

## P249 Consultation Responses

**Consultation issued on 25 January 2010**

What stage is this document in the process?

**01** Initial Written Assessment

**02** Definition Procedure

**03** Assessment Procedure

**04** Report Phase

We received responses from the following Parties

Company	No BSC Parties / Non-Parties Represented	Role of Parties/non-Parties represented
Thames Power Services	<b>1/0</b>	Generator
SAIC Ltd. (for and on behalf of ScottishPower)	<b>7/0</b>	Supplier / Generator / Trader / Consolidator / Exemptible Generator / Distributor
Derwent Cogeneration Limited	<b>1/0</b>	Generator
RWE Npower Limited	<b>8/0</b>	Supplier / Party Agent
E.ON UK	<b>6/0</b>	Supplier / Generator / Trader / Consolidator / Exemptible Generator
EDF Energy	<b>13/0</b>	Supplier/Generator/Trader/Consolidator/Exemptible Generator/Party Agent
Centrica	<b>10/0</b>	Supplier/Generator/Trader
ConocoPhillips (U.K.) Ltd	<b>1/0</b>	Trader

### Question 1: **Availability of the ELEXON Treasury Policy**

Would you like the ELEXON Treasury Policy to be made available to BSC Parties on request?

#### Summary

Yes	No	Neutral/Other
8	0	0

#### Responses

Respondent	Response	Rationale
Thames Power Services	Yes	It seems sensible to make the Treasury Policy available to parties in the interest of openness and to allow

P249  
Assessment Consultation  
Responses

8 February 2010

Version 1.0

Page 1 of 11

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Respondent	Response	Rationale
		participants to assess whether to continue to hold funds above the minimum requirements with ELEXON or place funds with other institutions.
SAIC Ltd. (for and on behalf of ScottishPower)	Yes	It is vital that Parties have visibility of the investment criteria being used to invest their cash. Without this visibility, Parties will be unable to assure themselves as to the security of the choices being made on their behalf. Companies may have particular investment or ethical policies which are at odds with the ELEXON policy, and this will be the only way they can assess the suitability of the ELEXON policy for themselves.
Derwent Cogeneration Limited	Yes	Transparency
RWE Npower Limited	Yes	RWE npower can see potential benefit in making the Treasury Policy available to those that request it as in these cases there must be a genuine reason for needing to review the policy. It is therefore envisaged that this could only lead to improvements being made or clarification/ understanding being gained by all participants involved.
E.ON UK	Yes	Parties should be able to confirm how and where any cash they lodge will be invested, in order to best understand the likely return and any perceived risk and make an informed decision whether to meet their required cover with cash or Letter(s) of Credit
EDF Energy	Yes	The risks and benefits managed by Elexon under this proposal, on significant and generally long term deposits provided by parties for cash credit, should not only be visible to parties, but should be subject to consultation with parties and approval by the BSC Panel on their behalf. We have less concern about Elexon's Policy towards other smaller and shorter term surpluses which may occur, but the Policy on these should also be visible to Parties.
Centrica	Yes	The Treasury Policy needs to be made available for transparency purposes and to allow Parties to make an informed decision as to whether to post cash or alternative security as credit cover. As the Treasury Policy directly impacts the credit quality and risks associated with the option to post cash collateral, but is not part of the BSC, it will need to be made available. There should also be a process where relevant Parties are informed as and when the Treasury Policy is amended. The relevant Parties have a fiduciary duty to understand the level of risks associated with all cash-based decisions.
ConocoPhillips (U.K.) Ltd	Yes	Users need to have confidence that those investing funds have authority and accountability to do so.

## Question 2: **Impacts**

Would the Proposed Modification impact your organisation?

