

ANNUAL CREDIT ASSESSMENT PRICE (CAP) PROCESS REVIEW

MEETING NAME	BSC Panel
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Purpose of paper	For Information
Classification	Public
Summary	In this annual review of the CAP process, the Credit Committee note that the process performed well during the 2014-2015 BSC Year. Thus, no changes are recommended. The BSC Panel is invited to note the views of the Credit Committee.

1. Why are we providing this review?

- 1.1 The last review of the Credit Assessment Price (CAP) process was presented to the BSC Panel in February 2014. The Panel agreed that a review should be carried out at least annually.
- 1.2 The aim of the review is to report how well the process that monitors and amends the CAP value worked during the 2014-2015 BSC Year. This review is provided by the Credit Committee, which is the Panel sub-Committee charged with operating the CAP review process; including determining changes to the value of the CAP and the reference price trigger level.

2. Operational CAP process

3. The CAP is defined in Section M 1.4 of the Balancing and Settlement Code (BSC). The CAP is essentially a parameter used to convert Actual Energy Indebtedness and the credit cover lodged by a BSC Party into an equivalent MWh amount. The CAP is considered to be a representative value of the System Buy Price (SBP). CAP can be compared against SBP as a performance measure.
- 3.1 The CAP review procedures are as follows:
 - On the first working day of each week ELEXON compares the current CAP value (or if a new CAP value has been formally notified to BSC Parties prior to its implementation, that new CAP value) to a value derived from forward looking electricity prices currently provided by ICIS Heren. The data provider is approved by the BSC Panel.
 - If the difference between the CAP and the reference price exceeds a pre-set trigger value ELEXON issues an industry consultation. ELEXON will present a proposed CAP within the consultation and ask industry to provide views on the CAP change along with the current trigger level.
 - The Credit Committee meets after the end of the consultation period to consider the responses and the latest data and, if the Committee feels it appropriate, approves a new CAP value and/or trigger level.
 - If a new CAP value and/or trigger level is approved by the Credit Committee, these values come into effect following a 20 working day implementation period as required by Section M 1.4.2(b) of the Code.

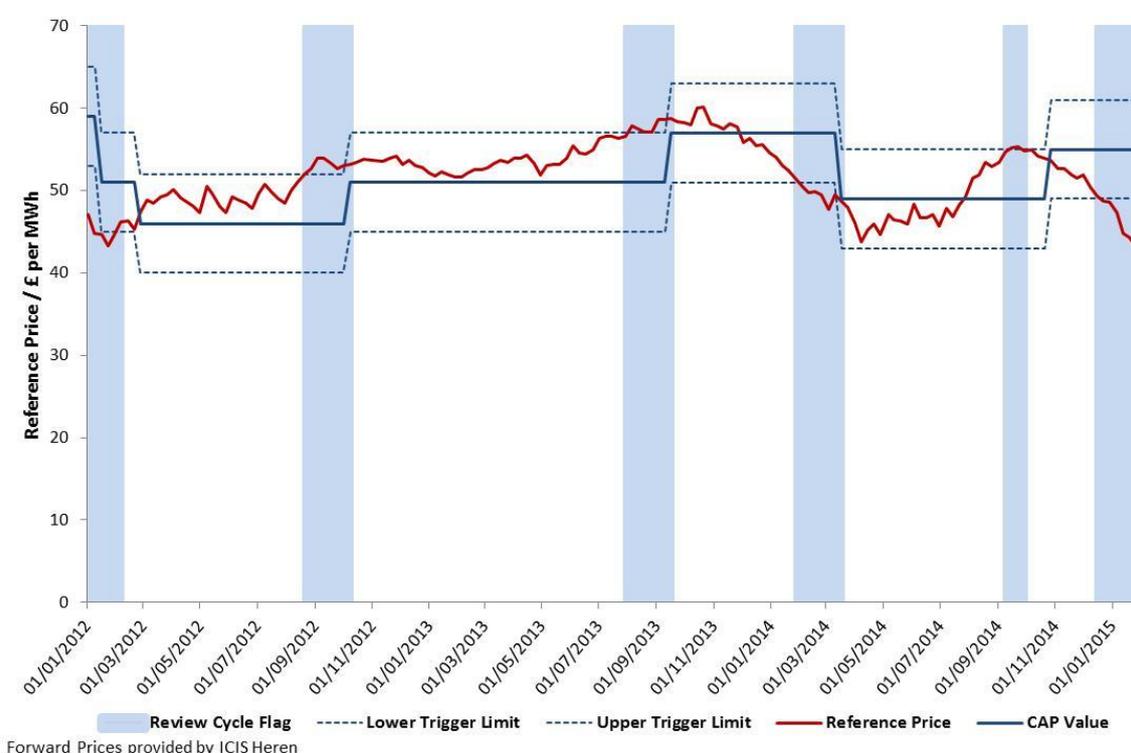
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4. What happened during the 2014-2015 BSC Year?

