P249 Consultation Responses

What stage is this document in the process?

01 Initial Written Assessment
02 Definition Procedure
03 Assessment Procedure
04 Report Phase

Consultation issued on 16 March 2010

We received responses from the following Parties

Company	No BSC Parties / Non-Parties Represented	Role of Parties/non-Parties represented
Centrica PLC		
E.ON UK	**6/0**	Supplier / Generator / Trader / Consolidator / Exemptable Generator
EDF Energy	**13/0**	Supplier/Generator/Trader/Consolidator/Exemptable Generator/Party Agent/Distributor
RWE Npower Limited	**8/0**	Supplier / Party Agent
SAIC Ltd. (for and on behalf of ScottishPower)	**7/0**	Supplier / Generator / Trader / Consolidator / Exemptible Generator / Distributor

Question 1: Do you agree with the Panel's unanimous view that the Proposed Modification should be approved?

Summary

Yes	No	Neutral/Other
2	3	0

Responses

Respondent	Response	Rationale
Centrica PLC	Yes	We think the decreased concentration of counterparty credit risk is the strongest reason for accepting the proposed amendments. Incrementally we also feel that the magnitude of the risk to the industry of having to fund any cash shortfalls as a result of bank default are reduced due to decreased expected losses achieved by diversifying. This is amplified if you consider that a bank failure would likely significantly impact BSC parties as well as the BSC banker when additional funding would be required. Lastly, the increased return to parties depositing cash as collateral should reduce the net cash cost to funding that collateral which increases efficiency. As an organisation we prioritise the reduction in risk over increased return although both benefits are welcomed and appear possible to achieve; but only if the Treasury Policy and surrounding controls and processes are effectively implemented.
E.ON UK	Yes	We remain concerned that the BSC Banker may still hold 100% of monies, which have been >£100m, and would also prefer a more stringent approach to credit ratings for all the institutions involved with the use of only those with the rating of A/A2. We also note that the consequences for Parties of a loss of funds are still unclear. However P249 would be an improvement on the baseline for the reasons given in the Draft Modification Report. The achievement of a better rate of return for Reserve Account monies is worthwhile in itself; however as the Group unanimously agreed risk is a greater concern than reward. In our view the diversification of financial risk through investment across several appropriate financial institutions is the more important aspect of P249.
EDF Energy	No	In principle, we support the view that increased diversity and an investment policy should be able to improve the overall effectiveness of credit management under the BSC arrangements. A proposal which

Respondent	Response	Rationale
		unambiguously reduces risks (for example multiple AA investments) while increasing returns for minimal additional effort should clearly better meet BSC objectives. However, we remain unconvinced that this particular modification necessarily reduces the overall risk associated with investment of parties' cash credit. Firstly, we think the BSC is unclear on whether a party which lodges cash credit bears the risk of it being lost by failure of Elexon Clear investments, or whether all parties bear the risk, or someone else. Note that cash credit amounts provided by a party are ultimately intended for the benefit of all other parties in the event of its default. If a party which lodges cash credit carries the risk of that cash being lost, we think there is a potential correlation with its own failure, in which case the loss could pass to other BSC parties anyway. We think it would be sensible to first establish who bears the risk from potential investment failure, before changing rules which affect that risk and how it is managed. The current arrangements have survived various party failures and the recent banking crisis. It seems inappropriate to seek to improve returns on cash credit without properly considering who bears the associated risk. Secondly, while it is asserted that the risk of loss of cash credit is reduced by this proposal, in association with the proposed initial Treasury Policy, no firm evidence is provided. It is self-evidently stated, and the Panel obviously agree, that "spreading of monies across a number of financial institutions would result in a smaller total loss if one of those institutions was to fail". However, if the risk associated with the individual investments is higher than present, and there is correlation of risks from different institutions, the overall risk could be higher (expressed as average expected £/year, for example). The proposed Elexon Treasury Policy indicates a required 'A' credit rating for investments, less than the current 'AA' rating of the BSC Banker. While Letters of Credit only require an A rating, the diversity amongst Letters of Credit is likely to be more than for the proposed investment accounts. Thirdly, even if there were an initial reduction in overall risk through diversification despite some lower individual investment credit ratings, the proposal also hands control of policy to Elexon, and the Board could change the policy in future, increasing the risk. We are not convinced that it is appropriate for Elexon to have total control over the risk management approach taken with BSC Parties' cash credit deposits provided for the benefit of potential creditors. We think the risk approach should be set out in the BSC, or at least be subject to BSC Panel approval on behalf of BSC parties subject to consultation. We do not understand the view that it would be unviable for Elexon to operate without the flexibility to vary the policy itself at short notice. It has had no difficulty operating under the