### Summary

Yes	No	Neutral/Other
6	1	1

### Responses

Respondent	Response	Rationale
Thames Power Services	Yes	There would be no impact upon Barking Power's workload however this modification seems to give scope to improve the level of interest received on funds placed on deposit by suitable treasury management from which Barking Power would benefit.
SAIC Ltd. (for and on behalf of ScottishPower)	Yes	Minor process change to review cash position against the ELEXON Treasury policy.
Derwent Cogeneration Limited	Yes	A potential increase in financial risk.
RWE Npower Limited	Potentially	It is envisaged that the modification as proposed, whilst operating as anticipated, would not impact RWE npower. However, we are still not clear from the drafting that has so far been provided as to where any liabilities lie. That is to say, is it the case that under the new proposed approach, or under the present arrangements for that matter, that if any of the Banks in question were to go bust, or invested monies were lost for some reason, that it would be the parties that would carry the cost? If this is the case then there is obviously a potential impact. It is fair to say that divesting investments as envisaged should minimise any potential impact.
E.ON UK	Yes	Only insofar as being a Party who may need to provide a large amount of credit cover, so potentially lodging several £m cash, we are keen to understand the Treasury Policy and any future changes.
EDF Energy	Yes	Elexon hold long term and short term cash deposited by parties within the EDF Energy group of companies, and EDF Energy are potential creditors affected by any shortfall arising from loss of deposits made by itself or other Parties.
Centrica	Yes - minor	The modification will not require any system changes for Centrica. However, there will be minor work required to incorporate the new policy into our decision making process.
ConocoPhillips (U.K.) Ltd	No	CPUKL policy is to lodge security by way of Letter of Credit in lieu of cash.

### Question 3: Implementation Approach

Do you support the implementation option as described in the Assessment Consultation document?

#### Summary

Yes	No	Neutral/Other
6	2	0

#### Responses

Respondent	Response	Rationale
Thames Power Services	Yes	Should the modification be approved, a speedy implementation would be appropriate.
SAIC Ltd. (for and on behalf of ScottishPower)	Yes	While we support the implementation date for changes to the BSC, we would expect there to be a cooling off period after that date before investments were made to allow Parties time to review the Treasury Policy against their own internal policies and take relevant action concerning their cash position.
Derwent Cogeneration Limited	No	Insufficient controls cited for investment counterparty criteria. Lack of diversification.
RWE Npower Limited	Yes	RWE npower tentatively support the proposal but recognise that it is prudent to understand any liabilities that may be impacted.
E.ON UK	Yes	Prompt implementation is desirable.
EDF Energy	No	<p>Although we acknowledge that it may be possible to secure additional returns on surpluses held by Elexon, we do not consider the issues have been assessed sufficiently to justify the proposal at this stage. In particular, we would wish to see:</p> <ul style="list-style-type: none"><li>• more analysis of the balance of risk and reward amongst those providing the surplus money, in particular long term credit deposits and other more transient amounts</li><li>• more analysis of the balance of risk and reward between providers of cash collectively and parties in general which are potential creditors in the event of party payment default and/or bank default (noting that the proposed minimum credit rating of potential banks to hold deposits appears to be less than that of the single current bank)</li></ul> <p>more visibility and control by parties of Elexon investment policy</p>
Centrica	Yes	-
ConocoPhillips (U.K.) Ltd	Yes	Subject to existence/implementation of satisfactory controls upon investment, option should increase income.

## Question 4: BSC Objectives

Would the Proposed Modification P249 help to facilitate the Applicable BSC Objectives?

### Summary

Yes	No	Neutral/Other
4	3	1

### Responses

Respondent	Response	Rationale
Thames Power Services	Yes	No prudent organisation would place such a large proportion of its funds with one financial institution. In the light of recent developments it is sensible to review the use of a single BSC banker and diversify risk by placing funds with a number of institutions which satisfy the financial criteria determined by the ELEXON Board. Applicable BSC Objective D is relevant as this would improve efficiency in the implementation and administration of the balancing and settlement arrangements.
SAIC Ltd. (for and behalf of ScottishPower)	No	We do not think that this Modification will better achieve the applicable Objectives for the following reasons: <ul style="list-style-type: none"><li>• The proposal will see additional resources, time and effort deployed in making investment decisions. Even if that is outsourced to a financial advisor, there will be a cost associated with this. (Objective d)</li><li>• The proposal unnecessarily complicates the arrangements, making them less efficient and more onerous to administer. (Objective d)</li><li>• There is no cost benefit or saving to ELEXON with these arrangements to offset the resource and costs incurred. Any returns are passed straight back to Parties. (Objective d)</li><li>• ELEXON would be effectively acting as a financial investment broker for a subset of Parties at the expense of all Parties. (Objective c)</li><li>• The greatly increased risk of losing part or all of the investment has not been mitigated. With no rules or procedures in place within the BSC to deal with such a loss, it is likely that costly and time-consuming legal action would ensue. Such costs and recovery of loss would be borne by Parties and ELEXON (who would most likely recoup that from all Parties). (Objective c and d)</li></ul>
Derwent Cogeneration Limited	No	It is not the role of ELEXON to increase financial risk and more controls need to be in place to mitigate this element.
RWE Npower	Yes/No	RWE npower understand and agree that the proposed