CAP Reviews & Changes

- 4.1 The monitoring and review process works by comparing the current value of CAP with a reference price derived from average quarterly forward market prices. Where the absolute difference between the two values exceeds an agreed trigger level, a CAP review is triggered. At the start of the 2014/2015 BSC year the CAP trigger level was set at £6/MWh.
- 4.2 Graph 1 shows the values of the CAP and the reference price over the last three years (the CAP process was started in October 2007). The blue shading indicates periods when the CAP was under review.

Graph 1: Reference Price and CAP



- 4.3 There were two reviews of the CAP during the 2014-2015 BSC Year (the same number of reviews as the previous year).
- 4.4 The first breach occurred on 15 September 2014, when the CAP upper trigger was breached due to higher Q1 2015 forward prices. As a result, the CAP was increased from £49/MWh to £55/MWh on 23 October 2014.
- 4.5 The second breach occurred on 22 December 2014. The CAP lower trigger was breached earlier than expected on one third Q1 2015 and two thirds Q2 2015 forward price (last year the lower level breach happened in March and was due to lower Q3 2014 forward prices). As a result, the CAP was decreased from £55/MWh to £47/MWh on 12 February 2015.
- 4.6 In previous years, the reference price has either continued to increase over December or sustain a constant level. For December 2014, there was a drop in the cost of power trades on the UK wholesale market which closely followed the movements on the NBP market (gas National Balancing Point). This has brought an

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earlier lower CAP price breach (22 December, whereas it has usually been late January) with the Credit Committee meeting in early January to agree a new CAP price and trigger level.

4.7 Details of CAP values and reviews during the 2014-2015 BSC Year are set out in the table below:

Date of CAP Trigger Breach	Effective Dates of CAP	CAP Value implemented	CAP Value proposed in Consultation
3 Feb 2014	12 March 2014	£49	£51
15 Sept 2014	23 Oct 2014	£55	£55
22 Dec 2015	12 Feb 2015	£47	£49