Respondent	Response	Rationale
		fixed policy implicit in the current BSC requirements. Given these concerns, we do not consider it has been demonstrated that the proposal would better meet BSC objective (c) relating to competition, because the balance of benefit and risk is not clear, or objective (d) relating to administrative efficiency, because it is not clear whether the risks are reduced or not, but there will be increased costs.
RWE Npower Limited	No	RWE npower does not agree with the proposal as it currently stands as it believes that the 40% rule for any single counterparty still provides for a large amount of money to be deposited with Banks that we have had no prior dealing with and so introduces an unnecessary risk. Whilst we understand and agree with the concept of spreading the Industry's Credit Cover risk across a number of Banks we feel that the values deposited should be capped to a reasonable amount, say £15m, at least for an introductory period or scaled upwards depending on their credit rating e.g. • AAA up to £50m; • AA up to £30m; and • A up to £15m. The RWE npower position stated here and the supporting comments provided are based upon the current drafting of the consultation document. Should the final position change in any way to incorporate these concepts we will be happy to reconsider our position.
SAIC Ltd. (for and on behalf of ScottishPower)	No	We do not think that this Modification will better achieve the applicable Objectives for the following reasons: • The proposal has the potential to see additional resources, time and effort deployed in making investment decisions. Although ELEXON have given assurances that there is a negligible impact on day to day operations, there will be effort (however small) expended on making these decisions, and as the complexity of the investing increases, so will the cost. (Objective d) • The proposal unnecessarily complicates the arrangements, making them less efficient and more onerous to administer. (Objective d) • 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) • ELEXON would be effectively acting as a financial investment broker for a subset of Parties at the expense of all Parties. (Objective c) • 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.

Respondent	Response	Rationale
		Such costs and recovery of loss would be borne by Parties and ELEXON (who would most likely recoup that from all Parties). While we acknowledge that the risk of losing sums invested is not new, this proposal increases the likelihood of it occurring. (Objective c and d)

Question 2: Do you agree that the legal text delivers the intention of Proposed Modification P249?

Summary

Yes	No	Neutral/Other
3	1	1

Responses

Respondent	Response	Rationale
Centrica PLC	Yes	This clearly outlines the need to alert BSC Parties to any changes in the Treasury Policy as required by the Parties' investment managers.
E.ON UK	No	4.10.1 appears to imply that there is only one Investment Account. Should 'and Investment Account' read 'and an Investment Account', or 'and Investment Account(s)'? Also, under 4.10.2 did the Group 10/02/10 not agree that where ELEXON review the Treasury Policy and decide not to change it, this would also be communicated to Parties, to remind them of the existence of said policy and provide assurance that it has been reviewed?
EDF Energy	-	Proposed N4.10.1 should refer to "each Investment Account" or "an Investment Account" or "Investment Accounts" rather than "Investment Account". Should it also refer to transfer between different "Investment Accounts"? An Investment Account as defined is not necessarily an account which is compliant with the Treasury Policy, even though transfers to and from such an account must be in accordance with the Treasury Policy (N4.10.1). Is proposed section N4.10.1 sufficient to ensure that money cannot be held in accounts which do not meet the Treasury Policy credit rating or other requirements, for example if the

Respondent	Response	Rationale
		credit rating of a previously qualifying investment drops?
RWE Npower Limited	Yes	RWE npower agrees that the proposed legal drafting delivers the intention of the proposed modification.
SAIC Ltd. (for and on behalf of ScottishPower)	Yes	-

Question 3: Do you agree with the Panel's suggested Implementation Date?

