

CREDIT COMMITTEE QUARTERLY REPORT: OCT - DEC 2014

Target Audience Credit Committee Members and BSC Parties

Date Published January 2015

Purpose of paper For Information

ELEXON produces this report on the Credit Assessment Price (CAP) review process every three months for the Credit Committee. This report covers the period October to December 2014. The purpose of the report is to assist the Credit Committee in its obligation to keep the CAP Review process under review.

In summary:

Summary

- The CAP changed once on 23 October 2014 to £55/MWh throughout the review period.
- The current CAP value was a good estimate of the outturn SBP.
- The CAP breached the lower trigger on 22 December 2014.
- A Credit Committee meeting was scheduled for 7 January 2015.

1. Why we produce the Quarterly Report

1.1 ELEXON creates this report every three 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 October to December 2014). We assess the weekly trigger checks and the performance of CAP against outturn System Buy Price (SBP) and forward market prices.

1.2 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.

1.3 Further information about the CAP review process can be found on the Credit Committee web page:

<http://www.elexon.co.uk/group/credit-committee-cc/>

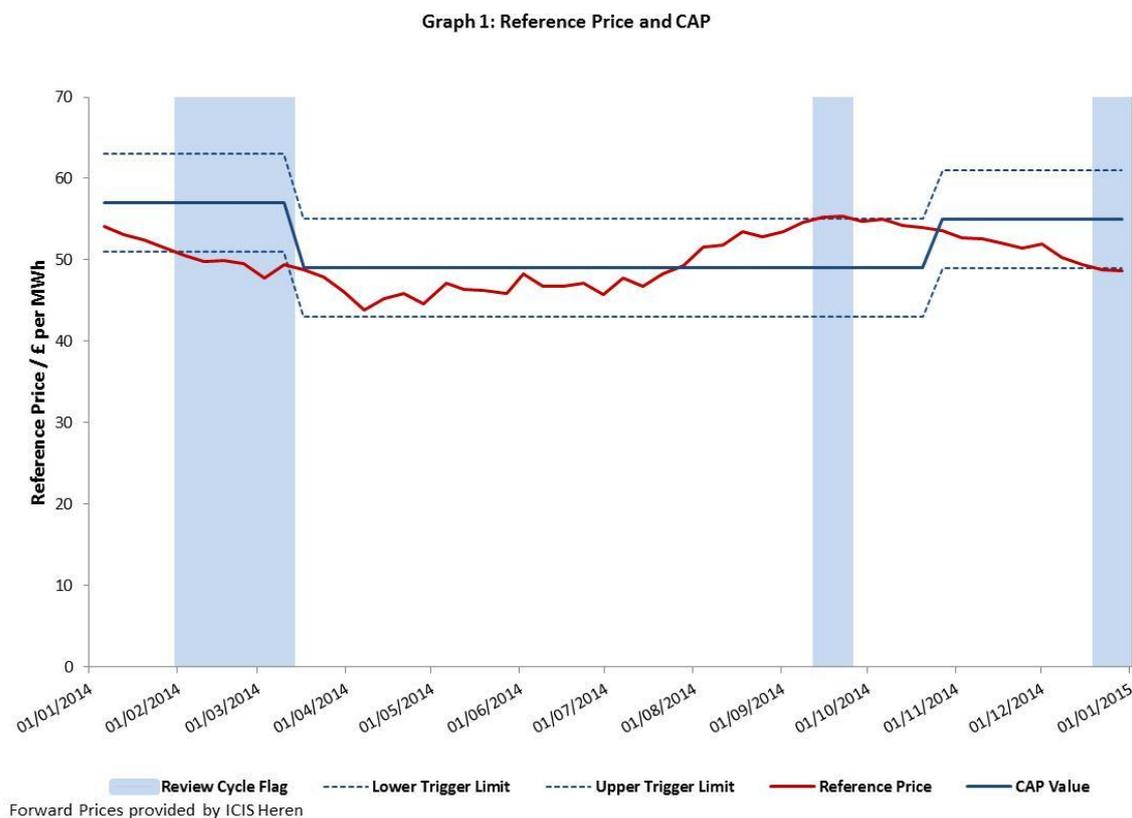
2. Background of the Credit Assessment Price (CAP) Review

2.1 The CAP is defined in section M1.4 of the Balancing and Settlement Code (BSC). The CAP is essentially a parameter used to convert the credit cover lodged by a BSC Party into an equivalent MWh amount and can be seen as a proxy of future outturn System Buy Price. It is set based on the probable cost a Party would face if it bought energy in the forward market. ELEXON actively monitors the CAP value against forward looking electricity prices. Where significant deviations occur the CAP value is reviewed.

