

## Credit Committee Quarterly Report: April – June 2011

<b>Target Audience</b>	Credit Committee Members and BSC Parties
<b>Date Published</b>	12 August 2011
<b>Purpose of paper</b>	For information
<b>Summary</b>	<p>ELEXON produces this report on the Credit Assessment Price (CAP) review process every 3 months for the Credit Committee. This particular report covers April to June 2011. The purpose of these reports is to assist the Credit Committee in its obligation to keep the CAP Review process under review.</p> <p>In summary:</p> <ul style="list-style-type: none"> <li>• No CAP reviews were triggered this Quarter. A review that was triggered in the previous Quarter resulted in CAP being increased from £50/MWh to £56/MWh in May.</li> <li>• CAP overestimated outturn SBP throughout the Quarter</li> <li>• If Q1 prices rise during the latter part of the current Quarter, another review may be triggered.</li> </ul>

### 1. Why we produce the Quarterly Report

ELEXON creates this report every 3 months to provide an overview of the performance of the CAP review process. We focus on the review process over the last Quarter (i.e. this report covers the months of April to June 2011). We assess the weekly trigger checks and the performance of CAP against outturn System Buy Price (SBP) and forward market prices.

The primary aims of these reports are to assist the Credit Committee:

- by indicating where a change in the trigger level may be necessary;
- in its task of keeping under review the suitability and availability of the forward price data and enabling the Committee, where appropriate, to recommend a change of provider(s) or additional provider(s) of forward price data to the Panel; and
- by providing a view on how well the methodology for reviewing CAP is working. The Committee can recommend a change to the standard methodology to the Panel if it believes it to be necessary or appropriate.



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As these reports are primarily for the Committee, there is no explanation in these reports of how the CAP review process works or what CAP is used for. Further information can be found on the Credit Committee web page:

<http://www.elexon.co.uk/bscpanelandcommittees/panelcommittees/CreditCommittee/default.aspx>

## 2. An overview of the CAP process from April to June 2011

At the beginning of the Quarter, a CAP review was ongoing following a trigger event in March 2011. This review resulted in the CAP value being increased from £50/MWh to £56/MWh. The new value went live on 4 May 2011. Following this increase, no further trigger breaches have occurred.

As part of the review that Credit Committee determined that the trigger level should remain as £6/MWh.

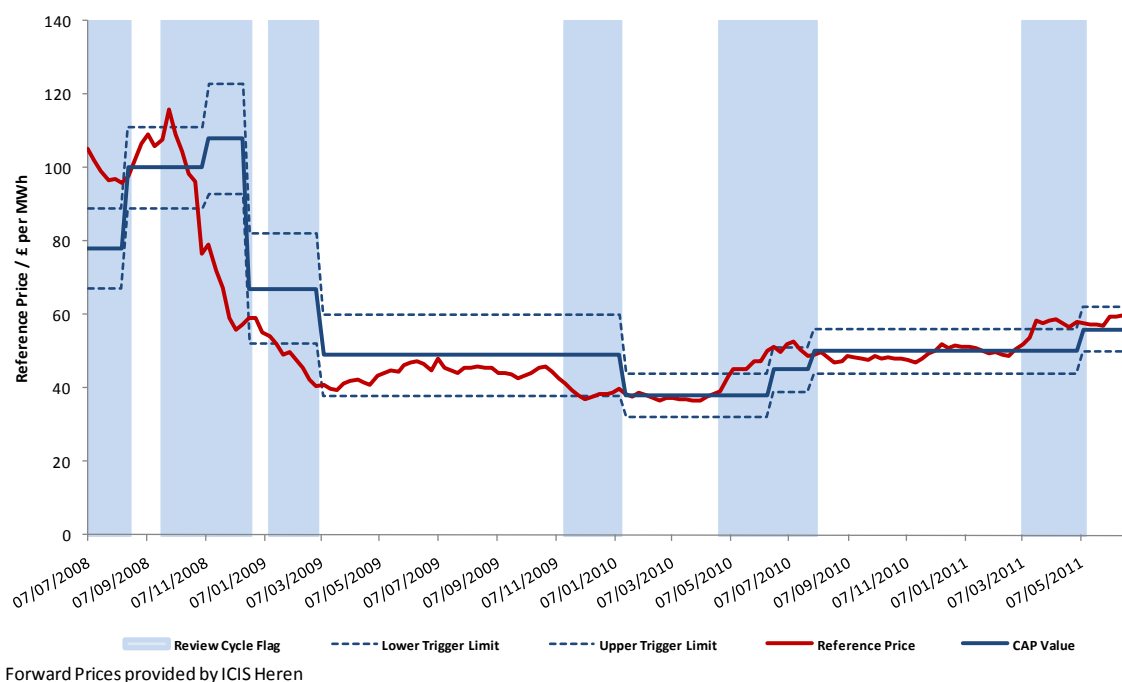
Cap Values and reviews in Q2 2011:

