

CREDIT ASSESSMENT PRICE REVIEW PROCESS

| | |
|---------------------|-----------|
| MEETING NAME | BSC Panel |
|---------------------|-----------|

| | |
|------------------------|---------------|
| Date of meeting | 8 August 2019 |
|------------------------|---------------|

| | |
|---------------------|--------|
| Paper number | 293/09 |
|---------------------|--------|

| | |
|---------------------|------------|
| Owner/author | Nick Baker |
|---------------------|------------|

| | |
|-------------------------|--------------|
| Purpose of paper | For Decision |
|-------------------------|--------------|

| | |
|-----------------------|--------|
| Classification | Public |
|-----------------------|--------|

| | |
|----------------|--|
| Summary | This paper provides an update to the Panel on the Credit Assessment Price (CAP) Review Process. It highlights potential improvements based on discussions with, and analysis presented to, the Credit Committee (CC) at its latest meeting in June 2019. The paper suggests two proposed changes to the CAP Review Process, and suggests consultation questions to seek the views of industry. |
|----------------|--|

1. Background information

- 1.1 The Credit Assessment Price (CAP) is a parameter defined in [Section M1.4 of the BSC](#) as 'the price which it would be appropriate to use to determine the equivalent financial amount of Imbalance Parties' Energy Indebtedness'.
- 1.2 The BSC Panel has delegated responsibility for reviewing and determining the CAP value to the Credit Committee (CC). The process for reviewing the CAP is set in the [CAP Review Guidance Document](#).
- 1.3 Currently, ELEXON performs a weekly check comparing the CAP to a reference price, which is calculated based on forward market prices for the next two months, taken from the ICIS Heren report.
- 1.4 If the reference price diverges from the CAP by a pre-determined value (referred to as the 'trigger level'), a review of the CAP is initiated.

2. Current Process

- 2.1 The CAP Review Process has evolved over time, with the process currently running smoothly and efficiently. The CAP Review Process last changed in June 2017 with the introduction of not holding a CC meeting if all CC members, and consultation respondents, agreed with the proposed CAP value suggested by ELEXON.
- 2.2 Since these changes were introduced, it now takes an average of 30 calendar days from breach to a new CAP being implemented when a CC meeting is not required. When a meeting is held, because not all respondents or CC members agree with the proposed new CAP value, the end-to-end process takes on average 35 days. This timescale is the same as before the June 2017 changes were made, but by not always holding a CC meeting the CAP Review Process timescales have been reduced on five of nine trigger events since June 2017.
- 2.3 Whilst the process has been operating smoothly since June 2017, there are changes which could be made to provide further improvements. ELEXON presented analysis on the CAP consultation price, the reference price, and the implementation date of any new CAP value at CC40 (24 June 2019) following a request by the CC. The analysis and discussion resulting from the CC led to the proposals in this paper.

3. Changing the consulted on reference price

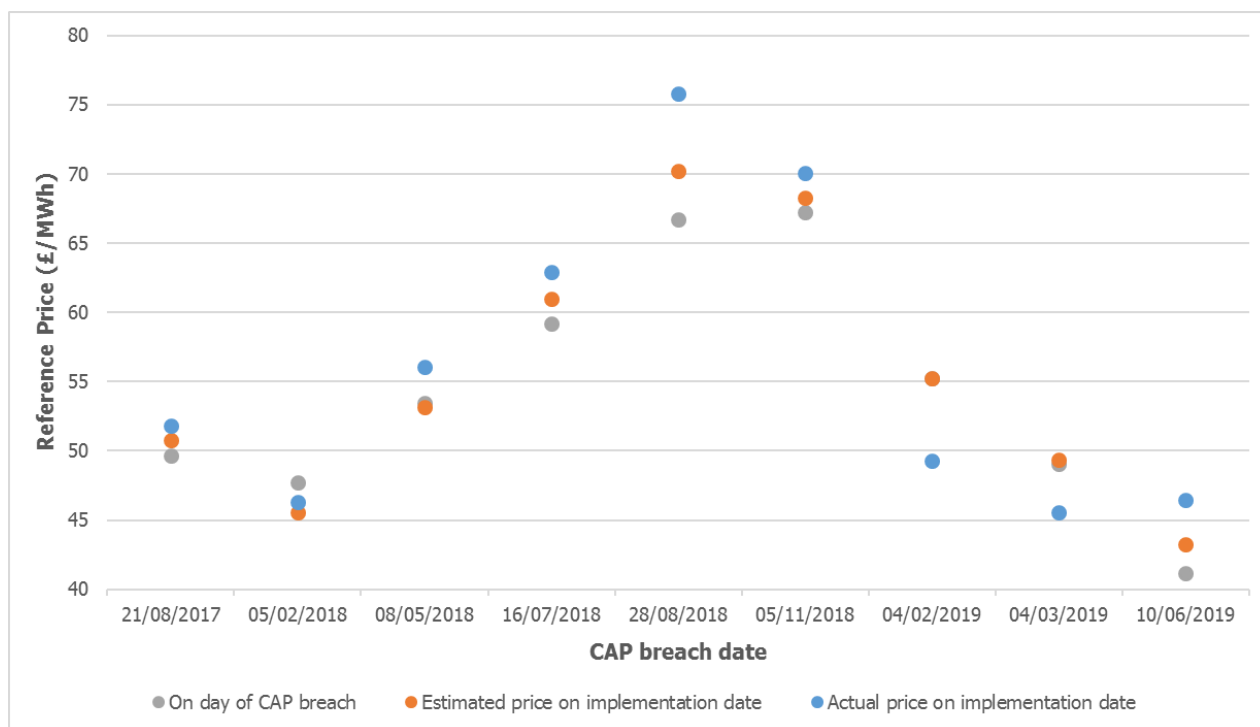
- 3.1 In accordance with the [CAP Review Guidance Document](#), ELEXON sets the price for consultation 'based on the latest reference price, and its potential implementation date'. This statement leads to ELEXON making a judgement on new CAP value for consultation. The CC has proposed this language be clarified so the CAP

