

# CREDIT COMMITTEE QUARTERLY REPORT: JAN - MAR 2015

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**Target Audience** Credit Committee Members and BSC Parties

**Date Published** April 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 January to March 2015. The purpose of the report is to assist the Credit Committee in its obligation to keep the CAP Review process under review.

## Summary

In summary:

- The CAP changed once on 12 February 2015 to £47/MWh in the review period.
  - The CAP trigger level was also changed to £5/MWh on 12 February 2015.
  - The CAP value was a good estimate of the outturn SBP in the review period.
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## 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 January to March 2015). 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 volume 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.

## 3. History of the CAP process

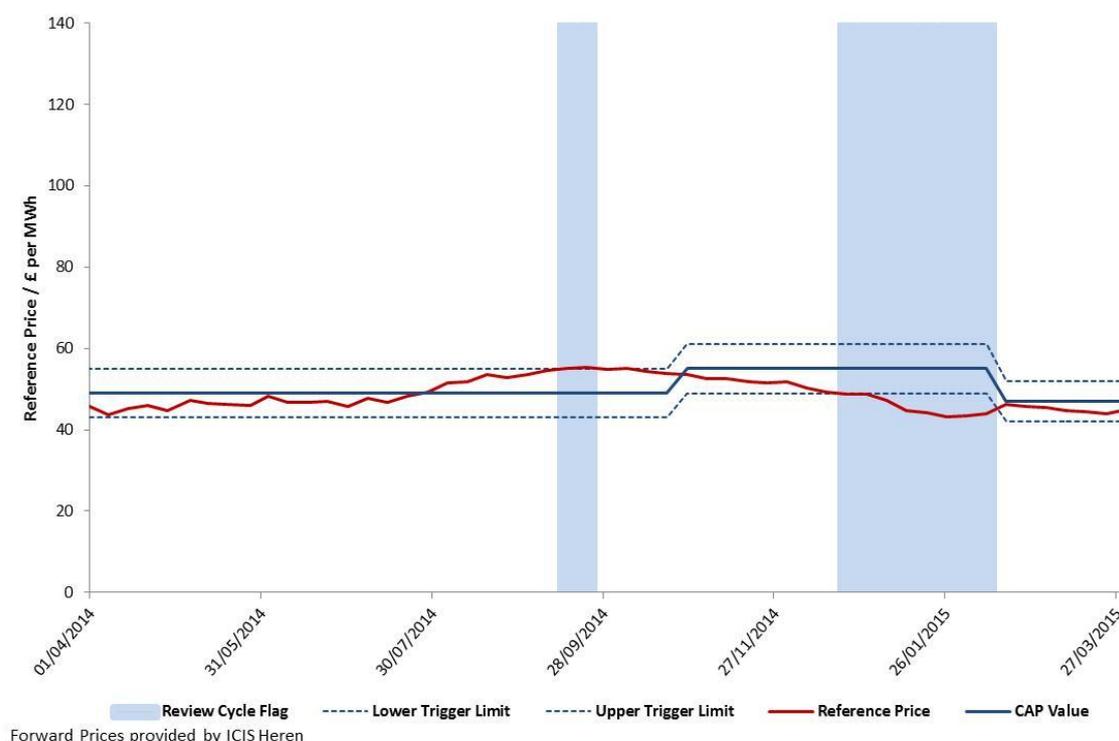
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- 3.1 Before August 2007, the value of the CAP was determined by the BSC Panel based on a recommendation from the Imbalance Settlement Group (ISG) and industry consultation. The ISG reviewed the CAP every six months based on the historic level of System Buy Price as a reasonable expectation of future prices, taking into account prevailing prices and expected future market conditions and forward prices. The problem with the six monthly review was that the market prices and the CAP could be out of step and then a large adjustment was needed.
- 3.2 At its August 2007 meeting, the BSC Panel approved that a new trigger level based methodology and the Credit Committee should be established with a view that this would allow the CAP value to be more responsive to the changes foreseen in market conditions. The methodology uses forward prices to determine when a CAP review shall be held. The Panel has also delegated the responsibilities of setting the CAP value and the trigger level to the Credit Committee.
- 3.3 To conduct its duty of reviewing the CAP, the Credit Committee uses both the forward price analysis and also its own expertise on the market outlook. They continue to try and make sure that the CAP would see a defaulting party able to cover its energy purchase shortfall, but also try to limit large amounts of unnecessary credit being lodged in the market.
- 3.4 This is the current arrangement of the CAP review process and has not been changed since August 2007.

