

# 0568:

## Security Requirements and Invoice Payment Settlement Cycle for the Trading System Clearer

This modification seeks to facilitate the Trading System Clearer’s compliance with requirements under the UNC (including the submission of Trade Nominations) via removing the obligation to provide Security and amending the invoice payment settlement cycle as applicable to the Trading System Clearer.



The Proposer recommends that this modification should be subject to self-governance and assessed by a Workgroup



High Impact: None



Medium Impact: None



Low Impact: Shipper Users, Trader Users, National Grid NTS, Trading System Clearer

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This modification will be presented by the Proposer to the Panel on 19 November 2015.		 <b>+44 (0)1926 654850</b>
The Panel will consider the Proposer's recommendation and agree whether this modification should be referred to a Workgroup for assessment.		Systems Provider: <b>n/a</b>
The Proposer recommends the following timetable:		 <b>n/a</b>
Initial consideration by Workgroup	30 November 2015	 <b>n/a</b>
Workgroup Report presented to Panel	18 February 2016	
Draft Modification Report issued for consultation	18 February 2016	
Consultation Close-out for representations	10 March 2016	
Final Modification Report presented to Panel	17 March 2016	
UNC Modification Panel decision	17 March 2016	

# 1 Summary

## Is this a Self-Governance Modification?

The proposer recommendation to the Modification Panel is that this modification meets the Self Governance criteria since only a small change to the UNC text is envisaged which is not expected to have a material impact on competition between Shipper Users, nor on operation of the pipeline system. The main impact that is anticipated is on the obligation for the Trading System Clearer to provide Security and to adhere to the existing 35-day invoice payment settlement cycle.

## Is this a Fast Track Self-Governance Modification?

Fast track procedures are not proposed as it is not a house keeping modification.

## Why Change?

It is intended that, on 24 November 2015, ICE Endex Spot Limited (ICE Endex) will assume the role of Trading System Clearer (TSC) for the independent market for balancing (On-the-day Commodity Market or OCM). Pursuant to a service level agreement, ICE Endex will discharge its obligations as Trading System Clearer by relying on ICE Clear Europe Limited (ICE Clear) to provide clearing and settlement services.

The UNC requires a User (including the Trading System Clearer) to provide "Security" i.e. letters of credit or cash by way of security for a User's indebtedness for Energy Balancing Charges in accordance with the Energy Balancing Credit Rules (EBCR).

ICE Endex will not be able to comply with the requirement to provide Security as described above, as ICE Clear – not ICE Endex – holds collateral provided by members of ICE Clear. Although the obligation to provide security is on ICE Endex, as role of Trading System Clearer, the Proposer notes that ICE Clear is also unable to use the collateral provided by its members to provide the Security due to restrictions under applicable regulatory laws, as described further below.

As a result of (1) ICE Endex's inability to provide the Security as a result of not holding collateral provided by members of ICEU and (2) ICE Clear's inability to provide the Security as a result of regulatory restrictions, the amendments detailed below are necessary to ensure that ICE Endex is able to discharge its obligations as Trading System Clearer.

## Solution

1. ICE Endex, as the proposed Trading System Clearer, will continue to be liable and accountable for proper performance of all Trading System Clearer obligations. As it is unable to provide Security for the reasons described above, it is proposed that UNC TPD Section X.2.1 be amended to allow the Energy Balancing Credit Rules (EBCR) to apply only to Trading System Clearer as modified or waived by National Grid NTS. This amendment would allow National Grid NTS to remove the requirement that the Trading System Clearer provides Security.
2. In order to reduce the credit exposure of NGG to the Trading System Clearer resulting from the above amendment of TPD Section X.2.1, it is also proposed to dis-apply the current 35-day invoice payment settlement cycle in relation to Energy Balancing Invoices by amending TPD Section S.3.1, and to replace the settlement cycle with a period as agreed between National Grid Gas (NGG) and the Trading System Clearer, following consultation with the Energy Balancing Credit Committee (EBCC). This shortened settlement cycle will additionally reduce security requirements for the Trading System Clearer.

## Relevant Objectives

This modification furthers Relevant Objective g) and indirectly supports objectives in line with Objective d).

