



## Stage 04: Draft Modification 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.



Initially, the Panel recommends  
**approval of Proposed Modification.**



Low/No Impact:  
BSC Parties and Party Agents

P249  
Draft Modification Report

15 March 2010

Version 0.2

Page 1 of 16

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### Any questions?

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## Contents

<b>1</b>	Summary	3
<b>2</b>	Why Change?	4
<b>3</b>	Solution	8
<b>4</b>	Impacts & Costs	11
<b>5</b>	Implementation	13
<b>6</b>	The Case for Change	14
<b>7</b>	Panel Discussions	15
<b>8</b>	Panel's initial recommendations	16
<b>9</b>	Further Information	16
	Attachment <b>A</b> : Assessment Report	16
	Attachment <b>B</b> : Detailed Assessment	16
	Attachment <b>C</b> : Legal Text for P249 Proposed Modification	16
	Attachment <b>D</b> : Draft CSD Amendments for P249 Proposed Modification	16
	Attachment <b>E</b> : ELEXON Treasury Policy	16
	Attachment <b>F</b> : Report Phase Consultation questions	16

## About this document:

This document is a Draft Modification Report, which ELEXON will present to the Panel on 8 April 2010. The Panel will consider the recommendations, and agree a final view on whether or not this change should be made.

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P249  
Draft Modification Report

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15 March 2010

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Version 0.2

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Page 2 of 16

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### 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.

### 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.

### 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.

### Impacts & Costs

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 C to this document. The redlining for the Code Subsidiary Documents impacted by P249 is included as Attachment D to this document.

### Implementation

The Panel'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 Panel agree with the P249 Modification Group's belief that P249 would achieve a better rate of return of Reserve Account monies. 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 Panel 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 Panel's unanimous view is that the implementation of Proposed Modification P249 would better facilitate Applicable BSC Objective (d). The Panel considered that there was a neutral, or no impact, on Applicable BSC Objectives (a), (b) and (c).

### Recommendation

The Panel initially unanimously recommends that P249 Proposed Modification should be made.

P249  
Draft Modification Report

15 March 2010

Version 0.2

Page 3 of 16

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### 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 Panel 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 Panel 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.

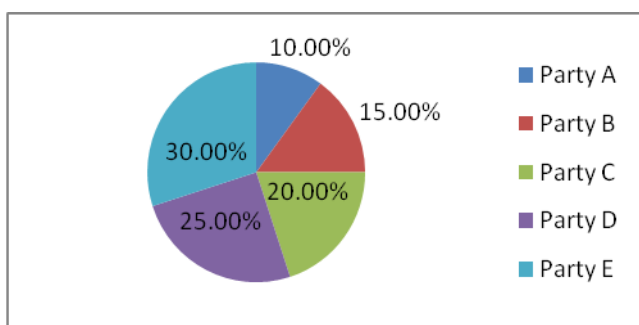
Standard Overnight Deposit				
Bank	Amount (£)	Term (Days)	Rate	Return (£)
Barclays	100,000,000	30	0.30%	24,658
Term Deposit				
Bank	Amount (£)	Term (Days)	Rate	Return (£)
Barclays	30,000,000	30	0.30%	7,397
Allied Irish Bank (UK)	35,000,000	30	1.35%	38,836
Cater Allen	35,000,000	30	0.52%	14,959
			Total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

## SIMPLIFIED EXAMPLE:

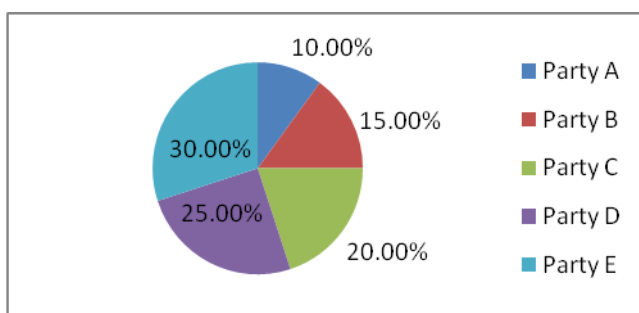
£100m exists in the Reserve Account.

A first investment is placed for 10% of the overall funds - £10m.