Date of Trigger Breach	Effective Dates	CAP Value actually implemented	CAP Value proposed in Consultation
21/06/2010	27/07/2010 to 03/05/2011	£50/MWh	£51/MWh
21/03/2011	04/05/2011 onwards	£56/MWh	£60/MWh

## 3. Detailed Analysis

A CAP review is triggered when the reference price (which is derived from forward prices provided by ICIS Heren) breaches a certain level above or below the current CAP value. Following the increase, CAP has been set at £56/MWh, with a trigger level of +/-£6; i.e. a review would have been triggered if the reference price fell outside of a band £50/MWh - £62/MWh.

**Graph 1: Reference Price and CAP**

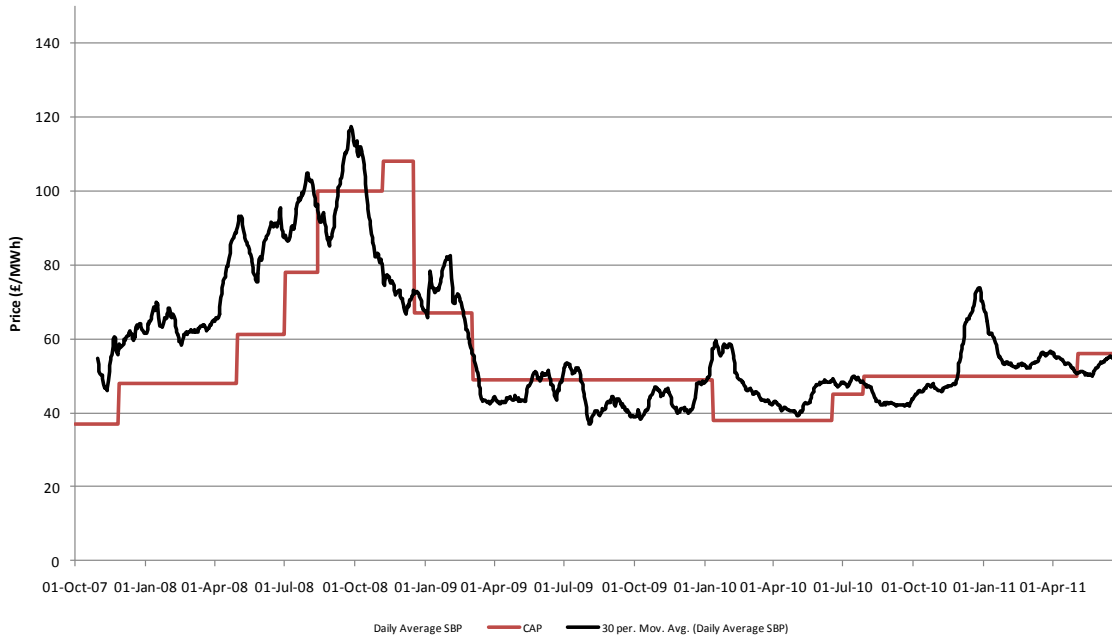


Graph 1 shows the variation in the reference price and the CAP value over the last 3 years (the process was started in October 2007). The graph also shows the upper and lower trigger levels, and the blue shaded areas indicate periods when the CAP value was under review.