## Implementation

ICE Endex Gas Spot Ltd request this Code Modification is implemented as soon as possible and no later than 01 May 2016.

## Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

There are no expected impacts on an SCR or other significant industry change projects.

# 2 Why Change?

## 2.1 Background

### *ICE Endex*

ICE Endex is designated by OFGEM and appointed by National Grid Gas (NGG) as the Trading System Operator of the On-the-day Commodity Market (OCM). ICE Endex has designated APX Commodities Limited (APX UK) as Trading System Clearer to provide clearing services in relation to transactions resulting from trading on the OCM. It is intended that, on 24 November 2015, ICE Endex takes over the role of Trading System Clearer from APX UK. ICE Endex will discharge its obligations as Trading System Clearer by relying on ICE Clear to provide all clearing and settlement services in respect of transactions resulting from trading on the OCM. For this purpose ICE Endex and ICE Clear have entered into a service level agreement.

ICE Endex would like ask the Panel to note that article 2.5.2 (a) of Section V of the Unified Network Code (UNC) places restrictions on the User rights that the Trading System Clearer can exercise. This article states that ICE Endex (as the Trading System Clearer) "will not ...exercise any right or entitlement of a User other than the right to make Trade Nominations ... and any rights (consequent thereon) arising under Sections F, S, GT Section A, [this Section] V, U and X". ICE Endex takes the position that it is allowed to exercise the right of a User to propose modifications under section V, article 12.3 of the UNC because the changes that are proposed relate directly to its obligations (as the Trading System Operator) to submit trade nominations on behalf of the Trading System Clearer and other Users trading on the OCM. To be able to fulfil these obligations, ICE Endex has been admitted as a User and therefore has to comply with the obligations under section S and X of the UNC. As this proposal for a modification of the UNC is directly related to the latter sections and thus ICE Endex' ability to continue to meet its obligations thereunder, the Panel is advised to recognize ICE Endex as the Proposer. Finally the Panel is asked to note that National Grid NTS believes that it is right that a modification is raised to bring the issue to industry and facilitate debate.

### *ICE Clear*

ICE Clear is a recognised clearing house under the UK's Financial Services and Markets Act 2000 and has submitted an application for approval as a central counterparty under REGULATION (EU) No 648/2012 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR). This application remains under review, however, in advance of such approval, ICE Clear is required by the Bank of England – which has supervisory responsibility over ICE Clear – to comply with the CPSS-IOSCO Principles for Financial Market Infrastructure (CPSS-IOSCO Principles), Recognition Requirements Regulations and EMIR.

## *Clearing of the OCM*

Under UNC Section D, ICE Endex, as the Trading System Operator, must act as the Trading System Clearer (TSC) or appoint another person as the TSC. ICE Endex will discharge its obligations by relying on ICE Clear to provide all clearing and settlement services in respect of transactions resulting from trading on the OCM. For this purpose ICE Endex and ICE Clear have entered into a service level agreement.

The main purpose of Central Counterparty Clearing offered by ICE Endex (and ICE Clear, through the service level agreement) is to decrease systemic risk arising in relation to trading on the OCM. ICE Clear decreases systemic risks through managing payments, deliveries and defaults, in particular, because ICE Clear's interposition between the counterparties of all contracts traded on the OCM. As a result Users (including National Grid NTS) can trade on the OCM without being concerned by the credit or delivery risk of counterparties with whom they are matched.

Under EMIR, ICE Clear is required to collect collateral from its members, which must cover at least 99% of price movements over an appropriate time horizon. ICE Clear has the power to enforce the collateral of a defaulter and apply such collateral against any loss to ensure that the defaulter's settlement obligations are met.

In order to ensure that ICE Clear has sufficient capital it has established a guarantee fund which is based on stress testing results as required by EMIR Article 43. The guarantee fund is calibrated to be sufficient to cover the potential cost of the simultaneous default of the two (clearing) member groups to which the clearing house has the largest exposure to, under extreme but plausible scenarios, and currently stands at USD 1.85 billion. In addition, ICE contributes U.S. \$100 million to the ICE Clear Europe Guarantee Fund, all of which sits in front of Members' obligations. Users (including National Grid NTS) trading on the OCM benefit from the protection these risk management arrangements provide.

