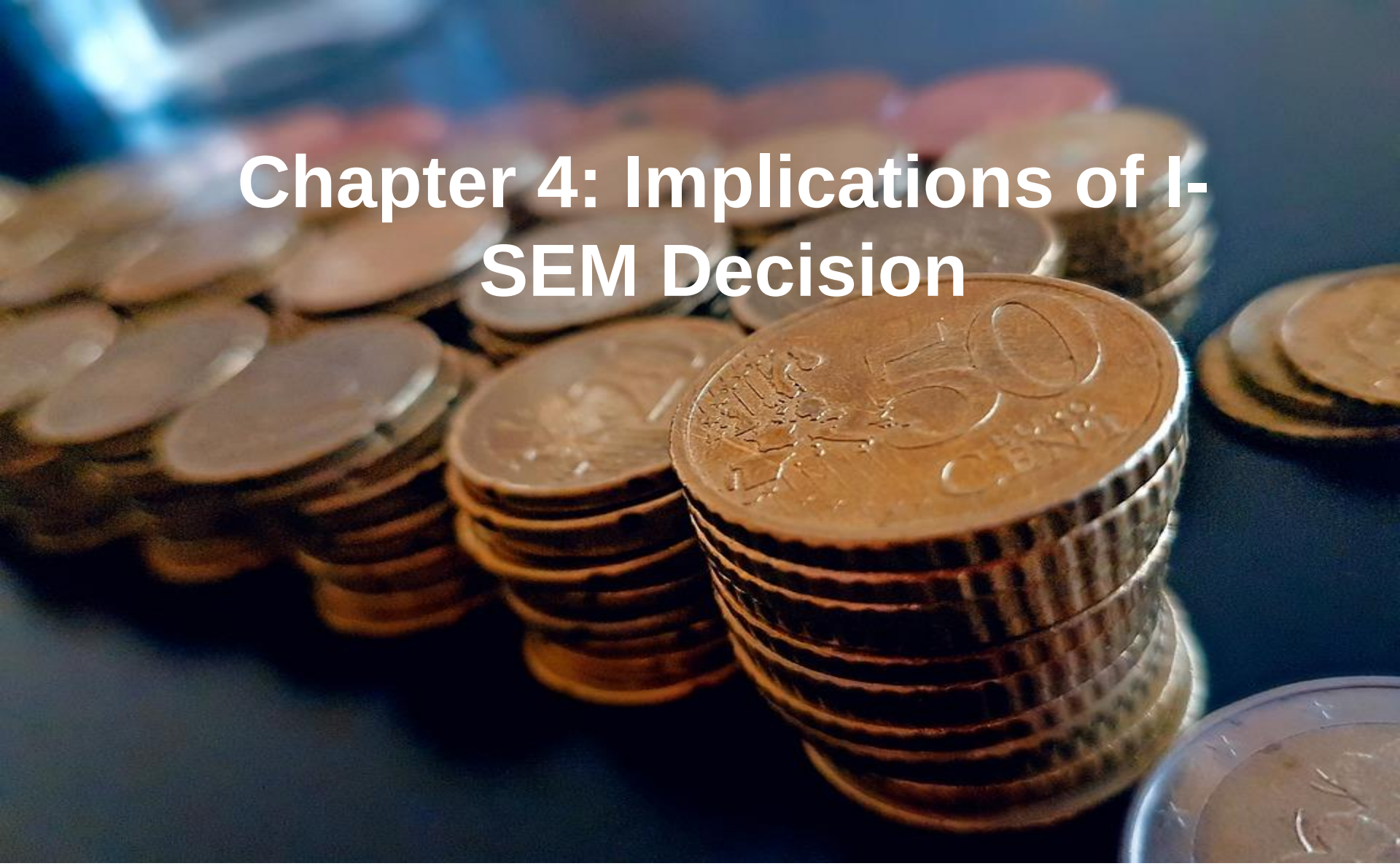
Chapter 4: Implications of I-SEM Decision



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Full collateralisation in the I-SEM

- The issue in the I-SEM is that collateral is now needed across different markets with different market operators
- Participants need to post collateral with SEM NEMO(s) for any ex-ante trading;
- For SEMOpx, a Trading Limit can be used
- In the same manner as SEMO's approach for Intraday Trading (IDT), if posted Credit Cover is insufficient, then trades above this level are not allowed
- However, exposure still exists in the balancing market
- What does full collateralisation look like for the BM?

