
Credit Assessment Price (CAP) Review Process Review 2020

BSC Panel Meeting

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Summary **Elexon provides an update to the Panel on the Credit Assessment Price (CAP) Review Process. Elexon invites the Panel to consider two potential ways forward following discussions with the Credit Committee (CC) in December 2020.**

1. Background information

- 1.1 The Credit Assessment Price (CAP) is a parameter defined in [BSC Section M1.4](#) 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 to the Credit Committee (CC). The process for reviewing the CAP is set out 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 following this breach.
- 1.5 The CC met in December 2020 to discuss the analysis on the CAP Review Process in the last year and to discuss whether further changes/improvements to the CAP Review Process could be made.

2. Recent changes to the CAP Review Process

- 2.1 The CAP Review Process has evolved over time, and last changed in September 2019, where two changes were made to the process:
 - 1) The introduction of the automatic setting of the trigger level to 10% of the CAP value, rounded to the nearest £/MWh. Previously the trigger level had been determined by the CC.
 - 2) Adjustment to the methodology for the value of the potential new CAP in the industry consultation when a CAP Review is triggered. The consulted on CAP is now based on what the reference price would be on the day of implementation (which is usually in the next month).
- 2.2 Prior to the September 2019 changes, 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 suggested by Elexon.
- 2.3 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 36 days. This timescale for the full end-to-end CAP Review Process is the same as before the June 2017 changes were made. However, by not always holding a CC meeting, the CAP Review Process timescales have been reduced on 11 of 16 standard CAP breaches since June 2017.

3. Review of the CAP Review Process since the September 2019 changes

3.1 Table 1 below shows each of the CAP breaches since February 2017. Colour coding and ‘**’ in the cells indicate the following:

- In the formal consultation responses, column a ‘**’ indicates where a respondent to the consultation on a new CAP value was by a CC Member.
- The orange highlighted dates show the first CAP breaches when changes highlighted in Section 2 (June 2017 and September 2019) were used.
- The green highlighted dates show breaches which were impacted by COVID-19.
- New CAP values in red show where the new CAP value has differed from the consulted on value. This has been the case twice since September 2019.

3.2 Since the September 2019 changes were made, there have been 10 CAP breaches, three of which have resulted in a CC meeting/conference call being held. On all occasions the meeting has been requested by CC Members.

Table 1. CAP breaches since February 2017

CAP Breach Date	Reference Price on Day (£/MWh)	Estimated Reference Price on Implementation Date (£/MWh)	Consulted on Value (£/MWh)	Formal Consultation Responses	Proposed Disagreed by Credit Committee/CC Held	New CAP Value (£/MWh)	Calendar Days to implementation
13/02/2017	51.88		52	1*		49	36
20/03/2017	43.43		44	3*		43	36
21/08/2017	49.65	50.78	50	1*	Yes	55	36
05/02/2018	47.75	45.56	47	2*	No	47	29
08/05/2018	53.42	53.13	53	2*	No	53	30
16/07/2018	59.16	60.99	59	1*	No	59	30
28/08/2018	66.75	70.19	70	1*	Yes	75	31
05/11/2018	67.26	68.27	68	0	No	68	29
04/02/2019	55.22	55.26	56	0	No	56	30
04/03/2019	49.09	49.38	49	0	Yes	48	36
10/06/2019	41.14	43.27	41	4	Yes	43	36
09/09/2019	48.19	54.00	54	0	No	54	30
16/12/2019	48.36	46.88	47	0	No	47	36
13/01/2020	41.52	40.63	41	0	No	41	30
10/02/2020	35.09	35.67	36	0	No	36	30
25/03/2020	31.33	31.70	32	0	Yes	30	22
01/06/2020	26.21	27.42	N/A	N/A	Yes	N/A	N/A
06/07/2020	36.27	36.27	36	0	No	36	17
10/08/2020	40.28	46.33	46	0	No	46	31
07/09/2020	51.64	56.25	56	0	No	56	30
21/12/2020	64.66	60.44	60	0	Yes	62	37

3.3 The CAP breach on 10 June 2019 represents the last occasion where an industry consultation response disagreed with the proposed CAP value by Elexon. Changes were made on the CAP included in any consultation from September 2019 as described in 2.3. No industry responses have been received, and hence there has been no disagreement by industry since these changes.

