

RISK EVALUATION METHODOLOGY 2019/20

MEETING NAME	Performance Assurance Board (PAB)
Date of meeting	27 September 2018
Paper number	PAB212/10
Owner/author	Ryan Dale
Purpose of paper	Endorsement
Classification	Public
Summary	We invite the Performance Assurance Board (PAB) to endorse the draft Risk Evaluation Methodology (REM) 2019/20 for industry consultation.

1. Background

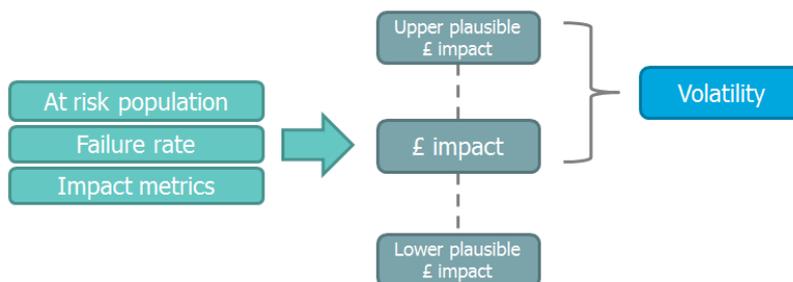
- 1.1 As required by the Balancing and Settlement Code Section Z 5.4.1, the PAB establishes and maintains a methodology for:
- Identifying which risks are Settlement Risks;
 - Evaluating risks which have been identified as Settlement Risks; and
 - Assessing the materiality of such Settlement Risks in relation to Performance Assurance Parties.
- 1.2 As required by the Balancing and Settlement Code Section Z 5.4.3, the PAB:
- Submits a draft of the proposed Risk Evaluation Methodology to all Performance Assurance Parties and other interested persons for comment;
 - Considers the comments received from Performance Assurance Parties and other interested persons, makes such changes (if any) to the proposed Risk Evaluation Methodology which are (in its opinion) appropriate; and
 - Approves and adopts the Risk Evaluation Methodology for the relevant operating period.

2. Review of the REM

- 2.1 ELEXON has reviewed and renewed the Risk Evaluation Methodology as part of the current Performance Assurance Framework (PAF) review¹. ELEXON has undertaken the review to ensure the REM is dynamic and robust in order to handle the unprecedented level of change being implemented within the market.
- 2.2 ELEXON is proposing a new risk scoring approach that will be applicable for both binary Settlement Risks (those which may only happen occasionally with a potentially large error) and transactional Settlement Risks (those which are likely to happen frequently but with on average a much lower error).
- 2.3 The approach establishes a plausible financial impact on Settlement – representing a combination of both the probability and the impact. The financial impact will take into account volatility, providing an upper and lower plausible impact:

¹ Full recommendations from the review of the PAF Procedures is in paper PAB212/06

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2.4 ELEXON will review a number of data sources used in existing risk scoring and new data sources in order to achieve a broad a picture of information for risk scoring, these sources include but are not limited to:

- a) PARMS Serials
- b) Data Transfer Network (DTN) Data Flows
- c) Central BSC systems data
- d) Supplier Meter Registration Service (SMRS) extracts
- e) Ofgem Published information
- f) Findings from the Performance Assurance Techniques e.g. BSC Audit Issues, TAM and TAPAP non-compliances, Disputes.

2.5 ELEXON proposes impacts are assigned to one of five bands, to support evaluation and reporting:

Impact rating	Description
5	Extreme - Potential financial impact of £25m or more
4	Major - Potential financial impact of between £10m and £25m
3	Moderate - Potential financial impact of between £2m and £10m
2	Minor - Potential financial impact of between £500k and £2m
1	Incidental - Potential financial impact of less than £500k

2.6 ELEXON will review these bands following publication of the full Risk Evaluation Register in November 2018, input from the REM consultation and PAB recommendations.

