

PAPER NO. : **EMC/RCP/2011/55/CP31**

SUBJECT : **NEW FORMS OF COLLATERAL**

FOR : **DECISION**

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DATE OF MEETING : **10 May 2011**

Executive Summary

The Market Rules permits Market Participants (MPs) to provide cash, bankers' guarantees, letters of credit and Singapore government treasury bills as credit support in the Singapore Wholesale Electricity Market (SWEM). This paper explores new forms of collateral that can be introduced into the SWEM.

Following an examination of collaterals accepted in other jurisdictions, four potential types of collateral were analysed, namely, unsecured credit limit, corporate guarantees, Singapore government bonds and stocks. Of the four, only corporate guarantees fulfil the guiding principles of low credit risk, low market risk and high liquidity, provided it meets the following conditions:

- a. Guarantor should not have a direct or indirect legal or beneficial interest of 5% or more of the value of shares in the MP.
- b. Guarantee must be issued by an institution that has a credit rating of "A" or above by S&P.
- c. Guarantor must agree to a prescribed standard form of agreement issued by EMC
- d. Guarantor must be an entity incorporated in Singapore

EMC did not receive feedback from any interested party that intends to provide corporate guarantees which satisfy the above criteria. Nevertheless, MSSL proposed the use of insurance bonds as collateral, given that it can potentially meet the above criteria and may possibly be obtained at a lower cost of credit as compared to banker's guarantees.

At the 55th RCP Meeting, the RCP tasked EMC to work with SP Services to further explore the operational feasibility of using insurance bonds as collateral in the SWEM. SP Services has sought potential insurance companies' feedback based on EMC's operational requirements. This includes a need for the insurer to pay EMC within the same day a claim is raised. However, the insurers have conveyed that they are unable to meet this payment timeline. This is due to their internal claim procedures which usually involve a week of processing time before being able to make payouts to beneficiaries.

At the 56th RCP Meeting, the RCP unanimously decided **not to support** the use of insurance bonds as collateral in the SWEM and **retain** the existing forms of collateral in the SWEM.

1. Introduction

Currently, Market Participants (MPs) are only permitted to put up cash deposits, letters of credit, bankers' guarantee or Singapore government treasury bills as credit support (collaterals) with Energy Market Company (EMC). The credit support is used to guard against an MP's non-payments to EMC arising from its trades in the Singapore Wholesale Electricity Market (SWEM). This paper explores new instruments that can be used as credit support in the SWEM.

Section 2 examines the existing credit support arrangements adopted in the SWEM. Section 3 discusses guiding principles considered in the selection of acceptable collaterals, while section 4 summarises various forms of collateral used in other electricity markets. Section 5 analyses potential collaterals that may be introduced in the SWEM, with industry comments reflected in section 6. Section 7 and section 8 concludes and presents recommendations to the RCP respectively.

2. Current credit support arrangements in the SWEM

This section describes the existing credit support arrangements adopted in the SWEM. It first lists the types of collateral permitted in the SWEM followed by a summary of the processes used to draw upon the credit support.

2.1 Types of credit support permitted in the SWEM

Chapter 2, Section 7.3.2 of the Market Rules requires an MP that intends to participate in the SWEM to place credit support with the EMC that is at least equal to its credit support value, calculated using the following formula:

$$\text{Credit Support Value} = \text{Estimated Average Daily Exposure} \times 30^1 \text{ days}$$

where Estimated Average Daily Exposure (ADE) = -1 x simple average of net settlement amounts set out on the 90 most recently available preliminary settlement statements (PSS) or corresponding final settlement statements (FSS) if available

This requirement ensures sufficient credit support to cover an MP's/MSSL's normal trading exposure over 30 days.

Chapter 2, Section 7.6.2 of the Market Rules further states the forms of credit support that can be provided to EMC. These permitted forms of collateral with associated criteria are summarised in Table 1 below.