3.4 In response to COVID-19, temporary changes were made to the CAP Review Process, primarily to make implementation dates shorter. Elexon triggered a CAP Review not on the first day of the week in March in order to implement a lower CAP (and potentially reduce the amount of collateral required by Parties) quicker than normal. Following a CAP breach on 1 June 2020, the CC decided not to consult on a further CAP change.

4. CC Member views

- 4.1 Elexon presented data for the review of the CAP Review Process in Section 3 to the CC in December 2020 to obtain their views and comments on the process.
- 4.2 The CC have expressed the view that the low number of industry responses demonstrates confidence in Elexon setting a new CAP value, and a trust in the operation of the process. A CC Member commented that the same respondents had previously been engaging from when the CAP Review Process was introduced in 2007, which meant once they moved on that engagement would drop. They further noted that the cause for responses in the past were often that they were habitual.
- 4.3 CC Members also commented that the lack of response from Parties is also in part due to Parties not being worried by a changing CAP value. They commented that Parties often lodge excess collateral than necessary, so any change of CAP may not have a major impact on their Credit Cover position, and therefore they do not engage.
- 4.4 The current timescales as defined in the [CAP Review Guidance Document](#) state that a CAP will be implemented 15 Business Days after notification of a new CAP to Parties. [BSC Section M](#) defines that this implementation time cannot be less than 10 Business Days. CC Members commented that shorter timescales are better, in order to respond to a fast market. CC Members noted that it is the implementation date, which poses a bigger issue in the overall time for a new CAP to be implemented rather than the length of consultation period. Elexon looked at a hypothetical 10 Business Day implementation in the [2019 CAP Review Process Review](#) (293/09), in which it advised that this maybe counter-intuitive with the CAP commonly breaching in the first week of the month.
- 4.5 Overall, the CC Members concluded that they are content with the process working as it should at their meeting in December 2020.

5. What further changes could be made to the CAP Review Process?

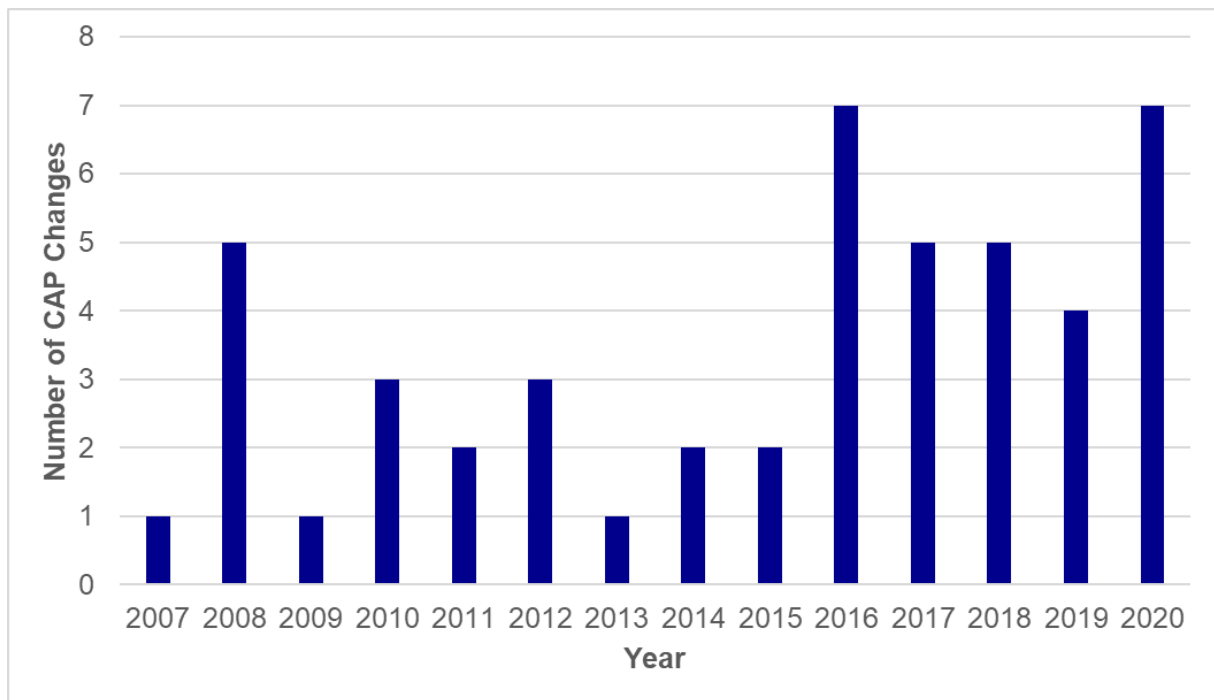
- 5.1 Whilst the process has been operating smoothly since September 2019, there are potential changes which could be made to provide further improvements. Following discussions with the CC in December 2020, Elexon agreed to present two ways forward for the Panel to consider.