2.7 The upper and lower plausible impact is a result of inherent uncertainty in forecasting the contributing factors, and the degree of uncertainty will vary, dependent upon the risk. ELEXON has identified several causes for volatility:

- a) Lack of information about the risk, leading to a high degree of estimation and assumptions
- b) Highly binary events, hard to predict whether an event will occur in the period
- c) Diverse impacts e.g. whether the failure could impact high or low volume metering systems

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- 2.8 The REM will treat CVA and SVA risks equally. In order to comply with Section Z 5.1 which instructs ELEXON to treat all CVA risks as significant, ELEXON proposes to review the Key Risk Indicators (KRI) for CVA risks on a quarterly basis at least.
- 2.9 The REM should be amended as necessary whilst a single live version will remain in place, updated annually and through within period revisions. ELEXON is proposing to issue the REM alongside the Risk Evaluation Register (RER) for consultation annually going forward². ELEXON recognises the benefit of stakeholders reviewing the methodology alongside the resultant RER.
- 2.10 The revised risk register will introduce aggregated risk areas taking into account risk factors. This will allow risks to be split and merged as required for effective, efficient, and dynamic risk measurement and management.
- 2.11 ELEXON proposes to treat some controls as risks due to their impact on the error value of non-compliances, although we will continue to use the BSC definition of a Settlement Risk.
- 2.12 ELEXON proposes to hold education events with BSC Parties and Party Agents to ensure that changes to the methodology is as widely understood as possible and that parties are able to engage with the consultation process effectively.

3. REM timetable

Endorse REM for consultation	27 September 2018
Issued for consultation (three weeks)	1 October 2018
Education events	TBD
Consultation responses by	22 October 2018
PAB approval of REM	29 November 2018
Published REM on website	3 December 2018
REM live	1 April 2019

4. Recommendations

- 4.1 ELEXON invite the PAB to:
- ENDORSE** the draft REM for 2019/20; and
 - AGREE** that the draft REM be issued to stakeholders for comment.

Appendices

Appendix 1 – REM worked examples

Attachments

Attachment A – REM 2018/19

Attachment B – Consultation Questions

² Modification P368, due for implementation on 1 November 2018, allows the REM and RER annual reviews to be done concurrently - <https://www.elexon.co.uk/mod-proposal/p368/>

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Appendix 1 – REM worked examples

This appendix provides two worked examples on the following pages of the methodology for the main two types of risks:

- **binary** - likely to happen only a few times or not at all, but individual instances could have a high impact
- **transactional** - likely to happen many times in any year, but the impact from an individual instance is on average low

The impact is quantified in three stages:

