ELEXON

Stage 03: Assessment Report

What stage is this document in the process?

01 Initial Written Assessment

02 Definition Procedure

03 Assessment Procedure

04 Report Phase

P249: Revision of Banking Arrangements under the BSC

P249 seeks to revise the BSC to enable the BSC Clearer to invest monies from the Reserve Account in financial institutions other than the BSC Banker, and on 'term' deposit so as to obtain better returns for Trading Parties.

Modification Group recommends **approval of Modification Proposal P249**.

Low/No Impact:
BSC Parties and Party Agents

166/07

P249
Assessment Report

5 March 2010

Version 1.0

© ELEXON Limited 2010

Contents

1	Summary	4
2	Why Change?	6
3	Solution	8
4	Alternative Solution	9
5	Impacts & Costs	10
6	Implementation	13
7	The Case for Change	14
8	Recommendations	16
9	Further Information	16
Attachment **B**: Industry responses to the P249 Assessment Consultation		16
Attachment **C**: Transmission Company Analysis		16
Attachment **D**: Legal Text Proposed		16
Attachment **E**: ELEXON Treasury Policy		16
Attachment **F**: Code Subsidiary Document redlining		16

About this document:

This document is an Assessment Report, which ELEXON will present to the Panel on 11 March 2010, on behalf of the P249 Modification Group. The Panel will consider the recommendations on the final page, and agree an initial view on whether or not this change should be made.

There are 6 parts to this document. This is Part 1. It provides details of the solution, impacts, costs, benefits and the potential implementation activities associated with this change.

- **Attachment A** provides details on the Modification Group's discussions in the light of Assessment Consultation responses, together with its recommendations for revisions to the ELEXON Treasury Policy.
- **Attachment B** provides a summary of the industry responses to the Group's consultation.
- **Attachment C** provides the Transmission Company's analysis.
- **Attachment D** contains the Group's agreed legal text for the P249 Proposed Modification.
- **Attachment E** contains the Treasury Policy as approved by the ELEXON Board.
- **Attachment F** contains the draft redlining for the impacted Code Subsidiary Documents.

P249 was issued to the industry for Assessment Consultation on 25 January 2010, with responses requested by 8 February. The P249 Modification Group met on 10 February to discuss these responses and to formulate its conclusions.

Any questions?

Contact:
Dickon Prior

dickon.prior@elexon.co.uk

020 7380 4032

© ELEXON Limited 2010

You can download copies of the full industry consultation responses and the Transmission Company's impact assessment here.

© ELEXON Limited 2010

1 Summary

Why Change?

At present the Code does not provide for the re-investment of funds lodged in the Reserve Account and does not envisage 'term' deposits. This limits ELEXON Clear (the BSC Clearer) from managing these monies in an efficient and economic manner so as to obtain the best returns for the Parties who have lodged cash cover.

Proposed Solution

Modification Proposal P249 seeks to revise the BSC in order to enable the BSC Clearer to re-invest monies deposited in the Reserve Account into accounts ('Investment Accounts') held by institutions other than the BSC Banker. The proposed changes would also enable Reserve Account monies to be invested on 'term' deposits. All investments of Reserve Account monies would be made in accordance with the ELEXON Treasury Policy.

Alternative Solution

The Group has not identified an Alternative Solution for P249.

Impacts & Costs

P249 would require changes to BSC Section N and Annex X-1. It would also require updates to the Funds Administration Agent (FAA) Service Description, the FAA User Requirements Specification (FAA URS) and the FAA Interface Definition and Design (FAA IDD).

P249 is likely to have no impact on BSC Parties' or Party Agents' systems, and little impact on their processes. No changes are required to BSC Central Systems or National Grid systems.

The P249 Proposed legal text is included as Attachment B to this document. The redlining for the impacted Configurable Items is still in development and will be circulated for industry consultation as part of the Report Phase Consultation.

Implementation

The Group's provisional recommended Implementation Date for P249 is 28 May 2010 if an Authority decision to approve is received on or before 21 May 2010, or 5 working days after such a decision is received thereafter.