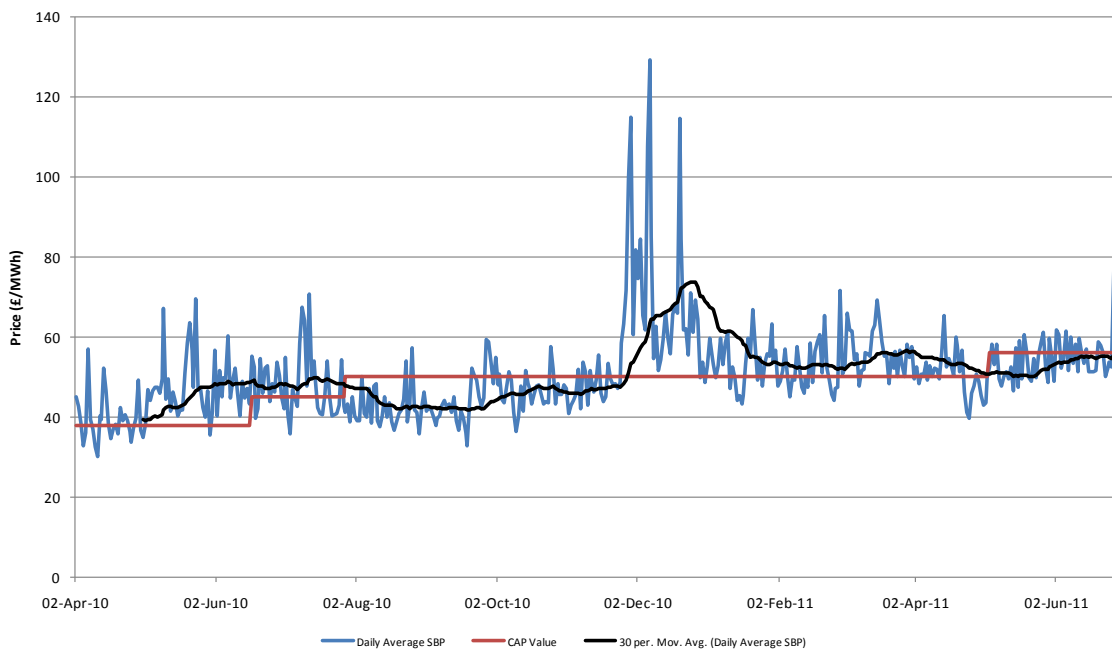
The graph shows that for the first two months of the Quarter the reference price remained relatively stable at the level that caused the review back in March. There was a jump at the beginning of June, which coincides with the reference price being based mainly on Q4 prices, which are generally higher than Q3. The average reference price over the Quarter was £58.09. The price dropped towards the end of the month, but at the time of writing has increased again.

In Graphs 2 and 2a you can see the relationship between CAP and daily average SBP. We believe that this is the real measure of how good the current CAP review process is at predicting outturn SBP. Graph 2 shows the period from October 2007 to date, while Graph 2a shows the data for the last 12 months only. To provide clarity over the longer time period in Graph 2, we have removed the daily average SBP but kept the 30 day moving average of daily SBPs.