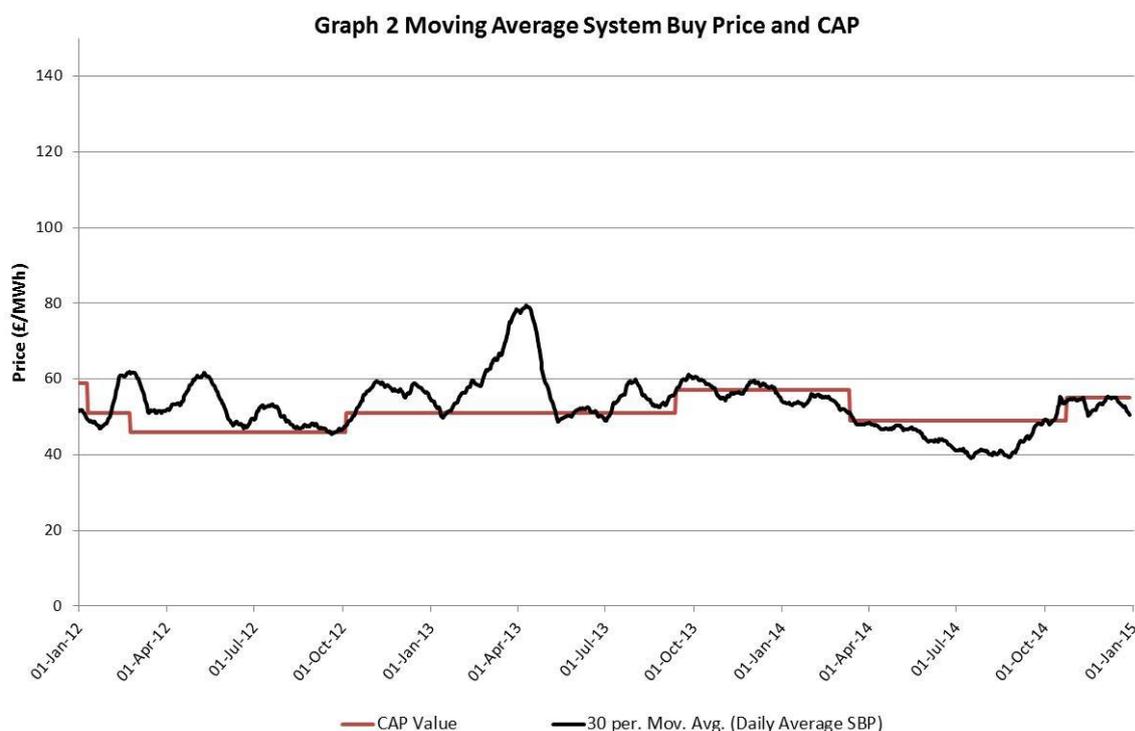
5. Changes to the Trigger Level

5.1 The Credit Committee considered the value at its meeting on 6 January 2015 and determined that it should be changed from £6/MWh to £5/MWh. This change was implemented on 12 February 2015. There were no other changes to the trigger level.

6. How well did the CAP reflect System Buy Price?

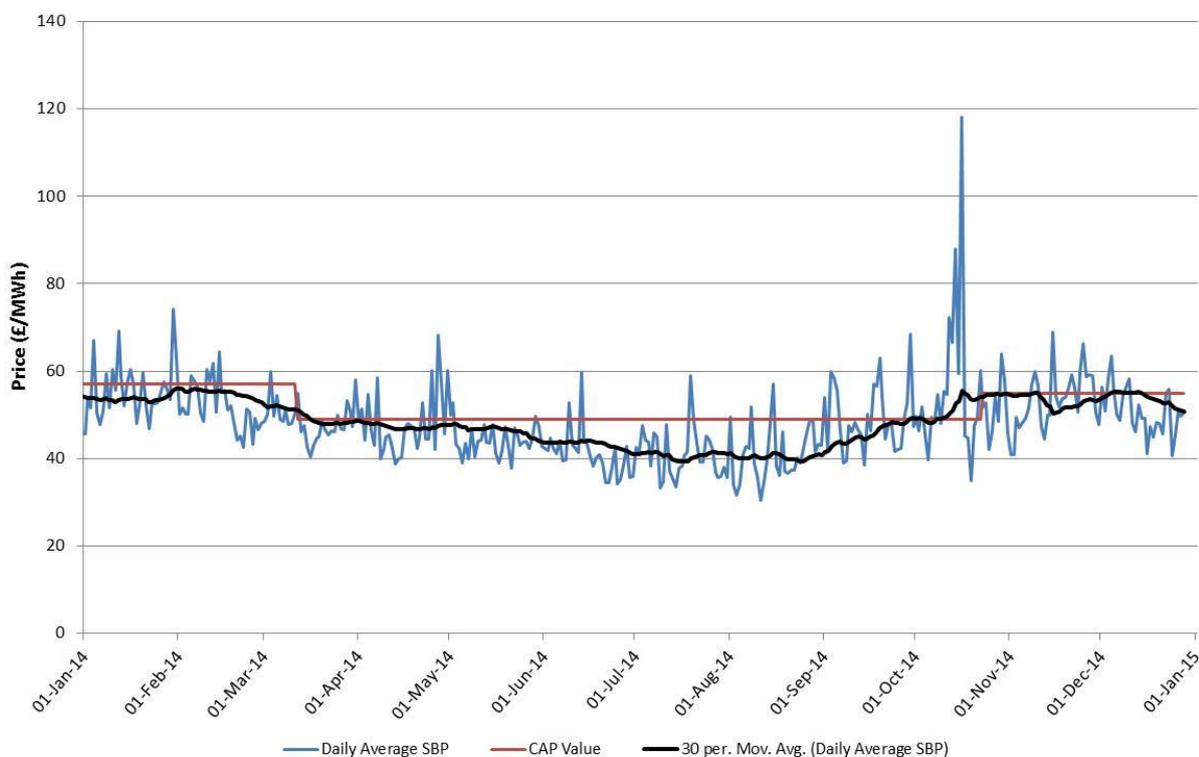
6.1 The CAP is considered to be a proxy for System Buy Price (SBP). The underlying reason for the CAP review process is to set the CAP so that it gives a good reflection of what we expect SBP to be. Because of the time taken to review and change the CAP, we set the CAP based on the industry expectation of general electricity price levels in 2 - 6 months' time.

6.2 Graphs 2 and 2a show the relationship between CAP and daily average SBP. These graphs show how the current CAP review process predicts outturn SBP. Graph 2 shows the last three years, 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.