The Case for Change

The Group believe that a better rate of return would be achieved by the introduction, under P249, of flexibility in relation to the institutions in which a proportion of the Reserve Account monies could be held. It could generally be expected that monies deposited on 'term' deposit (e.g. for up to 3 months) would achieve a higher rate of return than monies kept on overnight deposit. The Group also considered the diversification of financial risk pertaining to Reserve Account monies, through its investment across multiple financial institutions, to be an additional benefit of P249.

The Group's unanimous view is that the implementation of Proposed Modification P249 would better facilitate Applicable BSC Objective (d). The Group considered that there was a neutral, or no impact, on Applicable BSC Objectives (a), (b) and (c).

The Group unanimously believes that the Proposed Modification would provide for an improvement in the BSC banking arrangements. The Group did not propose an Alternative Modification.

What is held in the Reserve Account?

Around £100 million of Trading Parties' cash cover is held in a single bank account (the Reserve Account) with the BSC Banker, currently Barclays Bank plc. These funds are invested on overnight deposit.

© ELEXON Limited 2010

Recommendation

The P249 Modification Group recommends that Proposed Modification P249 should be approved.

© ELEXON Limited 2010

The BSC Banking Arrangements

The FAA operates 4 bank accounts on behalf of ELEXON Clear, namely a Clearing Account, a Collection Account, a Borrowing Account and a Reserve Account. These accounts are collectively termed BSC Accounts. The Reserve Account is the account into which the FAA credits or debits all Cash Cover, proceeds of Letters of Credit and surplus payments received from Payment Parties (Trading Parties and the Transmission Company) in the process of settling their Advice Notes. Over the last two financial quarters the Reserve Account has held a balance of around £100 million. The Reserve Account is held with the single BSC Banker, currently Barclays Bank plc.

Interest returns currently accrued on Reserve Account monies are apportioned among contributing Parties in accordance with the Code on a quarterly basis. These banking arrangements have been in place since NETA Go-Live (27 March 2001).

The P249 Modification Group envisages that such returns for Parties could be enhanced if ELEXON was given the ability to direct the depositing of Reserve Account monies in Investment Accounts. The Code currently provides ELEXON Clear with no capability to direct the investment of a proportion of the funds in other accounts with other financial institutions with a view to obtaining a greater return on investment. The Group considers this a limitation that would be addressed by the Proposed Modification.

What could we achieve?

ELEXON has conducted analysis, using market-tested rates, to determine the returns that could be achieved by enabling the investment of Reserve Account funds in other financial institutions.

For example, depositing £100 million in two separate financial institutions (retaining a set proportion in the Reserve Account with Barclays) on term deposit could yield £63,337 in investment return over a 30 day period, based on rates at the time of calculation. This is over £38,000 more than would be achieved by retaining the full sum on overnight deposit in the Reserve Account for the 30 day period, as is current practice in line with the Code. Over an annual period, assuming the total monies lodged by Parties remains at approximately £100 million, this would result in an additional £450,000 return.

What are the BSC Accounts?

The FAA operates the following core bank accounts (defined in BSC Section N 4.1.1), on behalf of ELEXON Clear, with Barclays Bank plc (the BSC Banker):

- The Clearing Account;
- The Collection Account;
- The **Reserve Account**, impacted by this Modification Proposal; and
- The Borrowing Account.

© ELEXON Limited 2010

Standard Overnight Deposit				
Bank	**Amount (£)**	**Term (Days)**	**Rate**	**Return (£)**
Barclays	100,000,000	30	0.30%	24,658
Term Deposit				
Bank	**Amount (£)**	**Term (Days)**	**Rate**	**Return (£)**
Barclays	30,000,000	30	0.30%	7,397
Allied Irish Bank (UK)	35,000,000	30	1.35%	38,836
Cater Allen	35,000,000	30	0.52%	14,959
			Total	63,337

It is intended that these returns are treated in aggregate (i.e. forming an interest 'pool'), regardless of how monies in the Reserve Account have been invested and what rates of return have been received. The interest from the interest pool will be apportioned among Parties based on and in proportion to the monies lodged by them from time to time. This is in line with the current Code provisions. For more information see Attachment A.

The Group also suggested that P249 could alter the risk to Reserve Account funds arising from the failure of a financial institution. 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.

© ELEXON Limited 2010

3 Solution

How will Modification Proposal P249 resolve the issues?