Table 1: Permitted forms of collateral in the SWEM with associated requirements

No.	Type of Collateral	Criteria
1	Guarantees	<ol style="list-style-type: none"> 1. Must be issued by a financial institution that is a local or foreign bank rated "A" or better by Standard & Poor's (S&P) 2. Must be executed as a deed 3. Must be in the form set out in Market Manual 1, Appendix 2 4. Must permit drawings or claims by the EMC and provide for payment by the guarantor on demand up to amount stated in the credit support.

¹ MPs pay EMC 20 days after trading. If non-payments persist, about 10 days is needed to suspend the MP. Thus, the credit support value is set based on 30 days.

No.	Type of Collateral	Criteria
2	Letters of Credit	<ol style="list-style-type: none"> 1. Must be issued by a financial institution that is a local or foreign bank rated "A" or better by Standard & Poor's (S&P) 2. Must be valid for a term of at least one year or provide for automatic renewal, unless advised by the issuing financial institution to the EMC 30 days prior to the renewal date that the letter of credit will not be renewed. 3. Enable partial draws and permit drawings or claims by the EMC on demand up to the amount stated in the credit support
3	Cash deposits	<ol style="list-style-type: none"> 1. Must be made with, or assigned to EMC, by or on behalf of the MP 2. Must be expressed in writing
4	Singapore Government Treasury Bills	<ol style="list-style-type: none"> 1. MPs should permit drawings and claims by the EMC up to the full amount on the bill. 2. Valued as cash at their current market value less 2% to account for potential eroding effects of interest rate increases.

2.2 Process undertaken to draw on credit support

The current settlement timetable requires net debtors (usually retailers and the Market Support Services Licensee) to make payment to EMC by 5pm of the twentieth calendar day after the trading day (herewith termed T+20 CD²). These payments are then transferred by EMC to net creditors (usually generating companies, service providers and interruptible loads) the next calendar day (herewith termed T+21 CD²).

Chapter 3, Section 7.3.1.1 of the Market Rules states that a situation under which an MP (net debtor) fails to make payment to EMC by 5pm of the T+20 CD constitutes as an event of default. In such an event, EMC is entitled to draw upon the defaulting MP's collateral to offset this MP's payments owed to EMC. The claim procedure differs depending on the type of collateral put up as credit support by the MP, as summarised in Table 2 below.

Table 2: Credit support claim procedure for collaterals permitted in the SWEM

No.	Type of Collateral	Procedure
1	Guarantees/ Letters of Credit	<ul style="list-style-type: none"> • EMC makes written demand to financial institution stating amount payable to them by MP • Upon receipt of written demand for payment, the financial institution undertakes the following procedures: <ul style="list-style-type: none"> – If made before 12pm on a banking day, the financial institution will make the full payment to EMC by 3 pm on the same day – If made after 12 pm but before 5 pm on a banking day, the financial institution will make the full payment to EMC by 11 am of the next banking day.
2	Cash deposits	<ul style="list-style-type: none"> • Set off debts, obligations and liabilities of MP against cash put up by MP

² Subject to business day convention

No.	Type of Collateral	Procedure
3	Singapore Government Treasury Bills	<ul style="list-style-type: none"> • EMC is required to maintain a custodian account to house the treasury bills • To enable same-day cash settlements from sale of treasury bill, the following conditions must be met • EMC executes a faxed indemnity for the bank to accept its faxed instructions to sell the bill. • EMC to maintain current account such that the bank can credit proceeds from sale of the treasury bills to the account.

The Market Rules only provides one day for payments received from debtors to be made out to creditors. Thus, in the event that a debtor defaults on payments, EMC is required to make a claim on the defaulting MP's credit support within this short span of one day to ensure that creditors receive their payments on time. As such, this short turnaround time implicitly imposes a strict requirement on the liquidity of collaterals accepted in the SWEM to ensure that it can be drawn upon within one day.

3. Guiding principles in accepting collaterals

This section establishes a set of guiding principles that form the basis of accepting new types of collateral into an exchange.