Party	Total Cash Lodged (£)	% Overall Total	% of Investment	Investment (£)
A	10,000,000	10.00%	10	1,000,000
B	15,000,000	15.00%	10	1,500,000
C	20,000,000	20.00%	10	2,000,000
D	25,000,000	25.00%	10	2,500,000
E	30,000,000	30.00%	10	3,000,000

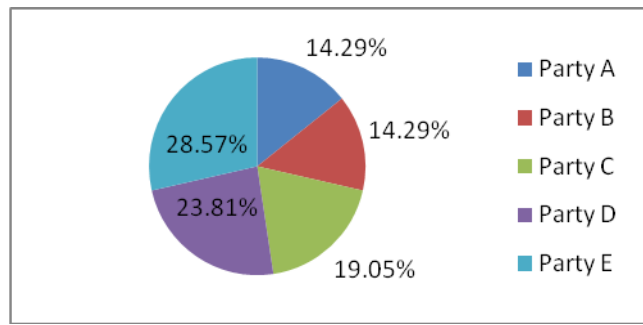
A second investment is placed for 20% of the overall funds held in the Reserve and Investment Accounts - £20m.



Party	Total Cash Lodged (£)	% Overall Total	% of Investment	Investment (£)
A	10,000,000	10.00%	20	2,000,000
B	15,000,000	15.00%	20	3,000,000
C	20,000,000	20.00%	20	4,000,000
D	25,000,000	25.00%	20	5,000,000
E	30,000,000	30.00%	20	6,000,000

Should Party A subsequently increase their cash deposit by £5m, the next investment will be based on a total of £105m held in Reserve and Investment Accounts, with Party A

having lodged £15m. Individual Party shares for a 10% investment will change, correspondingly, to:



Party	Total Cash Lodged (£)	% Overall Total	% of Investment	% of Investment (£)
A	15,000,000	14.29%	10	1,500,000
B	15,000,000	14.29%	10	1,500,000
C	20,000,000	19.05%	10	2,000,000
D	25,000,000	23.81%	10	2,500,000
E	30,000,000	28.57%	10	3,000,000

Party A will receive interest, quarterly, on their share of each investment.

- First investment: 10% of the share of interest received
- Second investment: 10% share of the interest received
- Third investment: 14.29% share of the interest received

Assuming an interest rate of 0.52%, on a 30 day deposit Party A would receive:

Investment	Amt Invested	Total Interest Earned	Party A Share	Party A Share
1	£10,000,000	£4273.97	10%	£427.40
2	£20,000,000	£8547.95	10%	£854.79
3	£10,500,000	£4487.67	14.29%	£641.29

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



## How will 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 and which will 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 Panel 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 Panel noted that it was appropriate for the ELEXON Board to own and maintain a Treasury Policy.

The Panel noted the Group's desire 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 Panel also noted that it was appropriate for ELEXON to inform Parties whenever the Treasury Policy was updated, and for ELEXON to engage in regular dialogue with the Board regarding the state of investments.

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.

P249  
Draft Modification Report

15 March 2010

Version 0.2

Page 8 of 16

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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.<sup>1</sup> 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).

The Panel suggested that ELEXON consider investing Reserve Account monies in certain financial vehicles other than UK banks and building societies, such as money market funds. The Modification Group concluded that such a strategy was unwise, as balances invested in money market funds could go down as well as up and as the administrative overheads that would be incurred by ELEXON in directing and monitoring such investments would be disproportionate to the benefits. ELEXON will not be investing Reserve Account monies in financial institutions where it might experience a loss on returns.

## 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.

<sup>1</sup> The Panel noted that the P249 Modification Group had 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. For further information, refer to Attachment A of the P249 Assessment Report, available from the [P249](#) page on the ELEXON website.

## 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, the P249 Modification Group and the Panel.

### Report Phase Consultation Question

Do you agree with the Panel's unanimous view that the Proposed Modification should be approved?

The Panel invites you to give your views using the response form in Attachment F

### Report Phase Consultation Question

Do you agree that the legal text delivers the intention of Proposed Modification P249?

The Panel invites you to give your views using the response form in Attachment F

## 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 C).

ELEXON implementation costs		Service Provider implementation costs	Total Costs
Man days	Costs		
11.5	£2,760	£1,300	<b>£4,060</b>

### P249 Report Phase

At its meeting on 11 March 2010 the Panel agreed that P249 be progressed to a one month Report Phase.

This is the Draft Modification Report which ELEXON will present to the Panel on 8 April 2010.

## Impacts

Impact on BSC Systems and process	
BSC System/Process	Impact
Funds Transfer System (operated by FAA)	<ul style="list-style-type: none"> <li>No systems impact identified. A minor update to processes is required to accommodate operation and management of Investment Accounts.</li> </ul>
Other BSC Central Systems	<ul style="list-style-type: none"> <li>None.</li> </ul>

Impact on BSC Agent/service provider contractual arrangements	
BSC Agent/service provider contract	Impact
BSC Services Agreement	<ul style="list-style-type: none"> <li>Impact from implementation of changes to the FAA Service Description</li> </ul>
Funds Transfer Agreement	<ul style="list-style-type: none"> <li>Impact from implementation of changes to the FAA Service Description</li> </ul>

Impact on BSC Parties and Party Agents	
No impact of Party or Party Agent systems. Possible impact on Parties' internal processes.	