P249 would amend Section N of the Code ('Clearing, Invoicing & Payment') to enable the FAA, acting on written instruction from ELEXON, to facilitate and manage the transfers of Reserve Account monies into **Investment Accounts**. Investment Accounts will be a new defined term and will, accordingly, be added to Section X Annex X-1 ('Definitions and Interpretation').

The revised Section N would enable ELEXON, from time to time, to provide written instructions to the FAA to transfer certain proportions of the monies in the Reserve Account into an Investment Account. All instructions given would be in accordance with the **Treasury Policy**, as governed and approved by the ELEXON Board. It is envisaged that the Treasury Policy would be made available to Parties on request. Treasury Policy will be another defined term in the Code which would be added to Section X Annex X-1.

The Group believe that the addition of such a capability to the Code provisions would result in enhanced returns for Trading Parties who have lodged monies in the Reserve Account.

Enabling Investments

There would continue to be a single Reserve Account, operated by a single BSC Banker. The FAA would operate according to instructions received from ELEXON at all times.

As currently happens, the FAA would initially deposit the sum total of credit cover received from Parties in respect of imbalance charges in the Reserve Account operated by the BSC Banker.

P249 would introduce new arrangements to enable ELEXON to instruct the FAA to deposit Reserve Account monies into Investment Accounts. These Investment Accounts may be with financial institutions other than the BSC Banker.

Governing Investments

Investments would be made in line with a Treasury Policy under the governance of the Board of Directors of ELEXON. The Group noted that it was appropriate for the ELEXON Board to own and maintain a Treasury Policy.

The Group discussed the need for transparency to enable Parties to understand how their monies in the Reserve Account may be invested. By making the Treasury Policy available to Parties on request, these Parties would be able to make an informed judgement as to the proportions of credit cover which they would lodge either as cash cover or via letters of credit. The Group also noted that it was appropriate for ELEXON to inform Parties whenever the Treasury Policy was updated.

The current Treasury Policy, as approved by the Board, is outlined below and forms Attachment E to this document.

Operating Practice in line with the Treasury Policy

Reserve Account monies would only be invested in pounds sterling with UK banks or building societies obtaining a satisfactory credit rating – at least an A grade (high quality/upper medium grade/strong) – with Standard & Poors, Fitch and Moodys. ELEXON's Finance department would monitor the ratings, in conjunction with the FAA.

What does the Treasury Policy cover?

The Treasury Policy sets out appropriate parameters for ELEXON's banking arrangements to deliver a reasonable rate of return on cash balances and being able to meet the organisation's financial obligations.

It covers the core objectives of security, liquidity and yield. It is governed by the ELEXON Board of Directors who are responsible for approving any changes.

© ELEXON Limited 2010

International Long Term Credit Ratings	Fitch Ratings	Moody's	S&P
Highest quality/ Best quality/ Extremely strong	AAA	Aaa	AAA
Very high quality/ High quality/ Very strong	AA	Aa	AA
High quality/ Upper medium grade/ Strong	A	A	A
Good quality/ Medium grade/ Adequate	BBB	Baa	BBB
Speculative/ Lower medium grade/ Speculative- less vulnerable	BB	Ba	BB
Highly speculative/ Low grade/ More vulnerable	B	B	B

In the table above, ELEXON would consider financial institutions which fulfil the shaded credit ratings to be suitable for depositing Reserve Account monies for the purposes of investment.

No more than 40% of Reserve Account monies would be invested in any one financial institution, with the exception of Barclays, as the BSC Banker, which could, at any one time, hold up to 100% of the Reserve Account monies.

ELEXON would direct investments into no more than two financial institutions, in addition to Barclays. [1] These financial institutions would not need to be individually approved by the BSC Panel. ELEXON's Chief Financial Officer would make the decision on which financial institutions (meeting the above criteria) would be suitable for investment purposes. ELEXON may retain a stockbroker to provide investment advice with a view to obtaining the best returns. ELEXON would make any instruction to initiate the transfer(s) to the FAA in writing; the transfer would be made by the FAA as instructed.

ELEXON would have the facility to direct the depositing of funds for longer than overnight, subject to a maximum period of three months ('term' deposit).