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3. Detailed Analysis

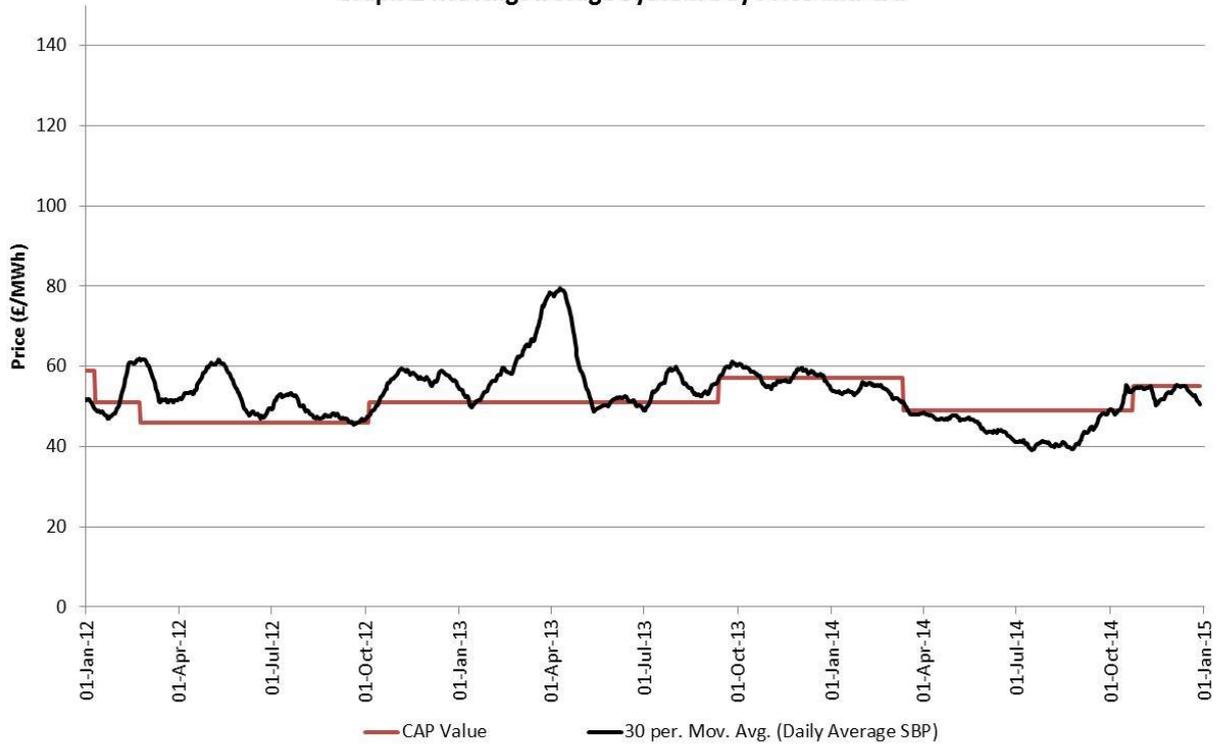
- 3.1 Graph 1 shows the variation in the reference price and the CAP value over the last year. The graph also shows the upper and lower trigger levels which are +/- £6 from the CAP value. The blue shaded areas indicate periods when the CAP value was under review.