1. Proceed with the current process

- 5.2 The first option proposes that no further changes are made to the CAP Review Process at this time. As highlighted in the review since the changes in September 2019, the CC are content with the process. Additionally there have been no comments or objections to the changes made in the last three years from industry. There could be slight tweaks to the process in the future, such as changes to the consultation period and how to change the implementation period, in order to try and speed up the overall implementation time of any new CAP.
- 5.3 Following discussion with the CC in December 2020, it is their recommendation of the CC that this option is the best way forward at this time.
- 5.4 Elexon suggests that despite no changes, there should be a review of the CC Terms of Reference (last updated in May 2016), to ensure that the changes made to the CAP Review Process in 2017 and 2019 are reflected in the Terms of Reference to ensure there are no instances where the two are in conflict. Elexon intends to present its review of the CC Terms of Reference to the Panel in March 2021.

2. A 'gold-standard' automated process

- 5.5 A change in the CAP Review Process to have a new CAP set once a month was discussed by CC Members in 2019, prior to the September 2019 changes. At the time, 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 asked a consultation question in September 2019 to try and help determine if a more mechanical and frequent CAP Review Process is possible in the future. No response was received.
- 5.6 Over the last five years, the CAP has changed on average just under six times a year (just over once every two months) as show in **Graph 1**. In the last five years, there have been changes to the CAP in four out of five years in the months of March, April and September. There has not been a CAP change in the month of May in the last five years.



Graph 1. The number of CAP changes per year since the CAP Review Process began in 2007.

- 5.7 Elxon presented some initial analysis to the CC in December 2020 which looked to investigate the impact of a changing CAP on BSC Parties. This was also in part to see if it could explain some of the lack of industry engagement. Elxon highlighted that depending on the indebtedness components of a Party’s Credit Cover calculation, an increasing CAP may not always increase a Party’s Credit Cover Percentage (and hence the amount of collateral they have to lodge). The opposite is true for a decreasing CAP; a Party may not always experience a reduction in collateral requirements. The scenario breakdowns have been included in Appendix 1.
- 5.8 Elxon also carried out some analysis to try and determine the percentage of BSC Parties who were negatively impacted by an increasing CAP, or positively impacted by a decreasing CAP. Analysis of three breaches in 2020 suggested this was between 12-19% of all BSC Parties in each breach. Note, however, that of ~470 total BSC Parties, only ~190 receive Trading Charges and are therefore potentially impacted by the CAP. When looking only at Parties who receive Trading Charges, this equates to 28-46% of these Parties being impacted by changing CAP in the three breaches looked at.
- 5.9 The CC discussed further in December 2020 whether there could be a change of CAP at the beginning of every month. A fully automated process could mean that there would be no need to have consultations, a trigger level or the current defined review process. It is also noted that under this proposal there may no longer be a requirement for a CC.
- 5.10 A CC Member commented that the CC have tried to engage with industry, but to no avail, and therefore backed a fully automated process.
- 5.11 Another CC Member responded that automation does not respond to current events. For example, if there was news on COVID-19 the day after the implementation of a new CAP, it would not be taken into consideration until the next month. A further CC Member agreed that there would be some flexibility required in any process.
- 5.12 A Modification would be required to change the requirement for a consultation on a new CAP to industry, or to reduce the implementation date of any new CAP below 10 Business Days. Both of these are outlined in [BSC Section M](#). Other aspects of the CAP Review Process are defined in the [CAP Review Guidance Document](#), which is under Panel control.
- 5.13 The CC agreed that if ‘gold-standard’ automation was to be pursued in the CAP Review Process it would be best to raise an Issue group to engage industry, rather than raise any potential Modification right away.

