charges are covered and is this still appropriate?
  - Non-BSC impact of fluctuating Credit arrangements (and should the BSC be concerned?)
  - What are the distributional impacts from the current Credit arrangements? Which BSC Parties are impacted by mutualisation and which are not? How are non-BSC Parties impacted in the event of a Default occurring?
  - Pain points of existing arrangements and root-cause of the pain points
  - Summary of quick wins

### Work stream 2:

- How is indebtedness calculated?
  - What should be the high-level principles for how indebtedness is calculated?
  - Is there precedence elsewhere where we can call on for Credit arrangements?
  - What data does (or could) BSCCo have access to, and how can it be used to determine potential charges likely to be incurred?
  - What timeframes should be involved – consider potential MHHS and the Review of Electricity Market Arrangements (REMA) changes?
- How should credit be lodged?
  - Merits/Cost/Cons respectively of cash, letter of credit, and insurance and how they impact BSCCo and Parties – what changes could make the existing processes for lodging and withdrawing Credit Cover more efficient?
  - Could more flexibility in how Credit Cover is calculated and lodged/withdrawn reduce need for ever-changing cover amounts?
  - Should credit amounts be based on retrospective volumes, predicted volumes or a combination?
- How can the identified pain points and issues identified by the Issue Group be addressed?

### Work stream 3:

- Compliance, Enforcement and Risk Mitigation
  - End to end process in terms of compliance
  - Are consequences commensurate with risk?
  - Consequential impacts of non-compliance e.g. counter parties and level-2 default
  - How can the risk of Default be mitigated?
  - Credit arrangements and market entry processes, including barriers to entry