

# Treasury Policy



## Purpose of this policy:

The purpose of this policy is to set out appropriate parameters as deemed fit by the Board for ELEXON's banking arrangements, in order to minimise counterparty risk, while delivering a reasonable rate of return on the ELEXON Group cash balances and being able to meet the organisation's financial obligations. There are therefore three core objectives which this policy covers; security, liquidity and yield.

The primary objective is to ensure the preservation of principal when investing. Liquidity should also be maintained such that the Group should seek to avoid having cash investments whilst it has any short-term requirements for funds. Yield should only determine an investment decision when deciding between two or more instruments which satisfy the first two objectives.

**Effective Date:** TBC

**Reason for Update:**

**Target Audience:** ELEXON Finance Team and the Funds Administration Agent

**Joint Policy Owners:** ELEXON Board and Finance Team

## Related Documents:

EAC 29/03 – ELEXON's Banking Arrangements

EAC 30/06 - ELEXON's Banking Arrangements

EAC 31/06 - ELEXON's Banking Arrangements

Finance Team – Banking LWI.

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## 1 Introduction

Due to the nature of ELEXON's cost recovery model, ELEXON Ltd maintains on average a cash surplus of around £3m in any given month. In addition to this, ELEXON Clear holds cash deposits for certain Trading Parties as credit cover for imbalance charges, which equate to approximately £130m (August 2009).

In order to minimise counterparty risk, ELEXON will spread funds across a range of financial institutions, however as the funds in question ultimately belong to Trading Parties, ELEXON's risk appetite is low, and the policy therefore reflects this by establishing stringent criteria for the selection of financial institutions.

Improved returns are achievable through the selection of investments with longer maturity; however ELEXON must be mindful of liquidity requirements. This is dealt with by ensuring accurate cashflow forecasting, and establishing parameters within this policy for the permitted term of any deposits.

## 2 Instruments & Currencies

Surplus funds will only be invested in UK bank/ building society deposits, denominated in GBP.

## 3 Selection Criteria

ELEXON Group funds will only be invested with UK financial institutions. In addition, only banks or building societies obtaining a satisfactory rating with Standard and Poors, Fitch and Moodys will be selected. Finance will monitor the ratings, and should an institution fall below the required level they will be deselected at the next possible time (i.e. when funds are due for re-investing). The minimum required ratings are shaded in the table below:

International Long Term Credit Ratings	Fitch Ratings	Moody's	S&P
<b>Investment Grade</b>			
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
<b>Non-investment grade</b>			
Speculative/ Lower medium grade/ Speculative-less vulnerable	BB	Ba	BB
Highly speculative/ Low grade/ More vulnerable	B	B	B
Poor quality/ currently vulnerable	CCC	Caa	CCC
High default risk/ Highly speculative/ Currently highly vulnerable	CC	Ca	CC
High default risk/ Extremely poor/ Imminent default	C	C	C
In default	D	C	D

*Note: Fitch Ratings and Standard and Poor's may append their ratings with '+' or '-' to denote relative status within major rating categories. Moody's may append their ratings with '1', '2' or '3' to denote relative status.*

Where a counterparty has more than one rating, the lowest rating will determine what overall limit applies to each counterparty. If an entity is on credit watch negative, then the limit to be applied should be taken as the limit for one rating notch lower.

In the event that a limit is exceeded because of a downgrade after the original investment was made, the Chief Financial Officer will review the risks and possible flexibility to come back within limit. Any investments remaining in excess of limit will be reported to the Board as part of the monthly report.

## 4 Spreading Proportions

For the purpose of security and to minimise counterparty risk, not more than 40% of cash balances will be invested with any one institution. The exception to this rule is Barclays Bank Plc who remain

the Group's main banker through whom all regular daily transactions are processed. ELEXON Ltd and ELEXON Clear will each use no more than three financial institutions in order to reduce multiple counterparty exposure. When deciding the amount of funds to be maintained in the main account (Barclays) consideration will be given to liquidity by the Finance Team by referring to the cashflow forecast.

## 5 Term of Investment

The main purpose of spreading funds is to minimise risk as opposed to aggressively pursuing maximum yields. The longer the time to maturity of any investment, the better the return, however consideration must be given to minimising risk and ensuring sufficient funds to meet ELEXON's obligations; therefore security and liquidity are of greater importance than yield.

Subject to satisfactorily assessing liquidity requirements through cashflow forecasting, funds may be placed with a financial institution for longer than overnight, subject to a maximum period of 3 months.

## 6 Treatment of Gains and Losses

The principle for treating gains and losses will differ slightly between ELEXON Ltd and ELEXON Clear.

Any interest earned or any losses suffered in relation to ELEXON Ltd funds lodged will be offset against, or added to, BSC Co costs and will therefore be spread across the industry on the basis of Funding Shares, in the same manner as all regular costs.

Interest earned on ELEXON Clear funds will be reimbursed to Trading Parties who have physical funds on deposit in proportion to their share of the overall total of all cash lodged with the FAA. Similarly, any losses suffered will be borne by Trading Parties in proportion to their share of overall deposits lodged.

## 7 Responsibilities & Reporting

Investment selection will be approved by the Chief Financial Officer, within the constraints of this policy. This document will be reviewed annually by the Board, or for time to time as they see fit.

Investment decisions will be reported to the Board as part of the monthly Finance report. This will cover investment decisions taken in the month, investment performance, as well as any breaches of limits.

## 8 Document History

Version	Date	Author	Reviewer	Reason for review
0.1	27 July 2009	Nigel Smith	Executive	New policy

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