Financial markets and exchanges use collaterals to manage its participants' credit risk, minimizing losses in the event of a default. As such, it is imperative that collaterals are characterised by low risk to minimise a double default event. For example, an exchange may be unable to draw on a defaulting party's collateral as it was issued by another defaulting entity. To meet this objective, the principles³ presented in the following subsections 3.1 to 3.3 should be considered when accepting new forms of collateral.

3.1 Low credit risk

Credit risk refers to risk of financial loss when one or more participants fail to fulfil their financial obligations, leading to default. A financial market or exchange should accept collateral issued by entities with low credit risk, often managed using strict credit policy such as imposing minimum credit ratings on collateralized assets.

An exchange should also avoid accepting collaterals that reduces in value when the participant defaults or its creditworthiness worsens, termed "wrong-way risk" by the CPSS-IOSCO. This risk is usually prevented by disallowing entities from being guarantors of their affiliates.

3.2 Low market risk

Market risk arises from financial loss caused by volatile price movements of the underlying asset. Collaterals accepted should possess stable and predictable price movements to ensure that the value of these collaterals do not fall below the underlying securitized amount in the event of liquidation, leading to further strains on the market.

³ These principles are derived from the Committee on Payment and Settlement Systems – Technical Committee of the International Organisation of Securities Commissions (CPSS-IOSCO) consultation report titled "Principles for financial market infrastructures (March 2011)".

Market risk can be managed by frequent revaluation of price-volatile collaterals that reflect true market conditions, which implicitly requires prices of such collaterals to be readily available. For example, an exchange that accepts corporate stocks as collateral should only accept liquid, publicly listed stocks and mark these stocks to market daily. More prudent haircuts also need to be applied to these forms of collateral.

3.3. High liquidity

An exchange should be able to make a claim on its collateral promptly when a default arises, which emphasizes the importance of accepting relatively liquid assets as collateral.

To ensure liquidity, an exchange should require that the asset can be sold promptly with a ready pool of buyers matched by a large trade volume. On the legal front, an exchange should be able to cash in assets such as letters of credit or guarantees without any disagreements or delays from the guarantor.

4. Collaterals accepted in other jurisdictions

Prior to analysing new collaterals that may be introduced into the SWEM, it is useful to explore accepted forms of collateral in other jurisdictions. This review would provide insights on potential collaterals that can be introduced into the SWEM.

Table 3 below summarises common types of accepted collateral across six jurisdictions, namely, the California Independent System Operator (CAISO), Independent System Operator New England (ISO-NE), New York Independent System Operator (NYISO), Pennsylvania-Jersey-Maryland Interconnection, Australian Energy Market Operator (AEMO) and New Zealand Exchange (NZX).

Table 3: Common forms of collateral accepted in other jurisdictions

No.	Collateral	Jurisdiction					
		CAISO	ISO-NE	NYISO	PJM	AEMO	NZX
1	Unsecured credit limit	✓	✓	✓	✓	✓	
2	Cash deposits	✓	✓	✓			✓
3	Letters of credit	✓	✓	✓	✓	✓	✓
4	Bank guarantees	✓			✓	✓	✓
5.	Corporate/Third party guarantees	✓		✓	✓		✓
6.	Surety/Security bonds	✓		✓			✓

CAISO, NYISO followed by NZX were found to accept the widest variety of collaterals. It is interesting to note that CAISO has a relatively longer payment cycle as compared to other jurisdictions, only paying its creditors 5 days following receipt of payment from its debtors. The longer time frame between inflow and outflow of payments offers CAISO more time to draw on its credit support in the event of a default, possibly enabling it to accept less liquid collaterals.

