

## Stage 01: Initial Written Assessment

# P308 'Alternative security product for securing credit under the BSC'

This Modification proposes to introduce an alternative method for securing credit under the BSC. This product would be provided centrally, and Parties would be able to use it in place of the existing requirements to provide Credit Cover individually.

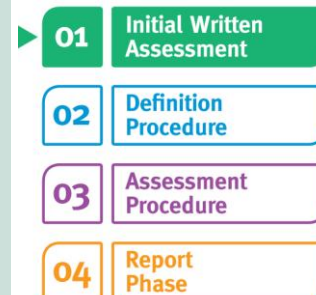


ELEXON recommends P308 is progressed to the Assessment Procedure for an assessment by a Workgroup

This Modification is expected to impact:

- BSC Parties
- The Energy Contract Volume Allocation Agent (ECVAA)
- The Funds Administration Agent (FAA)
- ELEXON

What stage is this document in the process?



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## About This Document

This document is an Initial Written Assessment (IWA), which ELEXON will present to the Panel on 12 June 2014. The Panel will consider the recommendations and agree how to progress P308.



### Any questions?

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# 1 Why Change?

## What are the credit arrangements?

Under the BSC arrangements, payments by 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 Party is required to lodge Credit Cover to cover this period, to ensure that, should it default, we have sufficient collateral available to pay off its debts. Otherwise the debts must be shared across all other BSC Parties.

The BSC does not stipulate the amount of Credit Cover that Parties must provide. Instead it is left to Parties to decide on the level of cover that they wish to provide.

We perform a credit check process every half hour to ensure that each Party's accumulated debt (their Energy Indebtedness) over the 29 day period does not exceed the amount of Credit Cover they have provided. If a Party has insufficient funds lodged to cover this debt, it will receive a default notice.

## What is Credit Default?

A Party will receive a default notice if its Credit Cover Percentage (CCP) (the ratio of its Energy Indebtedness compared to the level of Credit Cover lodged) exceeds 80%. If a Party breaches this threshold then it will be given a period of time to investigate the default, in case there are any errors in the data. Normally the Party will lodge additional Credit Cover to bring its CCP below 80% and exit the process within the specified timescales. If it does not, it will enter Credit Default, which can have severe consequences for the Party.

Upon entering Credit Default, the Party's situation is reported to all other participants via the Balancing Mechanism Reporting Service (BMRS). Furthermore, if its CCP goes over 90%, any Energy Contract Volumes Notifications (ECVNs) or Meter Volume Reallocation Notifications (MVRNs) that would increase the Party's Energy Indebtedness will begin to be refused or rejected. This will impact both the Party in Credit Default and the relevant counterparties.

## How do Parties currently provide Credit Cover?

BSC Section M2.1.1 currently provides two means by which 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 basis i.e. a Party would lodge Credit Cover only to cover its own Energy Indebtedness, and would not count towards any other Party's cover. 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



### Credit Guidance Notes

More detail on **Credit Cover** and **Credit Default** can be found in the respective Guidance Notes available on our [Credit webpage](#).

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Indebtedness. Parties will often lodge more than this to keep their CCP lower still. This results in large sums of 'excess credit' being held under the BSC.

## What is the issue?

The Proposer considers that the level of credit held under the BSC is in some cases exceptionally high, above and beyond the actual risk that Parties are likely to incur. This is in part due to Parties needing to individually lodge funds to cover their own positions. This is further compounded by the provisions of the BSC which requires each Party to lodge more than is actually required in order to ensure they do not breach the thresholds for entering Credit Default. The credit that is lodged under the BSC appears to cover a large part of the "tail risk" where the largest losses occur but, in terms of probability, are very unlikely.

The Proposer believes that requiring Parties to provide Credit Cover on an individual basis is inefficient, as it results in significant sums of excess money needing to be lodged as Credit Cover. This can be a burden for Parties in the current financial climate, especially smaller ones. They believe it would be more efficient to provide a single central security product that could cover all Parties, which would remove a lot of the excess credit that results from the current BSC arrangements.