Apportioning Returns on Investments

All interest earned on Reserve Account monies would be reimbursed to Parties who had lodged cash cover in proportion to their relevant share from time to time of the overall monies lodged in the Reserve Account and Investment Account(s).

Under P249 all monies deposited in the Reserve Account would be treated as a single pool. Returns from Investment Accounts would be pooled and apportioned to Parties, at quarterly intervals, in proportion to the amount of monies deposited by the relevant Party from time to time.

Implications for FSA Regulation

ELEXON has received external legal advice that the changes will not require the ELEXON Group to be authorised or regulated by the Financial Services Authority (FSA). This advice has been accepted by ELEXON and the Modification Group.

4 Alternative Solution

The Group identified no Alternative Solution for P249. A number of respondents to the Assessment Consultation suggested variations to the solution for the Group's

[1] The Group suggested that the ELEXON Treasury Policy be amended so ELEXON would be given the flexibility to direct investments into up to five financial institutions in addition to the BSC Banker. Refer to Attachment A for further details of the discussion.

P249 Assessment Procedure

At its meeting on 10 December 2009 the Panel agreed that P249 be progressed to a three month Assessment Procedure.

This is the Assessment Report which ELEXON will present to the Panel on 11 March 2010.

© ELEXON Limited 2010

consideration, which the Group decided not to progress as Alternatives. Many of these variations related directly to the ELEXON Treasury Policy; details of the Group's suggested amendments to the Treasury Policy are in Attachment A.

5 Impacts & Costs

Impacts and Costs

The P249 Proposed Modification will impact **BSC Section N and BSC Section X Annex X-1** as set out in the Proposed Modification legal text (Attachment B).

ELEXON implementation costs		Service Provider implementation costs	Total Costs
Man days	Costs		
11.5	£2,760	£1,300	**£4,060**

Assessment Consultation respondents reported that P249 would have no direct impact on their organisations' systems. Some respondents identified some impacts on their internal processes.

Indicative industry costs
None

Impacts

Impact on BSC Systems and process	
BSC System/Process	Impact
Funds Transfer System (operated by FAA)	• No systems impact identified. A minor update to processes is required to accommodate operation and management of Investment Accounts.
Other BSC Central Systems	• None.

Impact on BSC Agent/service provider contractual arrangements	
BSC Agent/service provider contract	Impact
BSC Services Agreement	• Impact from implementation of changes to the FAA Service Description
Funds Transfer Agreement	• Impact from implementation of changes to the FAA Service Description

Impact on BSC Parties and Party Agents
None identified.

Impact on Transmission Company
None identified.

Impact on ELEXON	
Area of ELEXON's business	Impact

© ELEXON Limited 2010

Impact on ELEXON	
Finance	Some change to operational procedures.

Impact on Code	
Code section	Impact
N 'Clearing, Invoicing & Payment'	New 4.1.2 New 4.10 New 8.6.2
X Annex X-1 'Definitions and Interpretation'	New definitions of Investment Account and Treasury Policy

Impact on Code Subsidiary Documents	
CSD	Impact
FAA Service Description	Amend sections 6.1 'Establishment of Accounts' and 6.2 'Banking Activities'

Impact on Core Industry Documents and other documents	
Document	Impact
Ancillary Services Agreements	None identified.
Connection and Use of System Code	None identified.
Data Transfer Services Agreement	None identified.
Distribution Code	None identified.
Distribution Connection and Use of System Agreement	None identified.
Grid Code	None identified.
Master Registration Agreement	None identified.
Supplemental Agreements	None identified.
System Operator-Transmission Owner Code	None identified.
Transmission Licence	None identified.
Use of Interconnector Agreement	None identified.

Impact on other Configurable Items	
Configurable Item	Impact
FAA IDD Part 2	New interface requirement for the instruction between BSCCo and the FAA
FAA URS	Amend section 2.1.9 'Maintain BSCCo Bank Accounts' (requirement FAA-R009) and add new requirement FAA-R076 'Invest Credit Cover'

Other Impacts

© ELEXON Limited 2010

Other Impacts	
Item impacted	Impact
None identified.	None identified.