CREDIT ASSESSMENT PRICE REVIEW PROCESS

value for consultation is based upon the reference price on the potential implementation date. Based on the timescales for the CAP Review Process (as highlighted in 2.2), the implementation date for any new CAP is usually in the following month. As the months used for calculating the reference price change at the start of each month, the reference price on the implementation date can be noticeably different to the reference price on the day of the CAP breach.

- 3.2 ELEXON has calculated an estimated reference price on the earliest possible effective from date (currently 15 Business Days after industry is notified of any CAP change). This is based on five days of ICIS Heren data at the time of the CAP breach, using the months that would be used in the reference price calculation on the implementation date.
- 3.3 **Graph 1** displays the reference price on the day of a CAP breach, the estimated reference price at the time a new CAP would be implemented (using the methodology described in 3.2) and the reference price on the actual day of implementation for a new CAP. Based on the [CAP Review Guidance Document](#) language, ELEXON currently consults on a value based on a judgement of the reference price on the day of the CAP breach and also an estimated price on the implementation day (grey and orange points in **Graph 1**).

Graph 1. Reference price and the implementation date for CAP breaches since June 2017



- 3.4 The change in methodology would set the reference price based on a rounded value of the estimated reference price on the implementation date (orange points). The estimated reference price on the implementation date is closer to the actual reference price on the implementation date (blue points) in six out of the nine CAP breaches since June 2017. For the breaches in May 2018, February 2019 and March 2019, the estimated price on the implementation date and the reference price on the day of the CAP breach are almost identical, so the new proposed process would not have had an adverse effect.
- 3.5 Analysis has been provided in **Table 1** on CAP breaches since February 2017, a '*' indicates where a respondent was a CC member. Since the changes described in 2.2 were made, there have been nine CAP breaches, four of which have resulted in a CC meeting being held. On three occasions the meeting has been requested by a CC member. CC 40 (CAP breach on 10 June 2019) represented the first occasion (since June

CREDIT ASSESSMENT PRICE REVIEW PROCESS

2017) where some consultation responses disagreed with the proposed CAP value by ELEXON. CC members also disagreed with the consulted on CAP value for the breach on 10 June 2019. Changing the process for setting the CAP value which was consulted on may have removed the need for this meeting.

Table 1. CAP breaches since June 2017 with consultation values using the current process, responses and consultation value under new process

| CAP Breach Date | Ref Price (£/MWh) | Estimated Ref Price on Implementation Date (£/MWh) | Consulted on Value (£/MWh) | Estimated Consultation based on new process (£/MWh) | Responses | Consulted on Value Disagreed/ Meeting Held | New CAP Value (£/MWh) |
|-----------------|-------------------|--|----------------------------|---|-----------|--|-----------------------|
| 21/08/2017 | 49.65 | 50.78 | 50 | 51 | 1* | Yes | 55 |
| 05/02/2018 | 47.75 | 45.56 | 47 | 46 | 2* | No | 47 |
| 08/05/2018 | 53.42 | 53.13 | 53 | 53 | 2* | No | 53 |
| 16/07/2018 | 59.16 | 60.99 | 59 | 61 | 1* | No | 59 |
| 28/08/2018 | 66.75 | 70.19 | 70 | 70 | 1* | Yes | 75 |
| 05/11/2018 | 67.26 | 68.27 | 68 | 68 | 0 | No | 68 |
| 04/02/2019 | 55.22 | 55.26 | 56 | 55 | 0 | No | 56 |
| 04/03/2019 | 49.09 | 49.38 | 49 | 49 | 0 | Yes | 48 |
| 10/06/2019 | 41.14 | 43.27 | 41 | 43 | 4 | Yes | 43 |

