

PAYMENT DEFAULT

This document outlines the methodology used to assess the Settlement Risk related to Payment Default. We are not seeking to exhaustively outline all aspects considered during this assessment; our aim is to draw out the main data items considered and any key assumptions when estimating a future impact range.

The risk that... Trading Parties do not or are unable to pay Trading Charges fully or at all, such that it triggers an Event of Default
resulting in... default funding by other Trading Parties.

Category: Trading Charges and central aggregation

Sub category: Payment Default

Covers: Failure for Parties to pay any Trading Charges as defined under BSC Section T

Does not cover: Other BSC charges that do not meet the definition of Trading Charges, e.g. Supplier Charges

Estimated impact in 2019/20

Lower	Middle	Upper
£0	£440k	£2.1m

Please note: For this initial assessment, we focused on the impact of Default Funding Share resulting from Supplier of Last Resort (SoLR) events, as this is where the material instances of the risk have manifested.

At risk population

As part of this assessment, we seek to understand the population at risk in the upcoming period, i.e. how many times will the underlying process occur where the risk can manifest.

The at risk population for this risk is all active Trading Parties.

Data point considered

To assess active Trading Parties, we considered historical domestic Supplier numbers reported publically by Ofgem and active Trading Party numbers held in BSC Central Systems. The below table provides active Trading Party numbers as per BSC Central Systems.

2015/16	2016/17	2017/18
61	80	103

- Active Trading Parties as per BSC central systems could be operating as Suppliers, Generators, non-physical Traders or any combination of each
- We have seen a continued trend in the number of active Trading Parties as new participants enter the market, such as through the 'off-the-shelf' model

Forecast

Below are the key considerations when forecasting the at risk population in the 2019/20 period:

- We estimate a continued trend in the number of active Trading Parties, however we're accounting for a further increase if more participants enter the market or conversely a decrease if a number of participants exit the market

Failure rate

From the population at risk, we need to estimate the proportion where the risk will manifest, i.e. the failure rate. To do this, we assess historical performance in the area and consider any upcoming changes that have the potential to impact future performance.

Data points considered

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When assessing historical performance in the area, we considered previous SoLR events, Default Funding Share amounts and trends in system buy and sell prices.

The following table provides the number of SoLR events per year from April 2015 through to September 2018, i.e. three and a half years.

2015/16	2016/17	2017/18	2018/19*
0	1	1	1

*The 2018/19 period covers Apr-18 to Sept-18

- This risk is of a binary nature, i.e. there is the chance that the risk does not manifest at all in an annual period (as for 2015/16)
- Since the 2016/17 period, we have consistently seen at least one SoLR event
- Since performing this assessment, we have seen two additional SoLR events in the 2018/19 period, however as they were both for very small participants, we did not update the risk assessment

Forecast

Below are the key consideration when forecasting failure rates in the 2019/20 period:

- In recent years, with the number of smaller participants operating in the market, we have seen the probability of SoLR events increase. We considered this recent trend for future forecasts

Impact

To estimate the future impact of a risk we need to understand the impact of historical occurrences and other feasible scenarios of this risk.

Historical SoLR events

The following table provides the estimated impact of historical SoLR events on Trading Charges.

No. of years	No. of SoLRs	Impact
3.5	3	£1.2m

- We have estimated future impact of SoLR events where Reconciliation Settlement Runs are yet to complete
- These estimates are based on net impact of the SoLR Party, as this is level that is reported by the Funds Administration Agent (FAA)
- The average impact per SoLR is £400k, however there is a large variance in impact depending on the size of the Supplier

Forecast

- In the upper impact value, we account of a number of SoLR events for Trading Parties of a similar size than previously seen or an event for a Trading Party of a larger size than historically seen