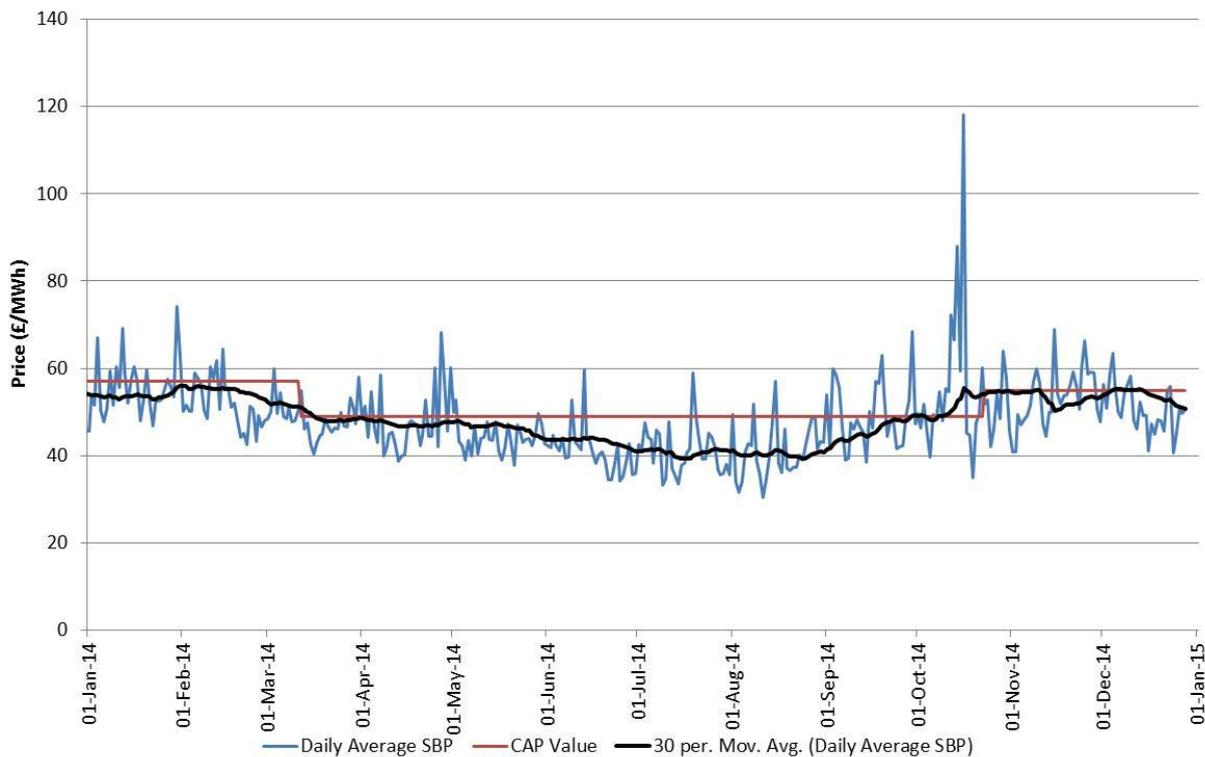
- 3.2 There were two CAP breaches that were reviewed during the report period, the upper trigger was breached in late September but the CAP price was consulted on and reviewed in October. The lower trigger was then breached in December 2014.
- 3.3 The CAP value for October increased to of £55/MWh which was due to higher Q1 2015 forward prices. For November the reference price was calculated on two thirds Q1 2015 and one third Q2 2015. The CAP reference price calculation breached the lower trigger level on 22 December 2014. December is calculated one third Q1 2015 and two thirds Q2 2015.
- 3.4 In previous years, the reference price has either continued to increase over December or sustain a constant level. For December 2014, there was a decrease in cost of power trades on the UK wholesale market which had closely followed the movements on the NBP market (gas National Balancing Point). This has brought an early lower CAP price breach (22 December, whereas it has usually been late January) with the Credit Committee to meet in early January to agree a new CAP price and/or trigger level.
- 3.5 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 2 Moving Average System Buy Price and CAP