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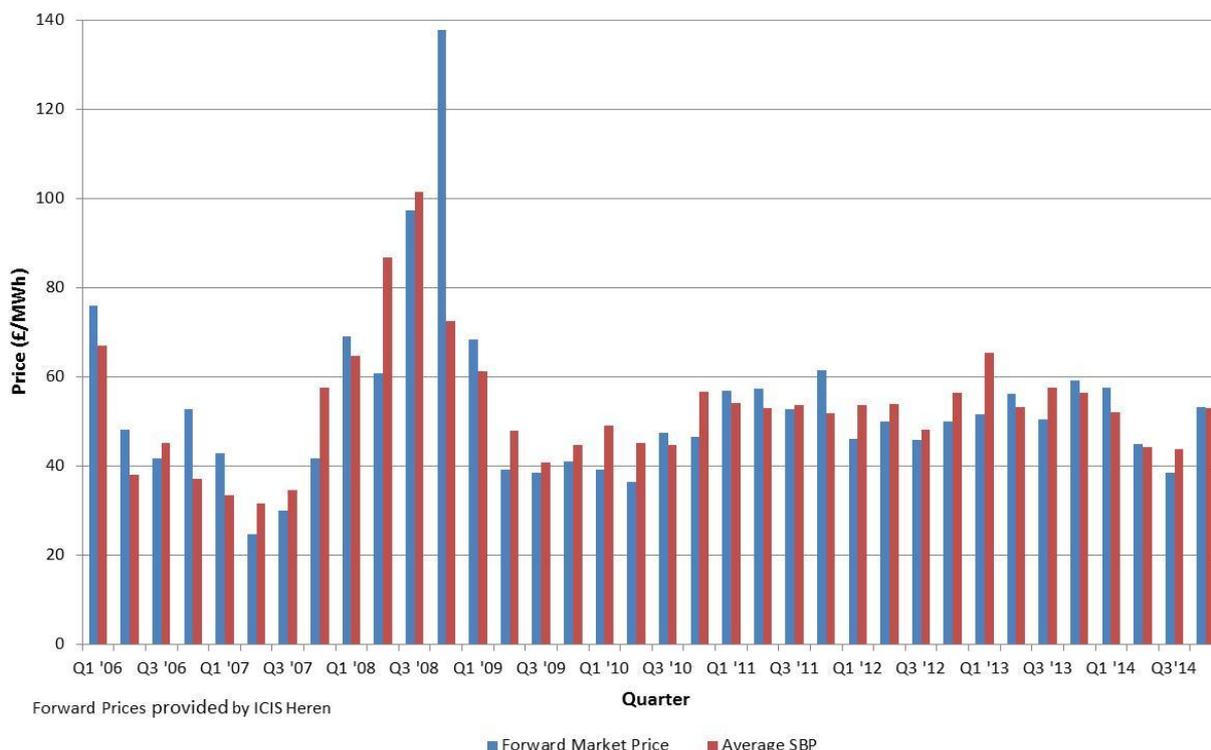
Graph 2a: Daily Average System Buy Price and CAP



- 6.3 The graphs show the £49/MWh CAP value over estimated the outturn SBP until it was revised on 23 October 2014. From 23 October the revised CAP value of £55/MWh followed more closely to the SBP but then towards the end of that month became an over estimation which again triggered a CAP price review.
- 6.4 Graph 3 shows the average outturn System Buy Price (SBP) over each Quarter against the forward price for that Quarter. This forward price is 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 under the current methodology, the CAP will not reflect future SBP well either.
- 6.5 Of course, 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.

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Graph 3: Average Outturn SBP against Quarterly Forward Market Prices



6.6 In Q4 2014, the forward price overestimated the average outturn SBP by £0.34/MWh.

7. Credit Committee Membership

7.1 There are currently six members of the Credit Committee. The BSC Panel Chairman, Michael Gibbons, continues as Chairman of the Credit Committee.

1.1. Under the Terms of Reference, the maximum membership is ten, with quorum for the meetings being three. Members of the Credit Committee are drawn from the Panel, Imbalance Settlement Group (ISG) or Supplier Volume Allocation Group (SVG).

8. View of the Credit Committee

8.1 The Credit Committee believes the CAP review process is working well within the constraints of the current BSC. It has reflected the market price well during the 2014-2015 BSC Year.

8.2 Although the Credit Committee took a decision to reduce the trigger level in January 2015, the committee recognises that commodity prices have moved sharply in recent months. If prices start to increase again the threshold may need a further review.

8.3 The Committee recommends no change to the current CAP process.

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9. Recommendations

9.1 We invite you to:

- a) **NOTE** that the Credit Committee recommends no change to the CAP review process.

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