Table 3 also shows that that the most common collaterals accepted in the jurisdictions surveyed are similar to that used in SWEM, except for unsecured credit limit, corporate guarantees and surety/security bonds. These are briefly described below.

a. Unsecured credit limit

Several jurisdictions allow participants to trade for up to a predetermined credit limit without any underlying collateralized asset. However, these jurisdictions generally conduct strict credit assessments of each participant to ensure low credit risk. For example, ISO-NE requires potential participants to submit financial statements, referees and other relevant financial information to demonstrate that they are in sound financial health. Trading limits are also imposed depending on each participant's credit rating (if available), net worth and net assets.

b. Corporate/Third party guarantees

Corporate/third party guarantees are generally, but not necessarily, provided by a parent company to guarantee financial obligations of a smaller affiliate. Some jurisdictions surveyed impose additional requirements on corporate guarantees offered by their participants' affiliates or foreign guarantors. For example, CAISO subjects a corporate guarantor of an affiliated MP to similar credit reviews undertaken by that participant. It also imposes a maximum guarantee amount on foreign guarantors depending on their respective credit rating.

c. Surety/security bonds

Surety bonds are usually issued by insurance companies, enabling the lender to cash in the bond in the event of a default. Jurisdictions that accept these bonds as collateral generally impose a minimum credit rating on issuers.

5. Analysis of potential forms of collateral in the SWEM

Drawing upon the experience of collaterals accepted in other jurisdictions, we identified four potential forms of collateral that may be introduced in the SWEM, namely, unsecured credit limit, corporate guarantees, government bonds and securities. Their advantages and disadvantages are presented below, taking into account the guiding principles discussed in sections 3.1 to 3.3.

5.1 Unsecured credit limit

Advantages

Unsecured credit limit lowers search costs and transaction costs for MPs without having to source for additional cash or pay for bankers' guarantees. This is especially applicable for new participants without any initial cash flow or bank credibility.

Disadvantages

However, permitting MPs to trade up to a predetermined amount without underlying collateralised assets defies the guiding principle of low credit risk. In the event of a default by a participant trading, EMC would be unable to cash in on the participant's non-existent collateral and in turn, default on payments to its creditors.

Recommendations

Arising from the high credit risks involved, EMC does not recommend introducing unsecured credit limit into the SWEM.

5.2 Corporate guarantees

Advantages

Corporate guarantees offer an alternative to banker's guarantees, possibly lowering the costs of credit for MPs. It may also be easier for participants to obtain guarantees from their parent companies with more recognized financial credibility.

Disadvantages

The possibility of a double default may arise if corporate guarantees are allowed, especially if issued by an affiliated company. For example, an MP may default on payment as its parent company and associated holding companies have filed for bankruptcy. In this instance, the guarantor would be unable to honor the guarantee, leading to the need for default levy. To avoid wrong-way risk (discussed in section 3.1), corporate guarantees should not be issued by organisations affiliated to MPs.

Guarantors should also meet predetermined acceptable credit ratings to minimise credit risk.

The 1-day payouts to creditors in the SWEM also impose strict liquidity requirements on such corporate guarantees. In the event of a default, the corporate guarantor must be able to provide the requested cash to EMC within a day without any dispute. This liquidity requirement may be met by imposing a standard form of agreement⁴ between EMC and the guarantor, with predetermined terms and conditions for making claims on the guarantee.

Recommendations

Corporate guarantees may be allowed in the SWEM provided they meet the following conditions:

- a. Guarantor should not have a direct or indirect legal or beneficial interest of 5% or more of the value of shares in the MP.
- b. Guarantee must be issued by an institution that has a credit rating of "A" or above by S&P.
- c. Guarantor must agree to a prescribed standard form of agreement issued by EMC.
- d. Guarantor must be an entity incorporated in Singapore to minimise cross border risk when enforcing the guarantee.

5.3 Singapore government bonds

Advantages

Singapore government bonds (SGS bonds), similar to Singapore government treasury bills (SGS T-bills), are characterised by low credit risk. These bonds can be sold to primary or secondary dealers with publicly available prices, demonstrating their relative liquidity.

