
SCHEDULE 1 SPECIFICATION

REQUIREMENTS FOR EXTERNAL SUPPORT FOR P308

About this document

The P308 Workgroup requires an external support provider to undertake work on its behalf as part of its assessment of Proposed Modification P308 'Alternative security product for securing credit under the BSC'.

This document details what the P308 Workgroup seeks from any external support provider.

Brief

P308 proposes to introduce an alternative method to secure credit under the Balancing and Settlement Code (BSC) in the form of a centrally provided product that Trading Parties could choose to use instead of the existing individual Credit Cover arrangements. The P308 Workgroup needs support to identify, develop and assess products to achieve this.

The external support provider will be required to seek suitable products that meet the P308 Workgroup's requirements as listed in this document. It will be required to engage with the insurance industry in order to seek:

- potential providers of products;
- the product(s) any product provider may offer; and
- the premiums it would charge for each product.

These can be both off-the-shelf and tailored products. At this time, the P308 Workgroup has no views as to what type of product should be put in place, and believes all options that meet its requirements should be considered by the external support provider.

As part of this investigation, the external support provider will need to undertake any work or analysis that is required to assess the risks that any product provider would face when providing a product, and thus would factor in to any premiums it may request for that product. The P308 Workgroup has listed the areas to be included in any such analysis. The external support provider may undertake further analysis that it believes is necessary to complete before it can approach potential product providers, but such further analysis would be under the original external support provider contract.

The external support provider will be required to present its written findings to the P308 Workgroup, along with its recommendations and rationale as to which product(s) (if any) would be the most suitable for the BSC arrangements. It will then be required to support the P308 Workgroup through its subsequent discussions, and so will need to be available to attend, or send representation to, all subsequent meetings of the P308 Workgroup as a non-voting attendee.

All work undertaken by the external support provider will need to be capable of being published in the public domain and used by the P308 Workgroup, the BSC Panel and Ofgem in the progression of P308. This would be subject to anonymising any sensitive low-level data, for example data relating to individual participants, and the protection of commercially sensitive information. The BSC Modifications process

REQUIREMENTS FOR EXTERNAL SUPPORT FOR P308

requires maximum transparency in order to facilitate debate and agreement within the industry of whether any change should be made to the BSC arrangements and why. All information will be provided to Ofgem at the conclusion of the Modifications process.

Background and overview of P308

Under the BSC arrangements, payments by BSC Trading Parties for Trading Charges arising on any particular Settlement Day are typically made 29 calendar days later. Thus, at any given time, Parties may have debts (or be due payments) for Trading Charges incurred over the previous 29 days.

Each Trading Party is required to lodge Credit Cover to cover this period, to ensure that, should it default, ELEXON has sufficient collateral available to pay off its debts. If it does not, any outstanding debts would be shared across all other Trading Parties. Furthermore, each Party is required to lodge sufficient funds to ensure that the ratio of its Energy Indebtedness compared to its level of Credit Cover, referred to as its Credit Cover Percentage (CCP), remains below 80% to avoid triggering the Credit Default processes.

BSC Section M2.1.1 currently provides two means by which Trading Parties can lodge Credit Cover:

- Parties can lodge cash directly; or
- Parties can submit a Letter of Credit meeting the requirements of [BSC Section M2.2](#).

A Party may lodge a combination of both, which can include multiple Letters of Credit, to meet their Credit Cover requirements.

Parties are required to lodge Credit Cover on an individual Party ID basis i.e. a Trading Party would lodge Credit Cover only to cover its own Energy Indebtedness, which would not count towards any other Party's cover. Participants that hold multiple Party IDs would be required to lodge Credit Cover individually for each Party ID; Credit Cover provided against one Party ID would not count towards any of the participant's other Party IDs. Furthermore, Parties will need to lodge sufficient cover to ensure that their CCP remains below 80% to avoid entering Credit Default. This means that they need to lodge Credit Cover amounting to at least 25% again of their maximum likely Energy Indebtedness. Parties will often lodge more than this to keep their CCP lower still.

BSC Modification P308 proposes to introduce a central insurance product that BSC Trading Parties could use to cover their position above a certain threshold. This product would be shared across all BSC Trading Parties that elect to opt-in to using the product. It should be noted that Parties will still be required to cover their own position individually for the portion of its debts below this threshold.

The Proposer of P308 considers that such an arrangement would be more efficient than the current arrangements, and would help to reduce the levels of 'excess credit' that BSC Trading Parties are required to provide.

Further information on P308 can be found in the P308 Initial Written Assessment, available on the [P308](#) page of the ELEXON website. Further information on the electricity market in general can be found in the attached supporting information document.

Product requirements

Any product that is put in place would need to meet the following requirements.