## **2.2 Security requirements**

The UNC (TPD Sections X.2.3.1 and X.2.2.3) requires Users to provide "Security" i.e. letters of credit or cash by way of security for a User's indebtedness for Energy Balancing Charges in accordance with the Energy Balancing Credit Rules (EBCR). The amount of Security or the Secured Credit Limit to be provided by a User represents the value of security provided by a User, which, in the event of a default, may be realised to meet its Outstanding Relevant Balancing Indebtedness (EBCR Section 2.1a). Outstanding Relevant Balancing Indebtedness is defined as invoiced, unpaid Energy Balancing Charges and accrued Energy Balancing Charges for the period that has yet to be invoiced (EBCR Section 2.1a).

ICE Endex is unable to provide this Security because it will discharge its obligations as Trading System Clearer by relying on ICE Clear to provide clearing and settlement services. This means that ICE Clear (and not ICE Endex) will in fact hold any collateral received from the clearing of transactions arising from the OCM.

Given that ICE Endex is unable to provide the Security, the amendments detailed below are necessary to ensure that ICE Endex is able to discharge its obligations as Trading System Clearer.

The Proposer also notes that ICE Clear is prohibited from providing the collateral it receives from its members as Security, due to prohibitions under the CPSS-IOSCO Principles, Recognition Requirements Regulations and EMIR, as set out below.

### *a. Recognised Clearing House restrictions*

ICE Clear, as a Recognised Clearing House under the UK's Financial Services and Markets Act 2000, is subject to supervision by the Bank of England. The Bank of England, in its Approach to the Supervision of

Financial Market Infrastructures (FMIs) document dated April 2013, notes that its regulatory regime is “framed by the CPSS-IOSCO Principles for Financial Market Infrastructures”. Principle 16 requires FMIs to safeguard their own and their participants’ assets, and hold their own and their participants’ assets at supervised and regulated entities that have robust accounting practices, safekeeping procedures, and internal controls that fully protect these assets.

Similarly, under paragraph 19(2)(e) of the Schedule to the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001, a recognised clearing house must make “satisfactory arrangements” in relation to safeguarding and administration of assets of its members.

#### *b. EMIR restrictions*

ICE Clear is has submitted an application for approval as a central counterparty under EMIR. This application remains under review. However, in advance of such approval, ICE Clear is required by the Bank of England – which has supervisory responsibility over ICE Clear – to comply with the requirements of EMIR. Pursuant to Articles 44 - 45 of Commission Regulation 153/2013, ICE Clear is required to hold the assets it has received as collateral only with central banks or securities settlement systems, or in limited situations, commercial sector regulated banks or custodians. NGG does not fall into one of these specified types of entities and therefore, there is no ability for ICE Clear to provide the collateral it has received from clearing members as Security to National Grid NTS.

## 2.3 Settlement Cycle

Under the EBCR, an Outstanding Energy Balancing Invoice is “[t]he amount invoiced to Users 23 Business Days after month end...” (EBCR Section 3.1). In addition, the UNC provides that the invoice due date is the 12th day after the day on which the invoice document was deemed to be received (UNC TPD Section 3.1.2). The result of the UNC and EBC Rules requirements is that ICE Endex, as Trading System Clearer, will be required to provide Security on the basis of the 35 day invoice payment settlement cycle.

ICE Clear and its members will typically settle transactions on a much faster (daily) invoice payment settlement cycle than 35 days after month end. In addition to reducing exposure of National Grid NTS to ICE Endex (as the TSC) – which is important given the removal of the obligation to provide Security as described above – a faster (daily) settlement cycle will also significantly lower the collateral requirement for Users (including NGG) who are trading on the OCM. This significant reduction in costs of trading increases the attractiveness of the OCM which helps to bolster the liquidity of this market. Additionally, the reduction in the invoice payment settlement cycle will bring the OCM in line with other trading venues offering comparable products, thereby eliminating the competitive disadvantage for the Trading System Operator (TSO) associated with the 35-day settlement cycle.

## 3 Solution

In order for ICE Endex, as Trading System Clearer, to comply with the requirement of the UNC to grant Security, the Proposer suggests that the wording contained in UNC TPD Section X.2.1 be amended to remove the obligation to provide Security, as set out below.