Disadvantages

Singapore government bonds generally have a longer maturity and in turn, higher interest rate fluctuations and price volatility. As such, they bear a higher degree of market risk as compared to treasury bills. This risk can be managed by constant price monitoring of each bond on EMC's part, but would translate to additional resources and higher costs. Varying degrees of haircuts would also have to be imposed on the bonds depending on their length of maturity.

⁴ This is similar to the existing standard form of agreement for a banker's guarantee used in the SWEM.

Although not directly related, it is also important to note that none of the MPs have provided SGS T-bills with EMC since the market started⁵. This implies that SGS bonds may not be popular even if they were to be permitted in the SWEM.

Recommendations

SGS bonds tend to be more price volatile than SGS T-bills, which pose a degree of market risk on the SWEM. Constant monitoring of these bond prices also leads to higher costs. They are also unlikely to be used since no MPs have provided SGS T-bills as collateral thus far. As such, EMC does not recommend the use of SGS bonds as collateral.

5.4 Stocks

Advantages

Some stocks are relatively liquid given that they are publicly listed and have significant trade volumes, which ensure ease in converting these assets into cash in the event of a default.

Disadvantages

Stocks possess significant market risk with highly volatile prices as compared to other assets. This characteristic implies a need for a daily revaluation of stocks to match prudential requirements and the application of different haircuts to different groups of stocks, translating to higher costs for EMC and MPs. In addition, the current settlement timeline of T+3 days on the Singapore Exchange does not align with the SWEM's 1-day payment cycle.

Recommendations

EMC does not recommend permitting stocks as collateral in the SWEM due to the high market risk involved.

5.5 Summary of analysis

Table 4 below summarises EMC's recommendations with accompanying reasons

Table 4: Summary of analysis of selected collaterals

No.	Collateral	Recommendations	Reasons
1	Unsecured credit limit	No	High credit risk.
2	Corporate guarantees	Potentially	Risks may be circumvented by imposing the following conditions on the guarantor: a. Must not have a direct or indirect legal or beneficial interest of 5% or more of the value of shares in the MP b. Must have a minimum credit rating of "A" (S&P) c. Must agree to a prescribed standard form of agreement d. Must be issued by an entity incorporated in Singapore.

⁵We understand from the local banks that these are not popular forms of collaterals.

3	Singapore government bonds	No	High market risk and high monitoring costs
4	Stocks	No	High market risk and mismatch in payout cycle.

6. Industry consultation

We published the paper for industry comments on 6 April 2011, in particular, whether it was possible for them to obtain corporate guarantees with the following conditions:

- a. Guarantor must not have a direct or indirect legal or beneficial interest of 5% or more of the value of shares in the MP
- b. Guarantee must be issued by an institution that has a credit rating of "A" or above by S&P.
- c. Guarantor must agree to a prescribed standard form of agreement issued by EMC
- d. Guarantor must be an entity incorporated in Singapore

The following comments were received:

Comments from Diamond Energy

Table 4 of the concept paper indicates corporate guarantees as a potential form of new collateral; however, a process to monitor the performance of the guaranteeing partying against the minimum credit rating requirements has not been adequately described.

Diamond Energy does not support any changes to the existing forms of collateral until such time that a credit management process is established and the incremental cost to the market operator (if any) has been quantified.

EMC's response

EMC will only specify the actual operational procedures and monitoring processes required for corporate guarantees or any other forms of collateral should RCP decide to introduce them into the SWEM.

Comments from Senoko

We have no objections to this proposal as long as the current types of acceptable collateral are retained.

EMC's response

We note Senoko's comments.

Comments from SP Services

Key comments from MSSL are reflected below, with a verbatim record attached in Annex 1.

SP Services' comments on EMC's proposed corporate guarantees

"As the biggest retailer in the wholesale electricity market, MSSL requires a credit support of approximately \$300M-S\$400M depending on the price of electricity. This amount of credit

support required coupled with conditions imposed by EMC restrict sources of corporate guarantees to locally incorporated well-established corporation.