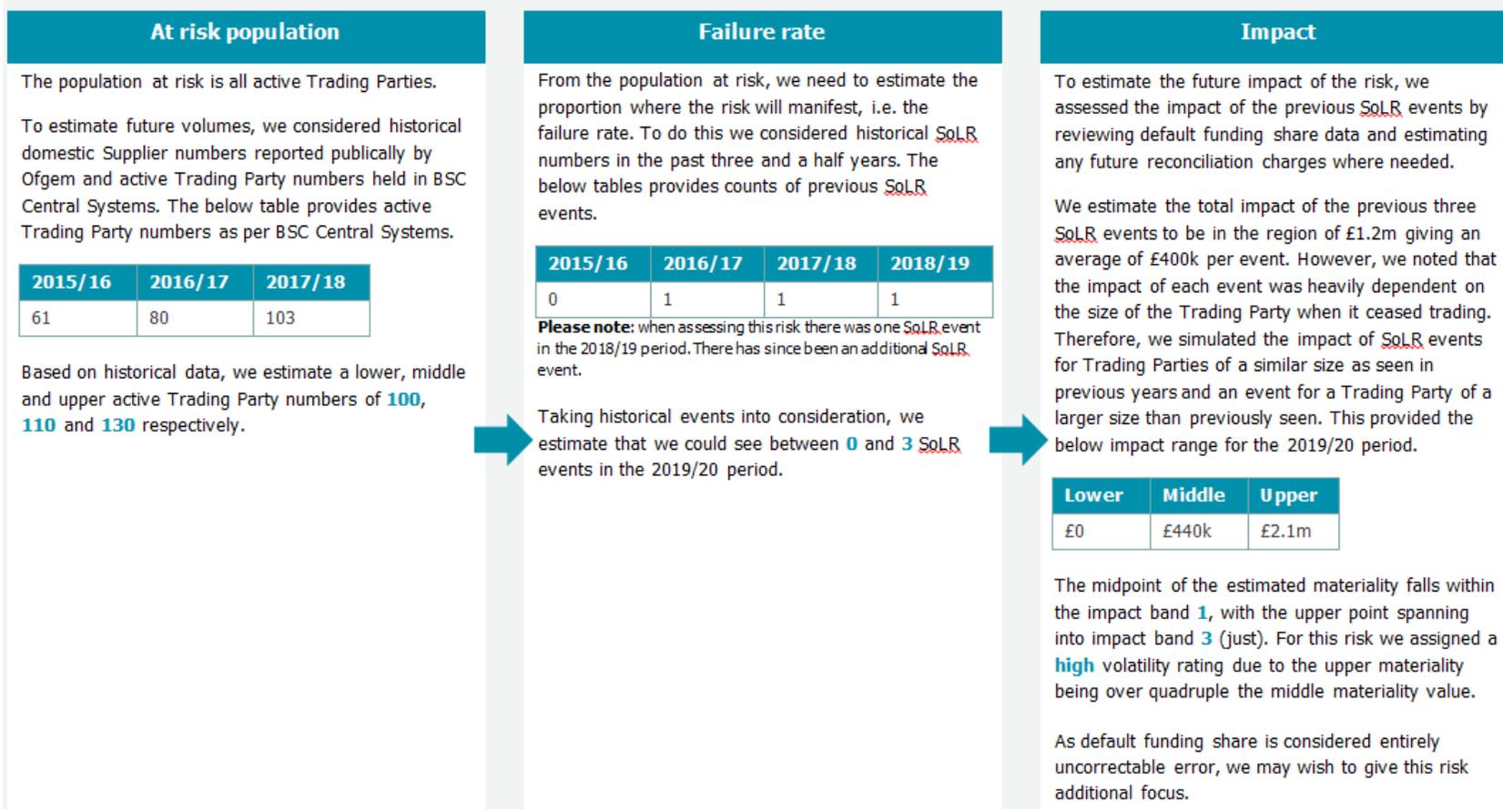
- i) Determining the at risk population (split by market segment / risk factor if necessary and feasible)
- ii) Determining the likely failure rate
- iii) Estimating the resulting impact

Data sources are identified that can give a view of these, overlaid with assumptions and judgement about what is likely to happen in the coming year. When assessing each risk we have sought to gather information related to the risk for at least the past 3 years where available.

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The risk that... Parties do not pay FAA Advice Notes, such that Payment Default is triggered, **resulting in...** default funding by other Trading Parties.

For this initial assessment, we focused on the impact of default funding share resulting from a Supplier of Last Resort (SoLR), as this is where the majority of material instances of the risk have manifested. As this risk is of a binary nature, i.e. there is the chance that the risk may not manifest at all in a year, there are a limited number of historical data points to consider when assessing the future risk.



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The risk that... on Change of Supplier or Change of Agent, Meter reading history is incorrect or not transferred such that sufficient history is not available for validating and estimating energy volumes, **resulting in...** erroneous or estimated data in Settlement.

For this initial assessment, we focused on the impact of missing Meter read histories in the Non-Half Hourly (NHH) market, as this is anecdotally where the risk has historically manifested. This is due to the Meter read history (provided by the previous Data Collector) being needed to valid a change of Supplier read in the NHH market. As there is no change of Supplier read in the Half Hourly (HH) market, the risk will not have a similar impact. In later iterations, we may want to include an assessment of the impact in HH.

