



**Response by Energia to Gas Network
Ireland's Consultation**

Financial Security Policy Draft Consultation

20 November 2015

1. Introduction

Energia welcomes the opportunity to respond to this consultation on GNI's Financial Security Policy. The proposal to maintain the credit rating for banks providing a Letter of Credit (LoC) at 'AA' (S&P or equivalent) is not reflective of the standards in the wider energy sector and severely limits the pool of banks that a supplier can access. Energia considers this threshold to be unsustainable and inappropriate, and calls for a review of the required bank credit ratings being applied by GNI to bring the policy in line with the standards across the sector, ultimately revising the suggested rating from 'AA' (S&P or equivalent) to 'BBB' or 'BBB-' (S&P or equivalent).

This response outlines our points on GNIs policy on provision of security cover before addressing credit requirements and finally concluding.

2. Provision of security cover

Section 5.5 (l) states that a *'counterparty shall have 3 business days to provide additional security once notified of a shortfall and during this period a counterparty will be allowed to book Non-IP capacity and participate in IP Capacity Auctions without providing such additional security during this period.'*

In this context, we ask that GNI clarify how this provision will apply to daily capacity products? It is considered that the only practical application of this provision is one where each day is treated separately and that bookings on successive days would each be able to avail of the 3-business days, separate from each other, in order to provide any additional security required.

3. Letter of Credit

The requirements outlined in section 3.1 and 3.2 of GNI's Financial Policy document stipulate a credit rating of 'BBB' or greater for a counterparty, 'AA' for a parent bank and a lower rating of 'A' for a subsidiary bank (S&P or equivalent). This approach appears to contain a significant inconsistency in GNIs approach to credit ratings, with different thresholds of risk being applied. Overall the variations here do not appear to be justified and are not reflective of the level of risk associated with the entity.

The 'AA' rating (S&P or equivalent) employed by GNI for a LoC issued by a Bank is outdated and refers to a time when the majority of banks attained this standard, almost be default. The ratings environment has undergone significant change since the recent financial crisis and can now be broadly characterised as taking a conservative approach to ratings, particularly of financial institutions. In the

intervening years the financial crisis combined with more stringent assessments has lowered the average or expected rating of a bank operating in today's climate. For example, Deutsche Bank, Bank of Ireland, RBS and Commerzbank now all have ratings lower than 'AA' (i.e. 'BBB'/'BBB-') (S&P or equivalent). While the market has changed significantly, GNI's policy has not. Coupled with the changes in the approach of ratings agencies, the operational environment within which financial institutions operate has also changes significantly, largely through increased levels of regulation in Europe (e.g. MiFID I & II, MAD, MAR, etc) and elsewhere (e.g. Dodd Frank Act). This further development has at least reduced but has arguably removed concerns over credit provided by institutions with a credit rating of 'BBB'/'BBB-' (S&P or equivalent), or better.

4. Counterparties and Banks

The 'AA' credit rating (S&P or equivalent) for banks is not universally applied by GNI to all credit cover. For example, counterparties can have an approved credit rating of 'BBB' (S&P or equivalent). Through the ratings system the ratings agencies already quantify the level of risk associated with an entity, as such if a corporate body and a bank are deemed to have the same credit rating they should be both accepted. In reality GNI deems a counterparty to be sufficiently healthy at a 'BBB' rating and a bank inadequate at the same rating level. In fact, GNI require a 6-step increase in ratings grades between a Counterparty and a Bank ('BBB' to 'AA', S&P or equivalent). Again, the inconsistencies across the sector are evident in comparison with both NIE and SONI who apply the same rating for both counterparties and banks ('BBB', S&P or equivalent).

The lower rating for Counterparties ('BBB') unduly favours certain companies (e.g. network backed, State shareholder, etc) and confers upon them an advantage that would appear to have little basis, provided the credit cover is provided by an investment-grade entity. These arbitrary thresholds likely act as a barrier to new entrants. We are advocating an alignment of credit requirements in the sector with a move towards the more realistic 'BBB'/'BBB-' (S&P or equivalent).

5. Alignment of Gas and Electricity Arrangements

With the introduction of the new EU Network codes we have seen a harmonisation of the gas and electricity rules across Europe. Despite this harmonisation at a European level, there is a persistent and problematic inconsistency in relation to credit ratings applied to banks issuing a LoC at a national level. The credit ratings applied in the sector (electricity and gas) seem, in part, to be subjective and not reflective of the

market conditions or the associated risk. The disparity is significant and ranges from a required credit Rating of 'BBB-' (NIE) to 'AA' (GNI) for a Bank issuing a LoC (S&P or equivalent). A significant factor in this disparity is likely to be the time at which these policies were originally developed or reviewed, or not reviewed, as the case may be.

Other stakeholders in the energy sector have adapted their financial security policies to reflect the changes to the banking sector, with NIE, SONI and SEMO all having 'BBB-' requirements for banks (S&P or equivalent). The 'AA' rating (S&P or equivalent) required by GNI leads to the unusual situation where no bank in the same jurisdiction meets the standards being applied. Conversely, GNI's approach to Counterparties has previously reflected the varying standards within the sector. With the majority of Counterparties unable to achieve an 'AA' rating (S&P or equivalent), GNI acknowledged this by using a 'BBB' rating. This approach should be mirrored in the banking requirements, as there would appear to be no apparent basis for this differing approach.

There appears to be further inconsistencies in the approaches within the gas sector. GNI's Northern Irish subsidiary requires a credit rating of 'A-' or better (S&P or equivalent) for Banks issuing LoCs. Similarly Premier Transmission Limited requires an 'A-' or better rating whereas GNI requires an 'AA' rating (S&P or equivalent). There would seem to be no justification to the significant differences in requirements between the various organisations when they are all effectively dealing with the same level of risk, as indicated by the ratings applied by the ratings agencies.

The use of such a high credit rating severely restricts Energia's ability to obtain LoCs and forces us, and others, to engage with financial institutions that we have no working relationship with and are outside of this jurisdiction. The lack of any historical interactions with a bank increases the difficulty and cost in obtaining a LoC, without any apparent additional benefit to the industry or customers.

6. Conclusion

The requirement for parties to procure Letters of Credit from banks with ratings of 'AA' (S&P or equivalent) is not practical and does not reflect the realities of the post-financial crash world. The practice of ratings agencies has changed, as has the level of financial regulation, giving rise to a significantly different environment from the time when GNI first developed their financial security rules and thresholds for credit. While other network stakeholders in the sector have lowered their credit requirements to reflect the changed landscape, GNI have not followed suit. This has

led to the unusual situation where there are no banks in GNIs jurisdiction that meet the standard ascribed by them. The current policy is inconsistent with practices in the wider sector and is prohibitively high. We ask that GNI revises its policy on credit rating to reflect the changes to the sector. Energia advocates the alignment of credit cover policies across the sector by moving towards a 'BBB-' or 'BBB' credit rating (S&P or equivalent) for banks issuing LoCs to align with Counterparties, while maintaining investment-grade status.