MSSL will not be able to obtain a corporate guarantee from an external party to collateralise our exposure in the SWEM. Hence, MSSL would like to counter propose to EMC to consider insurance bonds as an alternative form of credit support which was not explored in the concept paper.”

SP Services’ counter proposal on insurance bonds

“An insurance bond will be issued by an insurer to insure against events of default in the SWEM by the market participant. Events of default shall mean the occurrence of any event set forth in paragraph 7.3.1 in Chapter 3 of the Market Rules. Therefore, when an MP is unable to pay its due in the SWEM, the insurance bond may be called upon by EMC to make a payout to cover the amount.

Payout will be made immediately upon default notification and written demand by EMC and the insurer will have an S&P rating of “A” or above in order to minimise credit risks. Additionally, the payout amount is to be based on written demand by EMC, therefore, the value of collateral will not change with market conditions. These characteristics of an insurance bond satisfy the guiding principles set out by EMC.

MSSL has contacted insurers in Singapore and have found them willing to provide insurance bonds with such conditions to cover defaults in the SWEM by MSSL. Preliminary quotations confirm that insurance bonds are priced competitively when compared to MSSL’s current Banker’s Guarantee rates.

The insurers contacted have also indicated that the format of the agreement for the insurance bonds will closely follow the format of the current Banker’s Guarantee used by MSSL as credit support.

MSSL would thus like to urge EMC to evaluate allowing insurance bonds to be acceptable collateral in the SWEM as it fulfils all of the guiding principles set out by EMC in accepting new collaterals to the SWEM. Allowing insurance bonds as alternative collateral will likely result in lowering the cost of obtaining credit support for MSSL, and thus benefitting consumers in the long run”

EMC’s response

We note MSSL’s comments on the difficulties in obtaining corporate guarantees that meet the predetermined criteria and their counter proposal. We would recommend that the RCP agree to further examine the use of insurance bonds as collateral in the SWEM given that it potentially fulfils the criteria set out by EMC and yet lower the cost of credit for MSSL.

7. Conclusion

Based on preliminary analysis of selected collateral used in other jurisdictions, only corporate guarantees with pre-determined criteria were found to fulfil the guiding principles of low market, low credit risk, and high liquidity. However, we have not received feedback from any interested party that intends to provide corporate guarantees which meet the criteria set out by EMC.

Nevertheless, there is potential to explore MSSL's proposed use of insurance bonds as collateral, given it possibly meets the following criteria:

- a. Guarantor must not have a direct or indirect legal or beneficial interest of 5% or more of the value of shares in the MP
- b. Guarantee must be issued by an institution that has a credit rating of "A" or above by S&P.
- c. Guarantor must agree to a prescribed standard form of agreement issued by EMC
- d. Guarantor must be an entity incorporated in Singapore

In addition, MSSL has conveyed that preliminary quotes obtained for the cost of credit of insurance bonds are competitive and the agreement can be structured in a similar manner to that used for Banker's Guarantees. These are, however, subject to MSSL's verification.

8. Discussion at 55th RCP Meeting

The RCP considered SP Services' proposed use of insurance bonds as collateral in the SWEM and tasked EMC to work with SP Services to further explore the operational feasibility of using insurance bonds as collateral in the SWEM.

9. Discussion and Recommendations at 56th RCP Meeting

SP Services sought potential insurance companies feedback based on EMC's operational requirements for the insurance bonds. This includes a need for the insurer to pay EMC within the same day a claim is raised. However, the insurers have conveyed that they are unable to meet this payment timeline. This is due to their internal claim procedures which usually involve a week of processing time before being able to make payouts to beneficiaries.