6. Recommendations

6.1 We invite you to:

- a) **NOTE** the contents of the paper;
- b) **NOTE** the recommendation of the Credit Committee for the CAP Review Process to proceed as currently designed; and
- c) **AGREE** the way forward of the CAP Review Process based on the two options presented in Section 5.

Appendices

Appendix 1 – CAP Theory - Scenarios of how an increasing (a), or decreasing (b), CAP may affect a BSC Party.

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Appendix 1

The following tables highlight how a change of the CAP may impact a BSC Party depending on the breakdown of the indebtedness components in their Credit Cover calculation.

Notes:

- Total Energy Indebtedness (TEI) = Credit Assessment Energy Indebtedness (CEI) + Metered Energy Indebtedness (MEI) + Actual Energy Indebtedness (AEI)
- Positive indebtedness values signal a Party has a 'short' imbalance position, and negative values indicate a Party has a 'long' position
- $AEI = -\text{Trading Charges}/CAP$
- $\text{Credit Limit} = \text{Credit Cover}/CAP$
- $\text{Credit Cover Percentage (CCP)} = \text{TEI}/\text{Credit Limit}$
- Worse/Better colours indicate: **Red** scenarios indicate the Party has a **worse** CCP, **green** displays where a Party has a **better** CCP and **yellow** shows where the CCP stays the **same**.

(a) The impact of an **increasing** CAP from £50/MWh to £60/MWh on six scenarios of a Party's indebtedness

Scenario	CEI+MEI (MWh)	Trading Charges (£)	AEI (MWh)	TEI (MWh)	Credit Cover (£)	CAP (£/MWh)	Credit Limit (MWh)	Credit Cover Percentage	Worse/Better
1	10	£1,000.00	20	30	£5,000.00	50	100.00	30%	Red
	10	£1,000.00	16.66667	26.66667	£5,000.00	60	83.33	32%	
2	0	£1,000.00	20	20	£5,000.00	50	100.00	20%	Yellow
	0	£1,000.00	16.66667	16.66667	£5,000.00	60	83.33	20%	
3	0	£1,000.00	-20	-20	£5,000.00	50	100.00	-20%	Yellow
	0	£1,000.00	-16.66667	-16.66667	£5,000.00	60	83.33	-20%	
4	-10	£1,000.00	-20	-30	£5,000.00	50	100.00	-30%	Green
	-10	£1,000.00	-16.66667	-26.66667	£5,000.00	60	83.33	-32%	
5	10	£1,000.00	-20	-10	£5,000.00	50	100.00	-10%	Red
	10	£1,000.00	-16.66667	-6.66667	£5,000.00	60	83.33	-8%	
6	-10	£1,000.00	20	10	£5,000.00	50	100.00	10%	Green
	-10	£1,000.00	16.66667	6.66667	£5,000.00	60	83.33	8%	

(b) The impact of a **decreasing** CAP from £50/MWh to £40/MWh on six scenarios of a Party's indebtedness

Scenario	CEI+MEI (MWh)	Trading Charges (£)	AEI (MWh)	TEI (MWh)	Credit Cover (£)	CAP (£/MWh)	Credit Limit (MWh)	Credit Cover Percentage	Worse/Better
1	10	£1,000.00	20	30	£5,000.00	50	100.00	30%	Green
	10	£1,000.00	25	35	£5,000.00	40	125.00	28%	
2	0	£1,000.00	20	20	£5,000.00	50	100.00	20%	Yellow
	0	£1,000.00	25	25	£5,000.00	40	125.00	20%	
3	0	£1,000.00	-20	-20	£5,000.00	50	100.00	-20%	Yellow
	0	£1,000.00	-25	-25	£5,000.00	40	125.00	-20%	
4	-10	£1,000.00	-20	-30	£5,000.00	50	100.00	-30%	Red
	-10	£1,000.00	-25	-35	£5,000.00	40	125.00	-28%	
5	10	£1,000.00	-20	-10	£5,000.00	50	100.00	-10%	Green
	10	£1,000.00	-25	-15	£5,000.00	40	125.00	-12%	
6	-10	£1,000.00	20	10	£5,000.00	50	100.00	10%	Red
	-10	£1,000.00	25	15	£5,000.00	40	125.00	12%	