As a result of the removal of the obligation to provide Security, and to realise the other advantages noted above associated with a shorter invoice payment settlement cycle, the Proposer also suggests amending the wording contained in UNC TPD Section S.3.1 to provide for a shorter invoice payment settlement

cycle in relation to Energy Balancing Invoices, as agreed between the Trading System Clearer and NGG, as set out below.

### 3.1 Proposed changes to UNC TPD Section X.2.1

The effect of the proposed changes to UNC TPD Section X.2.1 set out below is that the provisions contained in the EBCR only apply, as modified or waived by NGG, to the Trading System Clearer who is either a Recognised Clearing House under the Financial Services and Markets Act 2000, or who has appointed a Recognised Clearing House under the Financial Services and Markets Act 2000 to discharge its obligations as a Trading System Clearer.

In regards to the proposed change of UNC TPD Section X.2.1 does not limit the ability of National Grid NTS (or Xoserve) to make a Cash Call to ICE Endex thereby reducing the exposure of National Grid NTS to a level deemed appropriate by the EBCC. ICE Endex would meet this requirement by instructing ICE Clear to apply Rule 305 of the ICE Clear Rules. Rule 305 gives the Trading System Clearer (through ICE Clear) the legal title to take money from the Member account(s) of the Users that bought gas from NGG on the OCM (which adds to the indebtedness of ICE Endex to National Grid NTS) and transfer it to the account of the Clearing Member if National Grid NTS.

### 3.2 Proposed changes to UNC TPD Section S.3.1

The effect of the proposed changes to UNC TPD Section S.3.1 set out below is that the Invoice Due Date, which, amongst other things, references the 12<sup>th</sup> day after the day on which the Invoice Document was deemed to be received, does not apply in relation to Energy Balancing Invoices applied to a Trading System Clearer who either is a Recognised Clearing House under the Financial Services and Markets Act 2000, or has appointed a Recognised Clearing House under the Financial Services and Markets Act 2000 to discharge its obligations as a Trading System Clearer. Instead, for Energy Balancing Invoices, the applicable meaning of Invoice Due Date to such a Trading System Clearer is as agreed between the NGG and the Trading System Clearer, following consultation with the EBCC, and can therefore be a shorter period. It should be noted that only Market Balancing Actions contained within Energy Balancing Invoices for transactions between NGG and the Trading System Clearer are within scope of this amendment. It should be noted that the reduction in payment settlement cycle in relation to such Energy Balancing Invoices will reduce the level of financial exposure and security requirements, which will ultimately lead to reduced costs for Users trading on the OCM.

User Pays	
Classification of the modification as User Pays, or not, and the justification for such classification.	No User Pays service would be created or amended by implementation of this modification and it is not, therefore, classified as a User Pays Modification.
Identification of Users of the service, the proposed split of the recovery between Gas Transporters and Users for User Pays costs and the justification for such view.	N/A
Proposed charge(s) for application of User Pays charges to Shippers.	N/A

Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.	N/A
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## 4 Relevant Objectives

Impact of the modification on the Relevant Objectives:	
Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	None
d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	Positive
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	Positive

This modification furthers Relevant Objective g) and indirectly supports objectives in line with d).

This modification furthers Relevant Objective g) because it allows the Trading System Clearer to discharge its obligations (either a Recognised Clearing House under the Financial Services and Markets Act 2000, or through the has appointed of a Recognised Clearing House under the Financial Services and Markets Act 2000) in a manner which is compliant with the UNC, the UK's Financial Services and Markets Act 2000 as well as EMIR.

In relation to Relevant Objective d), this modification will reduce the cost of trading thereby indirectly fostering the liquidity of the OCM in line with Ofgem, EC and ACER objectives to improve liquidity across the energy markets. Increased market opportunities and increased liquidity are expected to facilitate the securing of effective competition.

## 5 Implementation

The proposer requests this Code Modification is implemented as soon as possible and no later than 01 May 2016.

## 6 Impacts

### Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

There are no impacts on other industry change projects.

## 7 Legal Text

To implement the solution outlined above, it is proposed that Section S.3.1 and X.2.1. of the UNC are modified as below.