Summary

Yes	No	Neutral/Other
4	1	0

Responses

Respondent	Response	Rationale
Centrica PLC	Yes	As we will incur little to no impact as an institution we are fine with the proposed timeline
E.ON UK	Yes	P249 should be implemented as soon as possible.
EDF Energy	No	Notwithstanding our concerns about the proposal, an implementation date 5 working days after an Authority decision does not seem sufficient to allow parties to amend their credit approach if they wish. We think a period of at least 2 weeks, preferably 3 weeks or more, would be preferable. The proposed legal text (N4.10.2) itself suggests 15 business days is a suitable period for notice of revision of the Treasury Policy.
RWE Npower Limited	Yes	As our current understanding does not envisage any impact to our systems and processes as a result of this proposed modification we support the suggested Implementation Date.
SAIC Ltd. (for and on behalf of ScottishPower)	Yes	-

Question 4: Do you agree that the Code Subsidiary Document redlined changes deliver the intention of Proposed Modification P249?

Summary

Yes	No	Neutral/Other
4	0	1

Responses

Respondent	Response	Rationale
Centrica PLC	Yes	
E.ON UK	Yes	They look suitable.
EDF Energy	-	-
RWE Npower Limited	Yes	RWE npower agrees with and supports the proposed changes to the Code Subsidiary Documents.
SAIC Ltd. (for and on behalf of ScottishPower)	Yes	-

Question 5: Do you have any further comments on P249?

Responses

Respondent	Rationale
Centrica PLC	We welcome the proposal for the reasons mentioned above but stress that liquidity risk must also be managed in conjunction with credit risk. We would therefore like to state that we expect to see a conservative Treasury policy and a focus on liquidity management as term deposit with other institutions do add greater complexity here. Notwithstanding these cautions we feel that the expected diversification and increased return are adequate to warrant the proposed modification.
E.ON UK	We hope that the Treasury Policy/text will be expanded to confirm various points as discussed in the P249 Group, e.g. that 'UK financial institutions' means those that are incorporated and have headquarters in the UK and are FSA regulated. Also to state the dates the Policy was last reviewed and when the next review is due. Greater clarity on how/when the BSC Banker is chosen/reviewed might also be welcome. More importantly, as P249 has highlighted, 'worst-case scenario'

Respondent	Rationale
	provisions need clarification. ELEXON have confirmed that the BSC is silent regarding the potential loss of such funds; clarity regarding liabilities of Parties, the FAA and ELEXON in the event of such an event should be sought, the sooner the better. It would be useful if ELEXON could confirm if this might be possible through an Issue Group, or if internal/other work might be required for this.
EDF Energy	Comments on the draft Modification Report: Section 3 on page 8 "Enabling Investments" says that credit cover is received from parties in respect of imbalance charges. This should say Trading Charges. Section 3 on page 8 "Governing Investments" suggests that transparency of Treasury Policy is sufficient for individual parties to make informed judgement on how they lodge credit, taking into consideration the relative risks and costs associated with cash and letters of credit. While this may be true for parties providing credit, it provides no comfort to parties as ultimate creditors for the cash provided, who would have no control over the risks taken by Elexon with money provided for their benefit. In a normal bilateral situation, parties would agree terms between themselves. Section 7 of the draft Modification Report says that Elexon told the BSC Panel they had successfully addressed and resolved concerns expressed by respondents to the assessment consultation. This should simply say that Elexon had addressed queries, not that they had addressed all concerns. We have not commented on the proposed Treasury Policy. Given that BSC Parties would not be involved in setting Treasury Policy if this proposal were to be approved, there seems little to be gained from commenting on it.
RWE Npower Limited	Please see response to question 1.
SAIC Ltd. (for and on behalf of ScottishPower)	We do not think that this Modification will better achieve the applicable Objectives for the following reasons: • The proposal has the potential to see additional resources, time and effort deployed in making investment decisions. Although ELEXON have given assurances that there is a negligible impact on day to day operations, there will be effort (however small) expended on making these decisions, and as the complexity of the investing increases, so will the cost. (Objective d) • The proposal unnecessarily complicates the arrangements, making them less efficient and more onerous to administer. (Objective d) • 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) • ELEXON would be effectively acting as a financial investment broker for a subset of Parties at the expense of all Parties. (Objective c) • The greatly increased risk of losing part or all of the

Respondent	Rationale
	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). While we acknowledge that the risk of losing sums invested is not new, this proposal increases the likelihood of it occurring. (Objective c and d)