The Proposer notes that the trade association Energy UK has carried out some initial analysis with its members, the insurance broker Marsh and ELEXON to develop alternative security products as an alternative form of cover under the BSC. They believe that this work should now be taken forward and such a product introduced under the BSC.

### Proposed solution

This Modification proposes to introduce an alternative security product as an alternative method for securing credit under the BSC. This would be provided centrally, and would allow Parties to use this product in place of the existing requirements to individually provide cash and/or a Letter of Credit as Credit Cover.

The Proposer notes that Energy UK has carried out some initial analysis with its members, the insurance broker Marsh and ELEXON to identify the potential for developing alternative security products as an alternative form of cover under the BSC. They believe that this work should be built on and taken forward under P308 to introduce such a product under the BSC.

The Workgroup will need to consider the most suitable product to introduce into the BSC, which may require it to undertake some analysis to determine the suitability and cost-effectiveness of such products. Please see Sections 3 and 4 for more detail on this aspect.

### Applicable BSC Objectives

The Proposer considers that P308 would better facilitate **Applicable BSC Objective (c)**.

They believe that introducing an alternative security product within the BSC requirements relating to the provision of security available to BSC Parties would improve competition and reduce costs incurred by Trading Parties as it would reduce the levels of excess credit that Parties are required to lodge and replace it with a single central fund.

### Interactions with P306 and P307

This Modification has been raised alongside two other Modifications relating to the credit arrangements. However, while these Modifications are all looking at the credit arrangements, each is looking at a different aspect of the process and proposing mutually independent solutions. To summarise, these three proposals are:

- [P306 'Expanding the definition of a 'Letter of Credit' to include regulated insurance companies'](#) proposes to allow individual Parties to obtain a Letter of Credit from a regulated insurance company that is capable of providing security of a similar level and form as that provided by a bank.
- [P307 'Amendments to Credit Default arrangements'](#) proposes to amend the timings, triggers and thresholds in relation to Credit Default, including adjusting the thresholds for entering Credit Default, extending the duration of the Query Period and reviewing the processes around the Cure Periods.
- [P308 'Alternative security product for securing credit under the BSC'](#) (this proposal) proposes to introduce a centrally provided alternative security product as an alternative method for securing credit under the BSC, which Parties could use in place of the existing requirements to provide Credit Cover individually.



#### What are the Applicable BSC Objectives?

(a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence

(b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System

(c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity

(d) Promoting efficiency in the implementation of the balancing and settlement arrangements

(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators]

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All three Modifications can be progressed and implemented independently of each other; P308 could be implemented both with and without P306 or P307, and the solution it proposes would not impact the solutions proposed by the others. Nevertheless, all three Workgroups should be mindful of the other proposed solutions when developing its solution.

### 3 Areas to Consider

In this section we highlight areas which we believe the Panel should consider when making its decision on how to progress this Modification Proposal, and which a Workgroup should consider as part of its assessment of P308. We recommend that the areas below form the basis of a Workgroup's Terms of Reference, supplemented with any further areas specified by the Panel.

#### What alternative products should be used?

The Proposer has noted that an alternative security product should be used, but has left it open as to the most suitable product to put in place. The Workgroup will therefore need to consider the most appropriate product to use, and so will need to consider the following areas:

- Determine if such a product is necessary for the BSC arrangements.
- Define what sort of alternative security product should be put in place.
- Determine the minimum requirements such a product would need to meet under the BSC arrangements. As part of this, the Workgroup needs to determine the most suitable format or structure of that product and how it would work in practice.
- Consider the likely uptake and support of such a product by BSC Parties.
- Consider whether the use of this product should be optional for Parties to use instead of the existing Credit Cover arrangements, as proposed by the Proposer, or whether it should be mandatory and replace the existing provisions. As part of this, the Workgroup would need to assess the impacts either option would have on the existing BSC arrangements.
- Assess similar products, how they work in other markets, and whether these could be applied to the BSC arrangements.
- Determine the costs associated with implementing and maintaining any potential product and compare this against the benefits of it being available to BSC Parties to use.