**Graph 2 Daily Average System Buy Price and CAP**



**Graph 2a: Daily Average System Buy Price and CAP**



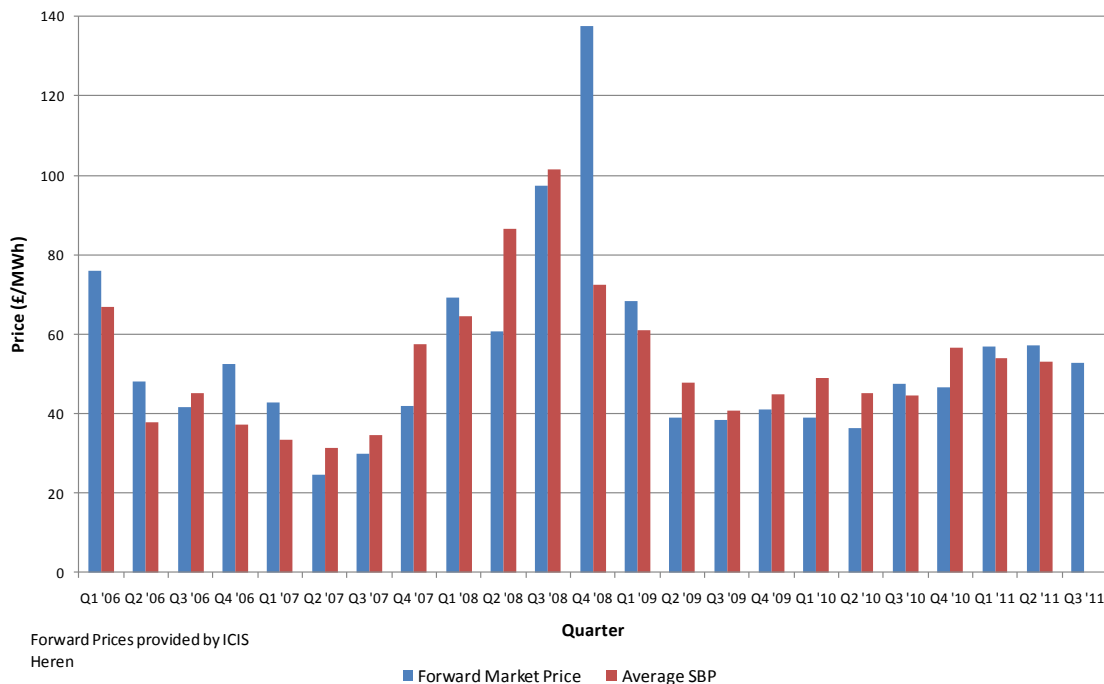
The graphs show that at the time of the increase in CAP, SBP was actually decreasing, and reached a level similar to that of the old value of CAP. However, in the second half of the Quarter it has increased again, and was back up at a similar level to CAP. Overall throughout the Quarter, the average SBP was £53.03.



	April 2011	May 2011	June 2011
Average Outturn SBP	£51.12	£52.57	£55.42
Average Outturn SBP - CAP	+£1.12 (CAP = £50/MWh)	-£3.43 (CAP = £56/MWh)	-£0.58

Graph 3 shows the average outturn System Buy Price (SBP) over each Quarter against the forward price for that Quarter. We have based this forward price on the last available forward market price before the Quarter actually began. This is another measure of how good the CAP review process is overall. This is because if the forward price does not predict outturn future SBP movements well, then with our current methodology, CAP will not reflect future SBP well either. Of course, we should make the point that forward prices are not necessarily used by the markets as predictors of SBP, but we have previously found that they are generally a good basis for this purpose, as can be seen over the years in Graph 3. Hence they have proved a good basis for use in the CAP review process.

**Graph 3: Average Outturn SBP against Quarterly Forward Market Prices**



As with last Quarter, the forward projection of price has over-estimated SBP, which fits with the trend noted on graph 2. However, the discrepancy is relatively small compared to previous Quarters.

## 4. Other comments on the CAP review process

### Credit Committee Membership Changes

In May, the BSC Panel approved the appointment of Gary Henderson, an ISG Member, to the Credit Committee.

## 5. Looking Forward

At the time of writing the reference price is £57.93. For most of Q3 the price has remained at around £59. In July, the reference price was based solely on Q4 prices, then in August and September Q1 2012 prices begin to be taken into account. At present the Q1 price is £59.13, so the reference rise again over the remainder of the Quarter, and may breach if the Q1 prices go up at any point.

## 6. Conclusions

- No CAP reviews were triggered this Quarter. A review that was triggered in the previous Quarter resulted in CAP being increased from £50/MWh to £56/MWh in May.
- CAP overestimated outturn SBP throughout the Quarter.
- If Q1 prices rise during the latter part of the current Quarter, another review may be triggered.