Impact on Transmission Company	
None identified.	

Impact on ELEXON	
Area of ELEXON's business	Impact
Finance	Some change to operational procedures.

Impact on Code	
Code section	Impact
Section N	New 4.1.2, 4.10 and 8.6.2
Annex X-1	New definitions of Investment Account and Treasury Policy

Impact on Code Subsidiary Documents	
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P249  
Draft Modification Report

15 March 2010

Version 0.2

Page 11 of 16

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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.

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

Other Impacts	
Item impacted	Impact
None identified.	None identified.

## 5 Implementation

P249 has no impact of BSC Agent or Party Systems, as such the Panel recommends that P249 be implemented:

- on **28 May 2010** if the Authority makes a decision to approve on or before 21 May 2010; or
- **5 working days after the receipt of an Authority decision** to approve, if this is later than 21 May 2010.

The Panel 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 for industry comment, in Attachment D to this document.

For efficiency purposes, changes to the FAA Service Description will be updated in the next available Release to follow the Authority's approval of the Modification..

### Report Phase Consultation Question

Do you agree with the Panel's suggested Implementation Date?

[Insert answer here](#)

### Report Phase Consultation Question

Do you agree that the Code Subsidiary Document redlined changes deliver the intention of Proposed Modification P249?

[Insert answer here](#)

### 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 Panel noted that the market tested example described in Section 2 of 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).

### Applicable Objectives

The Panel 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.

Panel's view of benefits of P249 against the Applicable BSC Objectives	
Description of Objective	Identified Benefit
a) Efficient discharge 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, supply, sale and purchase of electricity.	None identified
d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.	<p>Introducing flexibility in relation to the institutions where Reserve Account monies could be held, and for the period of time for which these monies could be deposited adds to efficiency.</p> <p>It could be expected that the spreading of funds across multiple financial institutions would lead to the diversification, and reduction, of overall financial risk.</p> <p>P249 introduces greater efficiency into the settlement of financial obligations between BSC Parties and ELEXON.</p>

### Panel's consideration of Assessment Report

In response to a query from the Panel, ELEXON confirmed that they had contacted respondents to the P249 Assessment Consultation who had initially declared their belief that the Proposed Modification did not facilitate the Applicable BSC Objectives, and that they had successfully addressed and resolved these respondents' concerns.

The Panel requested further clarification as to how liquidity in the Reserve Account would be managed. ELEXON confirmed that they would be responsible for managing and securing this overall liquidity through investing marginal proportions of the total Reserve Account balance across multiple financial institutions. ELEXON stressed that the ability to invest funds on 'term' deposit would enable them to leverage substantially higher returns than if such deposits continued to be limited to overnight.

In response to a query from the Panel, ELEXON confirmed that the BSC Auditor (PricewaterhouseCoopers LLP) were aware of the progression of P249 and that the managing of Reserve Account monies would form part of the scope of the BSC Audit going forward.

The Panel noted that a number of matters for discussion had arisen in the context of the progression of P249 but which were outside the scope of the Proposed Modification. The Panel made particular mention of the question of who would bear the liability if some or all of the monies held in the Reserve Account were to be lost, for example in the event of a bank failure. ELEXON suggested the issue of liability could be progressed by a BSC Issue Group, with a particular view as to whether such provisions would need to be clearly incorporated into the Code. This course of action would be dependent on a BSC Party raising an Issue.

In light of the above discussions, the Panel were of the unanimous opinion that Proposed Modification P249 better facilitated Applicable BSC Objective (d) (efficiency).

## 8 Panel's initial recommendations



### Recommendation

The Panel unanimously agreed an initial recommendation that the Proposed Modification should be made.

Having considered the P249 Assessment Report, the Panel:

- **AGREED** an initial recommendation that Proposed Modification P249 should be made;
- **AGREED** 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;
- **AGREED** the draft legal text for Proposed Modification P249;
- **AGREED** that Modification Proposal P249 be submitted to the Report Phase; and
- **AGREED** 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**: Assessment Report

Attachment **B**: Detailed Assessment

Attachment **C**: Legal Text for P249 Proposed Modification

Attachment **D**: Draft CSD Amendments for P249 Proposed Modification

Attachment **E**: ELEXON Treasury Policy

Attachment **F**: Report Phase Consultation questions

Other related documentation can be found on the [P249](#) page of the ELEXON website.