Respondent	Response	Rationale
Limited		new arrangements may be more profitable and that monies held in the Reserve Account can be made to work harder, but we doubt that the additional work required would better facilitate objective d) i.e. to promote efficiency.
E.ON UK	Yes	A very tenuous argument could be made under (C) but really as the Group confirmed this modification is essentially a positive move that will further achievement of BSC Objective (D) by enabling more efficient use of funds in the Reserve account.
EDF Energy	No	<p>The proposal has potential to better meet BSC Objective (d), here taken to mean efficient administration of the BSC arrangements, but we consider there is insufficient evidence that it does. It has not been explicitly shown that the net benefit from increased returns and changed risk on surplus cash held by BSCCo in relation to its own administrative and operational purposes would outweigh the additional administrative costs (and possibly risks) of managing the proposed approach, noting that the surplus for this purpose alone is small relative to credit deposits.</p> <p>We consider that parties depositing cash for credit effectively have beneficial ownership of that cash while no call on it is made, and therefore the changed risk and the benefits of increased returns are a competitive matter rather than an administrative matter. Also, the money is held for the protection of parties in general in case of failure of an individual party, also a competitive matter relevant to BSC Objective (c) rather than (d).</p> <p>The proposal has potential to better meet BSC Objective (c) if:</p> <ul style="list-style-type: none"> <li>increased returns and changed risk for those individual parties providing surplus cash reflect outcomes closer to what they could reasonably expect to achieve with that cash themselves, AND</li> <li>the resulting balance of risk between parties providing credit and parties in general (for the benefit of whom the credit is lodged) is broadly acceptable.</li> </ul> <p>However, these measures have not been fully assessed, and there remains a possibility that increased returns are obtained at the expense of increased risk for parties depositing cash, and/or increased risk for parties in general for whose protection that cash is provided, noting that the proposed minimum acceptable credit rating for alternative deposits appears to be lower than that of the current single bank.</p> <p>We see no significant impact on BSC Objectives (a) (transmission licence conditions) or (b) (system operation), except to the extent they overlap with BSC Objectives (c) and (d).</p>
Centrica	Yes	Centrica supports the views of the modification group that the benefit would be under objective (d) for the reasons given.
ConocoPhillips (U.K.) Ltd	Yes	As noted on the proposal.

## Question 5: **Alternative Solution**

Are there alternative solutions that the Modification Group has not identified that they should consider?

### Summary

Yes	No	Neutral/Other
3	5	0

### Responses

Respondent	Response	Rationale
Thames Power Services	No	This is a common sense step to introduce a more commercial and balanced approach to the investment and reduce the risk to participant's funds.
SAIC Ltd. (for and behalf of ScottishPower)	No	
Derwent Cogeneration Limited	Yes	Limiting deposit counterparties to an approved list. Greater diversification.
RWE Npower Limited	Yes	Suggested variation for consideration – Invest a fixed limit of the pot as opposed to a maximum % to avoid any potential excessive investment, at least until dealings with a new Bank and the appropriate relationships have been fully established?
E.ON UK	No	The defect P249 is addressing is the specific issue of allowing Reserve account monies to be held in other products and institutions than an overnight account with the BSC Banker. However as per further comments, greater clarity on wider issues such as the choice of BSC Banker and 'worst-case scenario' provisions is desirable.
EDF Energy	Yes	The Investment Policy for Cash Credit should be determined by the BSC Panel in consultation with BSC Parties, separately from the generally less significant investment of cashflow surpluses on Trading Charges and BSCCo Charges.
Centrica	No	-
ConocoPhillips (U.K.) Ltd	No	Other options may require greater regulatory approval and/or more risk.