- 3.6 The low number of industry responses demonstrates confidence in ELEXON setting a new CAP value and the success of the process. ELEXON has used its judgement when setting CAP values: setting the CAP based on the estimate reference price would take away the need for ELEXON's judgement, making the process more mechanical.
- 3.7 The CAP breach on 10 June 2019 highlights that despite low numbers of consultation responses since June 2017, when a CAP value included in the consultation is disagreed with by the industry, consultation responses will be provided and the process works as designed with the CC meeting to discuss an alternate CAP value.

4. Setting the trigger level

- 4.1 ELEXON currently asks Parties if they believe the current trigger level remains appropriate or if it should change. The CAP Review Guidance Document states that the trigger level is determined by the CC, and is subject to review from time to time and at least once a year.
- 4.2 The trigger level was initially set to +/-£11/MWh in October 2007 following consultation with industry. The value was ideally set to be low enough to trigger reviews of the CAP in light of changes in market conditions, but also to ensure the CAP did not go for long periods without review. This was balanced by the desire for the value not to be so low that it triggers a large number of reviews, which may have adverse effects for BSC Parties' forward planning.

CREDIT ASSESSMENT PRICE REVIEW PROCESS

- 4.3 The CAP has breached the trigger level on 40 occasions since the trigger level was introduced in October 2007; the trigger level has changed on nine occasions.
- 4.4 ELEXON and the CC have recognised through the operation of the CAP Review Process that the trigger level has been, on average, 10.7% of the CAP since 2010 (ranging from 7.5% to 15.8%). Between October 2007 and January 2010, the trigger level was set at either £11/MWh or £15/MWh, representing between 11% and 30% of the CAP value.
- 4.5 Based on this historical data, the manual process of reviewing the trigger level could be replaced with an automated process, which would set a new trigger level when a new CAP is implemented. The trigger levels set since 2010 have better aligned with the principles described in 4.2.
- 4.6 The proposed methodology is to automatically set the trigger level at 10% of any new CAP value, rounded naturally to the nearest £.
- 4.7 This methodology would be established in the [CAP Review Guidance Document](#), removing the need to update the [CAP Review Guidance Document](#) whenever the trigger level changes. The trigger level is also now displayed on the 'Calculating new CAP values' webpage. The supporting data to the CAP Review Process provides transparency and enables industry to view the CAP and reference price data themselves.

5. What further changes could be made?

- 5.1 At CC 40, members discussed what further changes could be made to improve the CAP Review Process.
- 5.2 ELEXON asked whether the implementation period for new CAP values should be changed. The [CAP Review Guidance Document](#) states a minimum implementation time of 15 Working Days for a new CAP, and Section M 1.4.2(b) specifies not earlier than 10 Business Days after notifying industry. Following the implementation of [BSC Modification P345 'Reducing the CAP change notice period and improving its flexibility'](#), the Panel has the ability (following a consultation) to change the implementation period from 15 Working Days in the [CAP Review Guidance Document](#) without a Modification.
- 5.3 A hypothetical 10-day implementation would see four of the nine breaches since August 2017 have an implementation date in the same month as the breach. As the change in months used is often the cause of large changes in the reference price, this would be counter-intuitive to the proposed changes of consulting on a value based on an estimated reference price on the implementation date, as there would be an increase likelihood of a CAP breach the month after.
- 5.4 A change in the CAP once a month was also discussed by CC members at the last CC meeting. CC members were hesitant to endorse this proposal due to the impact on Parties potentially having to adjust their collateral on a more frequent basis. ELEXON proposes asking in the consultation if Parties would be happy with their lodged collateral changing on a monthly basis. Responses can help determine if a more mechanical and frequent CAP Review Process is possible in the future.

6. Credit Committee recommendations

- 6.1 The Credit Committee suggested asking industry members for their views on changing the CAP Review Process. A consultation proforma is included in Attachment A. Should the Panel approve these questions, ELEXON will circulate the proforma amongst BSC Parties for 10 Working Days. We will return to the next Panel meeting in September with the responses, including recommended changes to the [CAP Review Guidance Document](#).

7. Recommendations

- 7.1 We invite you to:
 - a) **NOTE** the proposal to change the CAP review process; and

CREDIT ASSESSMENT PRICE REVIEW PROCESS

- b) **APPROVE** the questions included in the consultation proforma regarding the proposed changes to the CAP Review Process.

Attachments

Attachment A – Consultation questions

For more information, please contact:

Nick Baker, Market Operations Analyst

nick.baker@elexon.co.uk

020 7380 4337