Given the above operational difficulties, the RCP unanimously decided on the following at the 56th RCP Meeting:

- **do not support** the use of insurance bonds as a collateral in the SWEM
- **retain** existing forms of collateral in the SWEM

Annex 1

MSSL's Response to EMC's Concept Paper 31 on: New Forms of Collateral

TO : EMC – MARKET ADMINISTRATION DEPARTMENT
FAX : 6779 3030
SUBJECT : New Forms of Collateral
ATTENTION : JAN LEE

1. Background

- 1.1 At present, MSSL uses Banker's Guarantees (BG) as credit support to cover its trading exposure in the Singapore Wholesale Electricity Market (SWEM). In this concept paper, EMC has proposed to consider modifying existing Market Rules so as to introduce Corporate Guarantees as an alternative form of collateral to be accepted as credit support, provided it meets the following conditions:
- a. Guarantor must not be an *affiliate of the Market Participant*. The term "*affiliate of the Market Participant*" means any corporation that has a direct or indirect legal or beneficial interest of 5% or more of the value of shares in the Market Participant.
 - b. Guarantee must be issued by an institution that has a credit rating of "A" or above by Standard & Poor's (S&P)
 - c. Guarantor must agree to a prescribed standard form of agreement issued by EMC
 - d. Guarantor must be an entity incorporated in Singapore to minimise cross border risk when enforcing the guarantee
 - e. Guarantor to make payouts within 1 day

2. MSSL's Comments

- 2.1 MSSL has taken this opportunity to carry out a study on the various forms of security collateral available to us. While MSSL is supportive to the idea of introducing Corporate Guarantee as alternative collateral, the above conditions imposed by EMC are too rigid and restrictive to enable MSSL to obtain any corporate guarantee.
- 2.2 As the biggest retailer in the wholesale electricity market, MSSL requires a credit support of approximately \$300M – S\$400M depending on the price of electricity. This amount of credit support required coupled with conditions imposed by EMC restrict sources of corporate guarantees to locally incorporated well-established corporations.
- 2.3 It is not possible to obtain the high amount of corporate guarantee from any locally incorporated corporations which are not in the finance/insurance industry. Banks have their own products to provide credit support and will be unlikely to issue such corporate guarantees. The remaining option is to seek corporate guarantees from finance companies. An inquiry in Apr 11 to three major finance companies in Singapore, namely Hong Leong Finance, Singapura and Sing Investments confirms that they do not have credit ratings by S&P and hence are unable to fulfill condition b as required by EMC.

- 2.4 Based on the above findings, MSSL will not be able to obtain a corporate guarantee from an external party to collateralize our exposure in the SWEM. Hence, MSSL would like counter propose to EMC to consider insurance bonds as an alternative form of credit support which was not explored in the concept paper.

Counter Proposal

- 3.1. An insurance bond will be issued by an insurer to insure against events of default in the SWEM by the market participant. Events of default shall means the occurrence of any event set forth in paragraph 7.3.1 in chapter 3 of the Market Rules. Therefore, when MP is unable to pay its due in the SWEM, the insurance bond may be called upon by EMC to make a payout to cover the amount.
- 3.2. Payout will be made immediately upon default notification and written demand by EMC and the insurer will have a S&P rating of "A" or above in order to minimize credit risks. Additionally, the payout amount is to be based on written demand by EMC, therefore, the value of collateral will not change with market conditions. These characteristics of an insurance bond satisfy the guiding principles set out by EMC.
- 3.3. MSSL has contacted insurers in Singapore and have found them willing to provide insurance bonds with such conditions to cover defaults in the SWEM by MSSL. Preliminary quotations confirm that insurance bonds are priced competitively when compared to MSSLS' current Banker's Guarantee rates.
- 3.4. The insurers contacted have also indicated that the format of the agreement for the insurance bonds will closely follow the format of the current Bankers' Guarantee used by MSSL as credit support.
- 3.5. MSSL would thus like to urge EMC to evaluate allowing insurance bonds to be an acceptable collateral in the SWEM as it fulfills all of the guiding principles set out by EMC in accepting new collaterals to the SWEM. Allowing Insurance bonds as alternative collateral will likely result in lowering the cost of obtaining credit support for MSSL, and thus benefitting consumers in the long run.