

# Chapter 1: Introduction

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# Credit Risk Management

- **Credit Risk** is the risk of a Participant failing to meet their financial **obligations**
- Obligations are for the **exposures** they have, i.e. any unpaid bills, unbilled settlement or future settlement
- Participants are required to post **collateral** to cover this risk
- Collateral is the **Required Credit Cover** that Participant needs to have in place
- Effective management of Credit Risk is essential to ensuring the financial integrity of the market
- This process ensures that there is adequate liquid collateral in place to meet a participant's obligations should they default on their required payments
- This should prevent the other participants having to bear an unsecured bad debt in the event of payment default

# Credit Risk Management

- SEMO manages the ***Credit Risk Requirements*** of each Participant in the current SEM
- In the new arrangements, SEMO will manage ***Credit Risk Requirements*** only in relation to settlement under the Trading & Settlement Code in the new market arrangements
- This covers balancing and imbalance settlement and capacity market settlement
- As many of the existing requirements were persisted for the new arrangements
- This self-learning course will explain Credit Risk firstly in the context of the current arrangements, and then set out how these were adapted to cover the new arrangements

# Forms of Credit Cover

- Credit Cover under the TSC must be posted in the form of either:

**Cash in euro or Pounds Sterling**



**Letter of Credit from banks**



# Forms of Credit Cover

- Participants can meet their Required Credit Cover by posting **Cash collateral**
- A participant seeking to do this must establish a SEM Collateral Reserve Account with the SEM Bank in each Currency Zone in which the Participant has a registered Unit as applicable
- This account will be held in Trust for the Participant:
  - Participant can deposit but not withdrawal
  - SEMO can withdraw for defaults or refund to Participant
- The SEM Collateral Reserve Accounts are interest bearing accounts and Participants have benefit of this interest
- It is preferable to have some cash for each Participant as it is more liquid (just a transfer internally from Cash Collateral to market accounts)

# Forms of Credit Cover

- Participants can meet their Required Credit Cover by posting a **Letter of Credit**
- This is an **unconditional** and **irrevocable** standby letter of credit issued for the account of the Participant in favour of the SEMO
- This must provide for payment to the SEMO on demand (same day payment)
- This must be issued by a bank that meets the criteria stated in the code
- The wording of the LOC very important and needs to follow exactly the template in Appendix A of Part B the Trading & Settlement Code
- A LOC cannot be cancelled or amended without the Market Operator's agreement