It is likely that these questions cannot be answered by the Workgroup without support and advice from an external consultant. If this is the case, the Workgroup will need to determine what support and advice it would require to answer the above questions and whether and what supporting analysis, including a cost-benefit analysis, it may require to help it to make a decision.

Its determinations in this area and its initial answers to the questions above will inform the requirements for the procurement of any external consultant. These requirements would need to be presented to the Panel for approval before any such procurement process could begin. Please see Section 4 for more detail on the procurement of external support.

## Areas to consider

The table below summarises the areas we believe a Modification Workgroup should consider as part of its assessment of P308:

Areas to Consider
Is an alternative security product necessary for the BSC arrangements?
What sort of alternative security product would be needed for the BSC arrangements?
What are the requirements that need to be met by any alternative security product being introduced into the BSC arrangements?
How likely is an alternative security product to be taken up by BSC Parties?
Should the use of the alternative security product be mandatory or optional, and what impacts would these options have on the existing BSC arrangements?
What suitable alternative security products are available and could they be applied to the BSC arrangements?
What are the costs of implementing and maintaining an alternative security product and the benefits of having such a product available?
What changes are needed to BSC documents, systems and processes to support P308 and what are the related costs and lead times?
Are there any Alternative Modifications?
Does P308 better facilitate the Applicable BSC Objectives than the current baseline?



## 4 Proposed Progression

### Next steps

We recommend that P308 is progressed to the Assessment Procedure for assessment by a Workgroup.

### Workgroup membership

We recommend that the Workgroup membership should be formed of experts on the credit processes and any other relevant experts and interested parties.

### External support

The Proposer notes that analysis has already been initiated around alternative security products, and considers that the Workgroup will need to continue and build upon this. Furthermore, the Workgroup will require advice around such products. This advice and analysis will require support from an external consultant.

In order to obtain this support, we may need to undertake a procurement process on behalf of the Workgroup. We propose that the Workgroup meets to agree what advice and support it will need and what, if any, external analysis it will require to assist its assessment of P308. We will then return to the Panel to obtain approval to procure such external support that the Workgroup requires and the anticipated costs of doing so. We note that, depending on the alternative products discussed by the Workgroup and the abilities of any external consultant procured to support the Workgroup, additional external legal support may also be required. We will continue to update the Panel on this.

### Timetable

We recommend that P308 undergoes a 12 month Assessment Procedure, with the Assessment Report being presented to the Panel at its scheduled meeting in June 2015.

If the Panel agrees to procure external support for the Workgroup, we may need to undertake a procurement process before allowing time for the external consultant to complete any analysis required by the Workgroup. The dates in the proposed timetable below are based on needing to undertake such procurement, and may change depending on the Workgroup's discussions and whether it believes such support is required.

Following this period, we believe that the Workgroup will need to undertake the standard Assessment Procedure activities as shown in the table below, which includes a 15 Working Day industry impact assessment as well as a 15 Working Day Assessment Procedure consultation. The timetable below allows for both of these and for the Workgroup to fully develop the proposed solution outlined in Section 2, taking into account the outcomes of the analysis, and fully consider the areas highlighted in Section 3.

The BSC allows the Panel to set an Assessment Procedure timetable which is longer than three months where the Panel believes this is justified by "the particular circumstances of the Modification Proposal (taking due account of its complexity, importance and urgency)", (Section F2.2.9), and provided the Authority does not issue a contrary direction.

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We note that, should the Workgroup progress quicker than anticipated, we would seek to bring the Assessment Report back to the Panel at an earlier meeting.