## Question 6: Further Comments

Do you have any further comments on P249?

### Responses

Respondent	Response	Rationale
Thames Power Services	No	-
SAIC Ltd. (for and on behalf of ScottishPower)	Yes	We are very concerned that the issue of how this change would deal with any consequential losses has been deemed out of scope. The Modification, while reducing the risk (however small) of all the lodged cash being lost through a single bank default, increases the chance that a portion of that cash could be lost (by diversifying the investment portfolio). At the end of the day, this cash is Parties cash, and there should be a plan of action to address this increased risk. It seems foolhardy to proceed with this Modification without a complementary change to mitigate for loss.
Derwent Cogeneration Limited	Yes	<p>Credit ratings are a poor mechanism for determining counterparty quality. Icesave was a Aa3 rated bank before it collapsed. Enron was investment grade up to four days before it went bankrupt. Lehman went from AA to bankruptcy; AIG was AAA on 15.09.08 and A- on 16.09.08. Empirical studies have documented that yield spreads of investments start to expand as credit quality deteriorates but before a rating downgrade, implying that the market often leads a downgrade and therefore questions the informational value of credit ratings. Analysis in the 1970's and 1980's showed single 'B' rated companies do not default anymore often than triple 'A' rated companies.</p> <p>We support the idea of seeking to improve returns on available/surplus funds and applaud the initiative of the ELEXON's Finance Team for raising this issue.</p> <p>We are opposed to relying on credit rating agency criteria as a sole mechanism for determining the suitability of counterparties. We are of the view that insufficient analysis has been carried out to demonstrate an understanding of yield curve/reinvestment dynamics, risk-reward dynamics and convenience loss if a deposit has to be recalled early.</p> <p>We do not understand the logic of restricting investment outside of the main banker to only two other parties at any one time, what is the rationale?</p>
RWE Npower Limited	Yes	<p>Additional points for clarification:</p> <ul style="list-style-type: none"> <li>• If a Bank (or Banks) went bust who would be liable to carry that cost? ;</li> <li>• What process/ methodology is there to confirm the calculation and payment of any interest, what is the reporting strategy on this? ;</li> <li>• By allowing an investment of up to 40% with any one Bank could result in £52m being invested, we</li> </ul>



Respondent	Response	Rationale
		<p>suggest that this seems excessive, we therefore suggest considering an alternative approach in which you limit any investment to a fixed amount as opposed to a % of the monies held in the Reserve Account.</p> <ul style="list-style-type: none"> <li>• If for whatever reason the investment strategy is wrong and that as a result further liquidity is required on a particular day but cannot be obtained, at whose cost would this be?</li> <li>• We do not understand why there is a consideration to employ a stockbroker as this appears to be an additional cost for no perceived benefit taking account, as the consultation does, of the terms of the investments envisaged and the Banks that are likely to be approached? ;</li> <li>• Do we fully understand how the risks and benefits 'stack-up'?</li> <li>• Currently does any of the cash currently lodged with Elexon obtain interest and if so is this published?</li> </ul>
E.ON UK	Yes	<p>As per page 5 of the Assessment Consultation 'Solution' section:</p> <p>'The Group observed that P249 did not seek to amend the BSC provisions relating to the loss of such funds but noted that the spreading of monies across a number of financial institutions would result in a smaller total loss if one of those institutions was to fail.'</p> <p>Group discussions emphasized that risk rather than return was the major concern to all group members and highlighted the need for clarity in the event of the loss of such funds: ELEXON confirmed that BSC provisions relating to any such loss seem lacking or at least unclear. Clarity regarding what would happen and liabilities of Parties, the FAA and ELEXON in the event of e.g. a bank collapsing should be determined as soon as possible.</p> <p>As far as the Treasury Policy is concerned, a deposit term of 3 months is acceptable provided that as P249 intends Parties can still withdraw funds at any point. E.ON would prefer a more stringent approach to credit ratings with the use of only institutions with the rating of A/A2. Particularly given the present apparent dearth of information regarding provisions in the event of loss of funds, we are also concerned at the prospect that the BSC Banker may retain 100% of the Reserve Account monies. How and how often the BSC Banker is chosen/reviewed also appears unclear. Such concerns emphasize the need for Parties to have access to the Treasury Policy so that where possible they may decide what, if any, amount of cash to deposit.</p>
EDF Energy	Yes	<ul style="list-style-type: none"> <li>• Spreading deposits between more institutions each with the same small individual risk obviously creates smaller loss if any one of the institutions were to</li> </ul>