Full collateralisation in the I-SEM

- To answer this, we must ask what is the risk?
- **For a supplier**, the risk is maximal as long as they are consuming
- While a supplier who trades on the ex-ante market shifts the default risk for its day-ahead position from SEMO to its SEM NEMO, its undefined exposure risk remains for its total exposure for dates that have not yet traded
- As a result, while a participant can reduce their required Credit Cover through ex-ante trading, (which will reduce their Actual Exposures), SEMO will continue to calculate the undefined exposure as if it doesn't do any ex-ante trading
- The principle is that if a participant defaults on their obligations, ex-ante trading will be first to go and all consumption will be as an imbalance

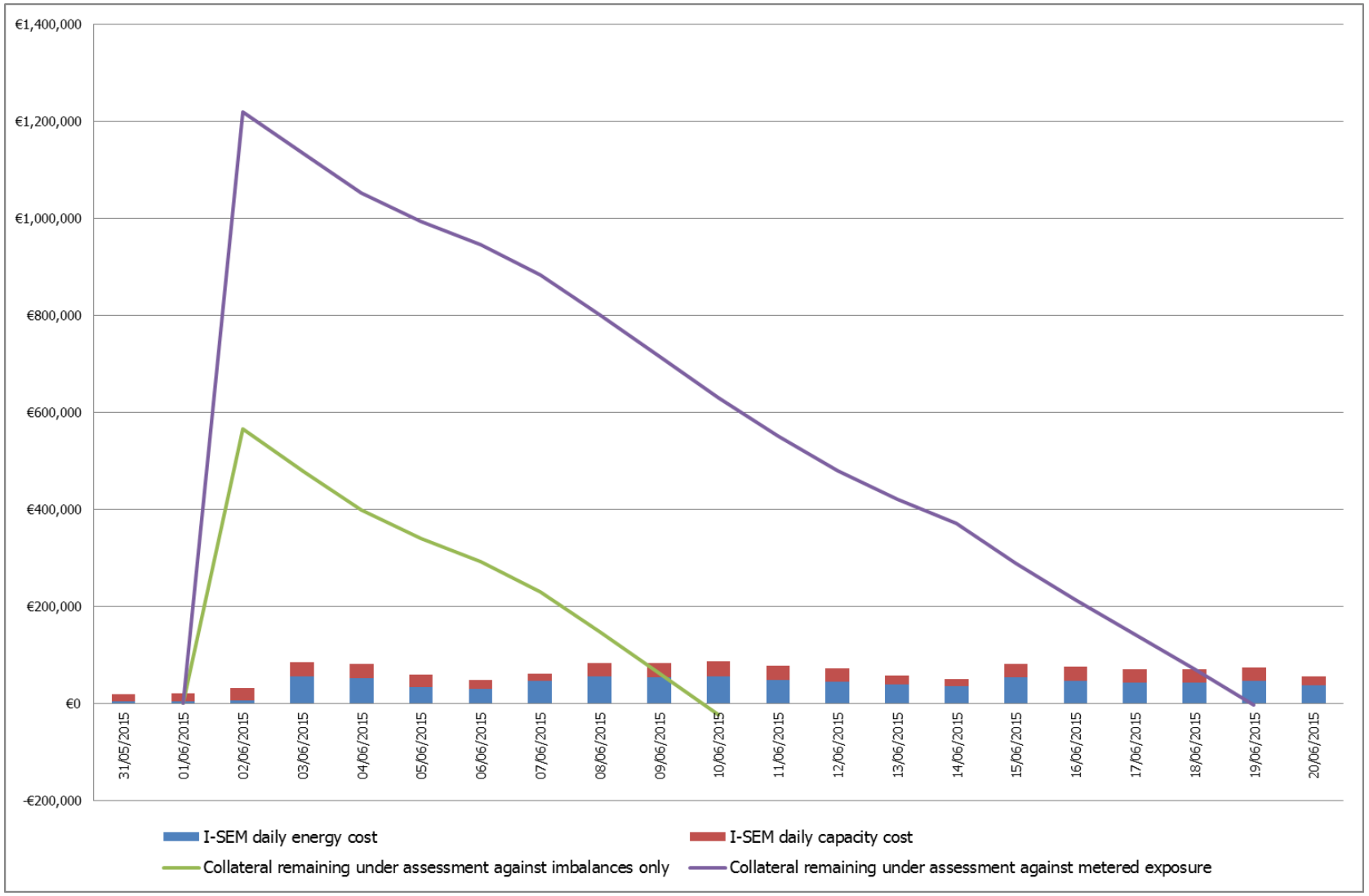
Full collateralisation in the I-SEM

- When a participant defaults, their trades in the day-ahead and intraday will be closed and all exposure will fall into ex-post settlement
- Therefore, if a default occurs, the full risk is that all liabilities of the defaulting party will appear in imbalance settlement
- The chart on **slide 27** demonstrates how calculating undefined exposure against historical imbalance settlement will not result in a collateral calculation that covers the undefined exposure as required
- The blocks at the bottom represent a participants energy and participant revenue and shows an increase in energy revenue after a default event has occurred

Full collateralisation in the I-SEM

- The green line represents the aggregate collateral that would be required if the calculation was based on historical imbalance settlement
- After the default, this collateral is drawn down to meet debts in imbalance settlement
- As can be seen, the posted collateral is exhausted under this approach after only nine days
- The purple line represents the aggregate collateral that would be required if the calculation is based on gross metering
- Again, after the default this is drawn down to cover non-payments