Proposed Progression Timetable for P308	
Event	Date
Present Initial Written Assessment to Panel	12 Jun 14
Workgroup Meeting	W/B 30 Jun 14
Present Request for External Support to Panel (if required)	14 Aug 14
Undertake Procurement Process and Analysis (if required)	15 Aug 14 – 31 Dec 14
Workgroup Meeting	W/B 09 Jan 15
Workgroup Meeting	W/B 23 Jan 15
Industry Impact Assessment	20 Feb 15 – 13 Mar 15
Workgroup Meeting	W/B 23 Mar 15
Assessment Procedure Consultation	16 Apr 15 – 08 May 15
Workgroup Meeting	W/B 18 May 15
Present Assessment Report to Panel	11 Jun 15
Report Phase Consultation	12 Jun 15 – 03 Jul 15
Present Draft Modification Report to Panel	13 Aug 15
Issue Final Modification Report to Authority	14 Aug 15

## 5 Likely Impacts

### Impact on BSC Parties and Party Agents

Party/Party Agent	Potential Impact
BSC Parties	BSC Parties will be indirectly impacted as a result of the option to use an alternative to the current Credit Cover provisions. This may mean they can reduce their levels of Credit Cover.

### Impact on Transmission Company

None anticipated.

### Impact on BSCCo

Area of ELEXON	Potential Impact
Credit Arrangements	ELEXON will need to manage the ability for Parties to use the new security products in place of or alongside the existing Credit Cover arrangements.
Finance	The addition of alternative security products may impact Finance arrangements.

### Impact on BSC Systems and processes

BSC System/Process	Potential Impact
ECVAA	Changes are likely to be required to implement the proposed solution.
FAA	

### Impact on Code

Code Section	Potential Impact
Section M	Changes will be required to implement the proposed solution.
Section X Annex X-1	

### Impact on Code Subsidiary Documents

CSD	Potential Impact
BSCP301	Changes will be required to implement the proposed solution.

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Other Impacts	
Item impacted	Potential Impact
Credit Cover Guidance Note	Changes will be required as a result of this Modification.
Credit Default Guidance Note	Changes may be required as a result of this Modification.

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## 6 Recommendations

We invite the Panel to:

- **AGREE** that P308 progresses to the Assessment Procedure;
- **AGREE** the proposed Assessment Procedure timetable;
- **AGREE** the proposed membership for the P308 Workgroup; and
- **AGREE** the Workgroup's Terms of Reference.

## Appendix 1: Glossary & References

### Glossary of defined terms

Acronyms and other defined terms used in this document are listed in the table below.

Glossary of Defined Terms	
Acronym	Definition
BMRS	Balancing Mechanism Reporting Service
BSCP	Balancing and Settlement Code Procedure ( <i>Document</i> )
CCP	Credit Cover Percentage ( <i>Parameter</i> )
ECVAA	Energy Contract Volume Allocation Agent ( <i>BSC Agent</i> )
ECVN	Energy Contract Volume Notification
FAA	Funds Administration Agent ( <i>BSC Agent</i> )
IWA	Initial Written Assessment ( <i>Document</i> )
MVRN	Metered Volume Reallocation Notification

### External links

A summary of all hyperlinks used in this document are listed in the table below.

All external documents and URL links listed are correct as of the date of this document.

External Links		
Page(s)	Description	URL
3	Credit Cover and Credit Default Guidance Notes	<a href="http://www.elexon.co.uk/reference/credit-pricing/credit/">http://www.elexon.co.uk/reference/credit-pricing/credit/</a>
5	P306 webpage	<a href="http://www.elexon.co.uk/mod-proposal/p306/">http://www.elexon.co.uk/mod-proposal/p306/</a>
5	P307 webpage	<a href="http://www.elexon.co.uk/mod-proposal/p307/">http://www.elexon.co.uk/mod-proposal/p307/</a>
5	P308 webpage	<a href="http://www.elexon.co.uk/mod-proposal/p308/">http://www.elexon.co.uk/mod-proposal/p308/</a>