Please note there are two variants of Requirement 5 to represent two possible options that the P308 Workgroup requires to be assessed. Product providers would be required to provide a quote for each option or specify that an option is unfeasible.

REQUIREMENTS FOR EXTERNAL SUPPORT FOR P308

Requirement 1: The product should pay out immediately upon submission of a claim

ELEXON, as the BSC Company (BSCCo), is required by the BSC arrangements to clear its position every day. Due to its vires and status as a not-for-profit organisation, it has no balance sheet and limited borrowing options to fall back on should this not be possible. In the event of a default by a BSC Trading Party, ELEXON will require the outstanding money from the insurance claim immediately in order to ensure it is able to clear its position for that day.

Any product should therefore be able to pay out immediately (the same Working Day) upon receipt of a claim from ELEXON for the required funds.

If immediate pay-out is not possible, product providers should provide the shortest possible timescales that can be achieved. The P308 Workgroup will then be required to determine whether this will be suitable under the BSC arrangements.

Requirement 2: The product must provide a true transfer of risk

Any product must provide a true transfer of risk, whereby the underwriter takes on any risks associated with the product.

Requirement 3: Parties will need to opt-in to use or benefit from the product

The product will only cover BSC Trading Parties that elect to opt-in to the product. These Parties would contribute to any premiums for the product, and the product would only pay out for defaults by an opted-in Party.

Any Party that does not opt-in will continue to cover their own position individually as per the current arrangements, and will not contribute to or benefit from the central product.

Requirement 4: The product will insure Parties above a threshold to be determined

BSC Trading Parties who opt-in to the product under Requirement 3 will be required to cover their own individual positions up to a threshold to be determined. They would do this via the current arrangements to lodge cash and/or Letters of Credit with the Funds Administration Agent (FAA) on an individual basis. The central product will only cover a Party's position above this threshold.

Requirement 5a: The level of pay-out for a claim will be unlimited

The product will cover all costs above the threshold determined under Requirement 4, with no cap on the level of pay-out that will be made for any given claim.

Requirement 5b: The level of pay-out for a claim will be capped at a threshold to be determined

The product will cover costs above the threshold determined under Requirement 4 up to a second threshold to be determined. Any pay-out on a claim will not exceed this upper threshold. Product providers will be invited to provide an acceptable level at which this upper threshold should be set.

In the event that further money is required, this will be sought from the defaulting Party, or if this is not possible from all BSC Trading Parties (irrespective of whether they have opted-in or not) in proportion to their Default Funding Share (see the attached supporting information document for details).

Analysis requirements

The external support provider will need to undertake any analysis that it may require before it can approach any potential product providers, in order to assess the risks that any product provider would

REQUIREMENTS FOR EXTERNAL SUPPORT FOR P308

want to consider when setting premiums. Where necessary, the external support provider should obtain the views and feedback from any potential product provider that they approach.

The P308 Workgroup has requested that any analysis contains at least the following areas:

- Care should be taken to ensure that premiums would not unexpectedly or excessively increase in the event that more claims are made than expected. As part of this, it should be considered whether the opted-in BSC Trading Parties should pay the premiums communally (all Parties pay equally based on market share) or constitutently (higher risk Parties pay an increased proportion per market share than lower risk Parties).
- Risk assessment and premiums should take seasonal effects into consideration. For example, the system is likely to be tighter in Winter than in Summer due to increased demand, which will potentially increase imbalance prices and the risk of a Party defaulting on its payments. Although it is likely premiums will be set on an annual basis, this seasonal effect should be incorporated where possible.
- Potential behavioural changes should be taken into account. In particular, it was considered that the presence of central insurance underwritten by BSC Trading Parties may cause individual Parties to take greater risk with their Imbalance position.
- Policy changes will need to be considered. In particular, the implementation of the Electricity Balancing Significant Code Review's conclusions will cause more marginal imbalance prices with the potential to be very high in times when demand is greater than available generation.

The external support provider may undertake any other analysis and assessment it believes necessary to help it identify suitable products for the P308 Workgroup, and may request any data or information it requires from ELEXON in order to do this.

Subsequent support to the P308 Workgroup

Following the completion and presentation of the work outlined in this document, the external support provider will be required to support the P308 Workgroup through its subsequent discussions. It will therefore need to be available to attend, or send representation to, all subsequent meetings of the P308 Workgroup as a non-voting attendee. It will also be asked to provide technical input to any documents that are produced as part of its assessment.

The expected progression of P308 following the completion of the work outlined in this document includes between four and six Workgroup meetings and three industry documents. Additional meetings may be called if required.

It is anticipated that each meeting will require between one and two man days of effort in preparing for and attending the meeting. Each document is anticipated to require approximately one man day of effort to review.