- However, here the posted collateral covers all debts that arise during the undefined exposure period and lasts to the end of the **Supplier Suspension Delay Period**

Full collateralisation in the I-SEM



Full collateralisation in the I-SEM

- This demonstrates that to calculate collateral based on historical imbalances is not a true risk assessment as it assumes no risk under the TSC where one actually exists
- This approach will not fulfil the SEMC position with regards to full collateralisation
- Given this, for the new arrangements, the Required Credit Cover for a supplier is determined from a statistical analysis of the gross metered demand over the Historical Assessment Period, by the Combined Credit Assessment Price
- The Combined Credit Assessment Price is made up of:

The Credit Assessment Price	The other tariffs that apply
Determined from a statistical analysis of historical imbalance settlement prices	The Imperfections Price, the Residual Error Volume Price and the Currency Adjustment Price

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Full collateralisation in the I-SEM

- We must also consider what the risk is in respect to generators
- For generators, the risk is minimal as long as they are producing
- When a generator sells and delivers, their exposure is limited to their imbalances only
- However, when a generator sells but still has yet to deliver, this creates **delivery risk**
- This is the risk that the generator will not deliver according to its sale and will result in a significant imbalance
- This risk arises around a generator tripping, inaccurate wind forecasts, or assetless traders not closing out their ex-ante positions

Full collateralisation in the I-SEM

- This is a new element to the undefined exposure
- The risk that you've sold something in another market but you default in the ex-post market
- Therefore, ex-ante sellers (generators, demand side units, assetless traders) must have sufficient credit posted in SEMO to cover the volume they've sold ex-ante at the imbalance price
- This is the **Traded Not Delivered** exposure
- This is included in calculations of Required Credit Cover for each participant