Graph 2a: Daily Average System Buy Price and CAP



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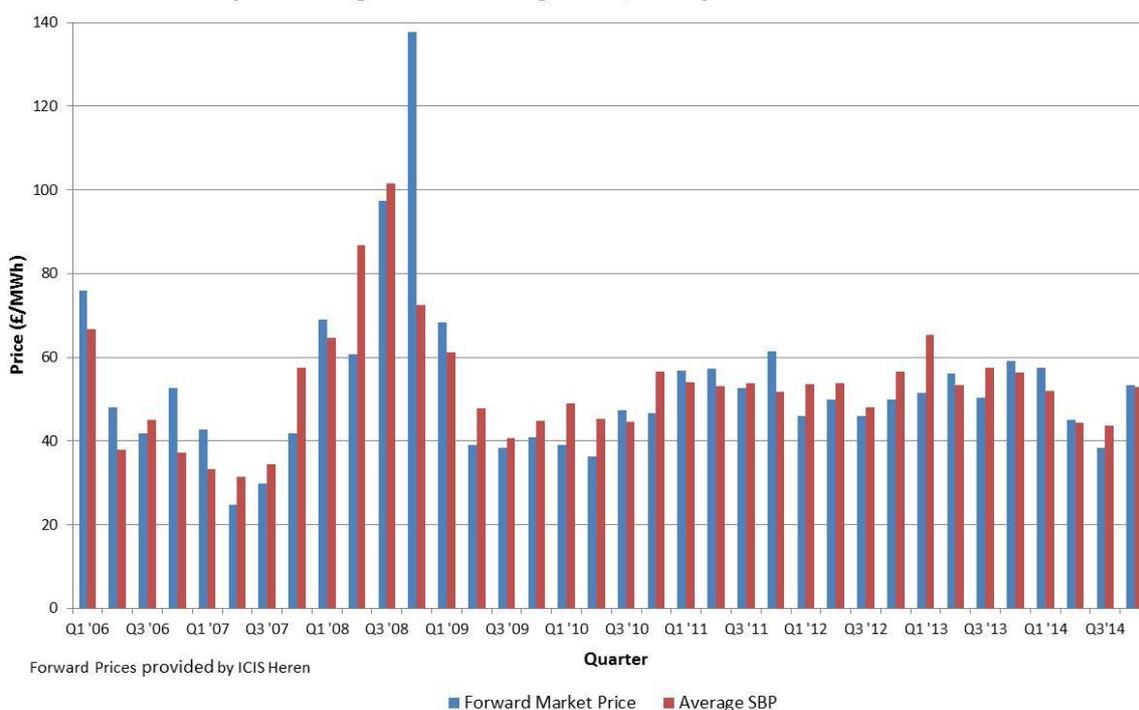
3.6 The graphs show the £49/MWh CAP value under estimated the outturn SBP until it was revised on 23 October 2014. There was an increase of SBP on 16 October which was a result of expensive balancing actions accepted by National Grid, however this would have had little effect of the CAP reference price. From 23 October the revised CAP value of £55/MWh followed more closely to the SBP but then towards the end of the month became an over estimation when again triggered a CAP price review.

3.7 The table below shows the average SBP and variance from the CAP in each month of the Quarter.

	Oct 2014 (up to 22 Oct)	Oct 2014 (from 23 Oct)	Nov 2014	Dec 2014 (up to 28 Dec)
Average Outturn SBP	£55.87	£51.40	£53.26	£50.73
CAP	£49.00	£55.00	£55.00	£55.00
Average Outturn SBP - CAP	£6.87	−£3.60	−£1.74	−£4.27

3.8 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, CAP will not reflect future SBP well either. 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.

Graph 3: Average Outturn SBP against Quarterly Forward Market Prices



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3.9 In Q4 2014, the forward price overestimated the average outturn SBP by approximately £0.34.

4. Looking Forward

4.1 There was a CAP breach on 22 December 2014 and a consultation was raised with the Credit Committee meeting on 7 January 2015. The committee reviewed the CAP price and consultation notes and agreed to change the CAP price to a lower level of £47/MWh with effect from 12 February 2015. The Credit Committee also agreed to reduce the trigger level to £5/MWh.

The reference price in the coming Quarter will be calculated using Q2 2015 (January), two thirds Q2 2015 and one third Q3 2015 (February) and one third Q2 and two thirds Q3 (March). Forward prices are expected to be lower as a result of using cheaper spring/summer prices. Since the Credit Committee meeting there has been a continued decline in the CAP reference price and should this trend continue, when the new CAP becomes effective on 12 February 2015 there may be another breach to the lower CAP trigger level. ELEXON will closely monitor the reference price and notify the Committee when we envisage a breach is likely to happen in the future.

5. Conclusions

- The CAP was changed to £55/MWh within the review period.
- The current CAP was a good estimate of SBP.
- The CAP price breached the lower CAP trigger level on 22 December 2014 with a new CAP effective in February 2015.
- Currently, there are some signs that the CAP trigger level may be breached in the next Quarter.

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