### Text Commentary

Commentary to support the Text will be provided by National Grid NTS at an appropriate point.

### Proposer's Suggested Text

#### Changes to UNC TPD Section S.3.1

##### 3.1 Invoice Due Date

- 3.1.1 *Subject to paragraphs 1.7.2, 1.7.4 and 4.2.2, the Invoice Amounts under each Invoice Document shall be paid (by the User to the Transporter or by the Transporter to the User, as the case may be) on or before the Invoice Due Date.*
- 3.1.2 *Subject to 3.1.2a, ~~t~~**The "Invoice Due Date"** in respect of an Invoice Document is the day ending at 24:00 hours on:*
- (a) *subject to paragraphs (b) and (c), whichever is the later of:*
    - (i) *the 12th Day after the Day on which the Invoice Document was deemed to be received in accordance with Section U and GT Section B5; and*
    - (ii) *the 20th Day after the last Day of the Billing Period to which the Invoice Document relates;*
  - (b) *in the case of an Adjustment Invoice, Interest Invoice or Ad-hoc Invoice, subject to paragraph (c) and paragraph (d), the 12th Day after the Day on which the Invoice Document was deemed to be received in accordance with Section U and GT Section B5;*
  - (c) *where the Day (the "target due date") determined under paragraph (a), (b) or (d) is not a Business Day:*
    - (i) *subject to paragraph (ii), the Business Day (whether before or after the target due date) which is nearest to the target due date; or*
    - (ii) *if the nearest Business Days before and after the target due date are equally near, the nearest Business Day after the target due date.*

- (d) *subject to paragraph (e), in the case of a Small Value Invoice, the 30th Day following the end of the month in which the Invoice Document was deemed to be received in accordance with Section U and GT Section B5, or*
- (e) *the Day determined in accordance with paragraph (b), where the Small Value Invoice is not paid by the Day in paragraph (d).*

3.1.2a In relation to a Trading System Clearer which either:

- (a) is a Recognised Clearing House for the purposes of the Financial Services and Markets Act 2000; or
- (b) has appointed a Recognised Clearing House for the purposes of the Financial Services and Markets Act 2000 in order to discharge its obligations as a Trading System Clearer.

the Invoice Due Date, in relation to Energy Balancing Invoices, shall be as agreed between National Grid NTS and such Trading System Clearer following consultation with the EBCC, and shall be such shorter period as proposed by such Trading System Clearer.

## **Changes to UNC TPD Section X.2.1**

### **2.1 Energy Balancing Credit Rules**

- 2.1.1 *The "Energy Balancing Credit Rules" are the rules established by National Grid NTS dated 1 March 1996 and so entitled, as from time to time amended in accordance with paragraphs 2.1.4 and 2.1.5.*
- 2.1.2 *Subject to paragraph 2.1.6, ~~the~~ Energy Balancing Credit Rules provide for the specified forms and the basis on which a User may provide a letter of credit or cash by way of security for the User's indebtedness in respect of Energy Balancing Charges.*
- 2.1.3 *Subject to paragraph 2.1.5, and without prejudice to any express requirement under this Section X to comply therewith, the Energy Balancing Credit Rules do not form part of and are not incorporated into the Code.*
- 2.1.4 *With the approval of the Energy Balancing Credit Committee, National Grid NTS may revise the Energy Balancing Credit Rules upon giving notice to all Users of not less than 2 months or such shorter period as may in any particular case be approved by the Committee.*
- 2.1.5 *For the purposes only of enabling National Grid NTS or a User to propose a modification pursuant to the Modification Rules, the Energy Balancing Credit Rules shall be deemed to be incorporated into and to form part of the Code.*

2.1.6 In relation to a Trading System Clearer which either:

- (a) is a Recognised Clearing House for the purposes of the Financial Services and Markets Act 2000; or
- (b) has appointed a Recognised Clearing House for the purposes of the Financial Services and Markets Act 2000 in order to discharge its obligations as a Trading System Clearer.

the Energy Balancing Credit Rules shall only apply to such Trading System Clearer as modified or waived by National Grid NTS.

## 8 Recommendation

The Proposer invites the Panel to progress to Workgroup assessment.