© ELEXON Limited 2010

6 Implementation

Recommendation

Modification Group recommends APPROVAL of Proposed Modification P249.

The implementation of P249 would change documentation only. There is no impact on BSC Agent systems or Party or Party Agent systems.

As the Group consider the required changes to Code Subsidiary Documents and the Configurable Items to be relatively minor and straightforward. Redlining for such documentation has been prepared and is attached (see Attachment F). This will be consulted on with the industry via the Report Phase.

The Panel will consider the Modification Report and make its recommendation to the Authority in April 2010. In light of the timetable for progressing Modification Proposal P249, the Group recommends that P249 be implemented on **28 May 2010** in the event that the Authority makes a decision to approve on or before 21 May 2010. If the Authority makes a decision to approve later than 21 May 2010, the Group recommends that P249 be implemented **5 working days after the receipt of an Authority decision** to approve.

For changes to the FAA Service Description, we will update the Service Description in the next available Release to follow the Authority's approval of the Modification. The provisions of the Code take precedence over the Service Description, which would simply be amended to mirror the Code.

© ELEXON Limited 2010

Costs and Benefits

The annual operating costs associated with the investment facilities proposed under P249 are expected to be minimal:

Area	Description	Annual Cost
ELEXON Processes	Monitoring and selection of investments	Absorbed within existing operational cost base
FAA	Operation and management of Investment Accounts at ELEXON's written instruction	Zero

The Group noted that the market tested example described in Appendix A to this document suggested an additional £38,000 may be returned to Trading Parties on 30-day investments made using Reserve Account monies when compared with the current situation.

This implies an additional £450,000 return over the course of a 12 month period (assuming the total cash cover lodged by Parties is approximately £100m).

Proposed Modification against the current baseline

The Group unanimously believe that the Proposed Modification would be better than the current arrangements, and unanimously cited Applicable BSC Objective (d). Further details are given in the table below.

Groups' view of benefits of P249 against the Applicable BSC Objectives	
Description of Objective	**Identified Benefit**
a) Efficient discharge of the obligations of the Transmission Licence.	None identified
b) Efficient, economic and co-ordinated operation of the GB transmission system.	None identified
c) Promoting effective competition in the generation and supply of electricity and in the sale and purchase of electricity.	None identified
d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.	P249 could facilitate Objective (d) by introducing flexibility in relation to the institutions in which a proportion of the Reserve Account monies could be held, and in relation to the period of time for which these monies could be deposited. It could be expected that the spreading of funds across multiple financial institutions would lead to the diversification, and reduction, of overall financial risk. It could also generally be expected that monies deposited on term deposit (e.g. for up to 3 months) would achieve a higher rate of return than monies kept on overnight

© ELEXON Limited 2010

Groups' view of benefits of P249 against the Applicable BSC Objectives	
	deposit. P249 therefore introduces greater efficiency into the settlement of financial obligations between BSC Parties and ELEXON. In this way P249 promotes efficiency in the implementation and administration of the BSC arrangements.

© ELEXON Limited 2010

8 Recommendations

The P249 Modification Group invites the Panel to:

- AGREE an initial recommendation that Proposed Modification P249 should be made;
- AGREE an initial Implementation Date for Proposed Modification P249 of 28 May 2010 if an Authority decision is received on or before 21 May 2010, or, if later, 5 working days after the receipt of an Authority decision to approve;
- AGREE the draft legal text for Proposed Modification P249;
- AGREE that Modification Proposal P249 be submitted to the Report Phase; and
- AGREE that ELEXON should issue the P249 draft Modification Report for consultation and submit results to the Panel to consider at its meeting on 08 April 2010.

9 Further Information

More information is available in

Attachment A: Detailed Assessment

This information includes:

- Costs;
- Impacts;
- Modification Group membership;
- Modification Group discussions;
- Modification Group's recommendations for revisions to the ELEXON Treasury Policy; and
- Process followed for P249.

Attachment B: Industry responses to the P249 Assessment Consultation

Attachment C: Transmission Company Analysis

Attachment D: Legal Text Proposed

Attachment E: ELEXON Treasury Policy

Attachment F: Code Subsidiary Document redlining

All consultation and impact assessment responses are on the P249 page of the ELEXON website.

© ELEXON Limited 2010