Respondent	Response	Rationale
		<p>fail. But the overall risk depends on the risk associated with the individual institutions, and the proposed policy appears to lower the credit rating requirements below that of the existing single bank. Did the mod group do any risk assessment of relative risks?</p> <p>Did the mod group consider the change in risk to potential BSC Creditors of co-incident bank failure and party failure? There may be parties for whom loss of a cash deposit or failure of a bank is critical. Higher return usually means more risk. For example, bank creditors with longer term deposits can usually be expected to have higher risk than those with short term deposits, in the queue of creditors in the event of bank failure.</p> <ul style="list-style-type: none"> <li>• It is not clear whether or how Elexon cash surpluses are distinguished between longer term deposits of cash credit, and transient cashflow surpluses arising from (a) Trading Charge timing mismatches and (b) BSCCo Charges.</li> <li>• At page 7 of the consultation, Elexon say they will retain capability to withdraw money immediately with penalty not exceeding any returns on the principal amount. This should be explicit in the proposed Treasury Policy.</li> <li>• At page 7 of the consultation document "Apportioning Returns on Investments": Would parties get a detailed report on how returns had been achieved? This would obviously reveal the total amount of credit lodged and the terms on which Elexon Clear has banked it. Did the group consider transparency/confidentiality issues around such information?</li> <li>• In proposed Treasury Policy section 3, clarification should be provided on exactly what is meant by a "UK financial institution". UK incorporated entity? UK licensed subsidiaries of foreign banks/European banks? FSA Authorised entity?</li> <li>• The assessment mentions external legal advice that Elexon would not need to be FSA approved despite exercising an element of discretion over "investment" of parties' funds. Elexon should share this advice.</li> <li>• In proposed Treasury Policy section 3, we think it would be prudent to retrieve money immediately in the hopefully rare event of an institution losing the minimum rating (but not necessarily immediately upon negative credit watch).</li> <li>• The proposed Treasury Policy at section 7 Responsibilities &amp; Reporting says "Investment selection will be approved by the Chief Financial</li> </ul>

Respondent	Response	Rationale
		<p>Officer, ...". Given the potential materiality of this issue, we think the investment decision should be approved by at least one BSCCo Board Member, with Board agreed arrangements for urgent or emergency circumstances.</p> <ul style="list-style-type: none"> <li>Legal Text 4.1.2. The FAA should only establish the means by which to facilitate and manage the transfer of monies between the Reserve Account and an Investment Account(s) on request from BSCCo in accordance with the Treasury Policy.</li> <li>Legal Text 4.10.1. Noting concerns about the distinction between cash credit and other surpluses, what are the "certain monies" referred to here?</li> <li>Legal Text 4.10.2. As described previously, we do not agree with this clause, and consider that parties depositing cash for credit, and parties in general for whose benefit the credit is lodged should have opportunity to comment, with Panel approval on their behalf taking into account views given and the balance of risk and reward of all concerned. Elexon should not have sole discretion over the balance of risk and return on these deposits.</li> <li>In several places the proposed legal text refers to transfers from the Reserve Account to an Investment Account. It also needs to cover the return of money from an investment account to the reserve account.</li> <li>Assuming FSA authorisation is not required, it might be clearer if the proposed new type of deposit was described in the legal text as an "alternative reserve account" or similar rather than an "investment account".</li> <li>We note the legal text itself does not limit the number of Investment Accounts as suggested in the assessment report.</li> </ul> <p>Does this proposal interact with P235 and/or P248?</p>
Centrica	No	-
ConocoPhillips (U.K.) Ltd	No	-