## 4. Analysis

- 4.1 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 now set as +/- £5 from the CAP value. The blue shaded areas indicate periods when the CAP value was under review.

Graph 1: Reference Price and CAP



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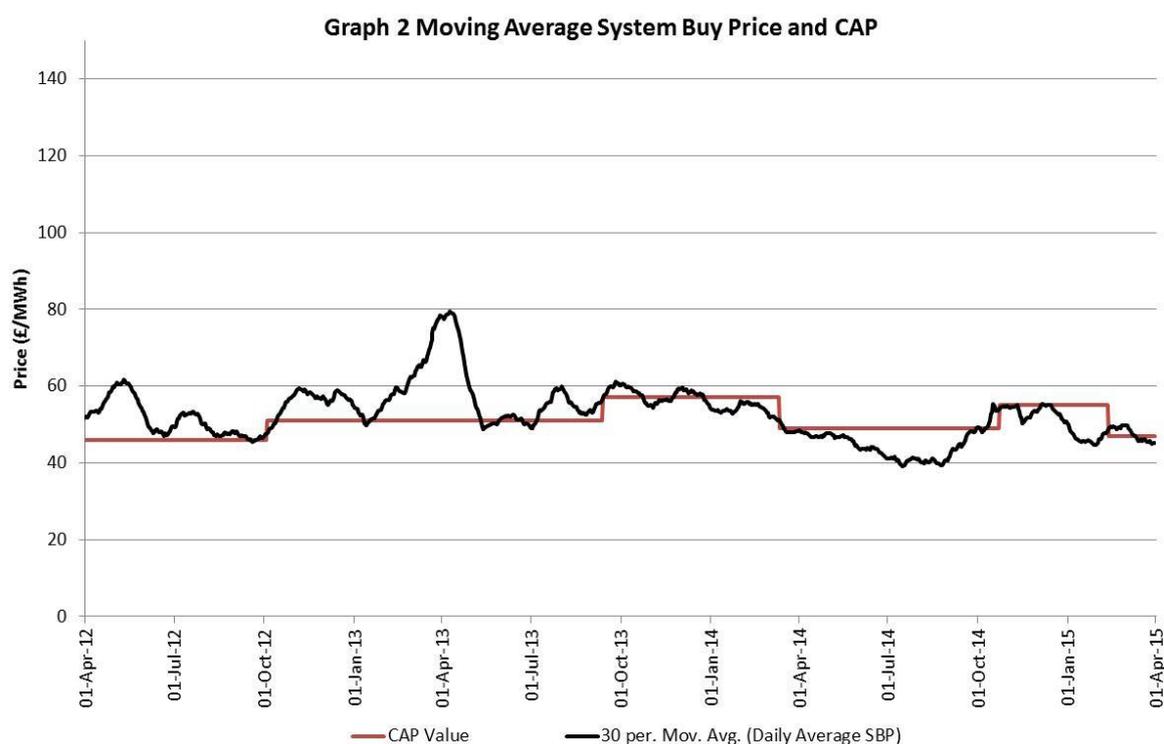
4.2 The CAP price is calculated using a combination of quarterly average prices. The formula depends on which month the check date falls in and is determined as below.

- January: Q2
- February:  $(2/3*Q2)+(1/3*Q3)$
- March:  $(1/3*Q2)+(2/3*Q3)$

4.3 There were no CAP breaches during the report period, but the CAP was changed following the review that was triggered last quarter. The lower trigger was breached in late December, the CAP price was then consulted on, reviewed in January and the new CAP implemented on 12 February 2015. The Credit Committee also agreed to reduce the trigger level to £5/MWh.

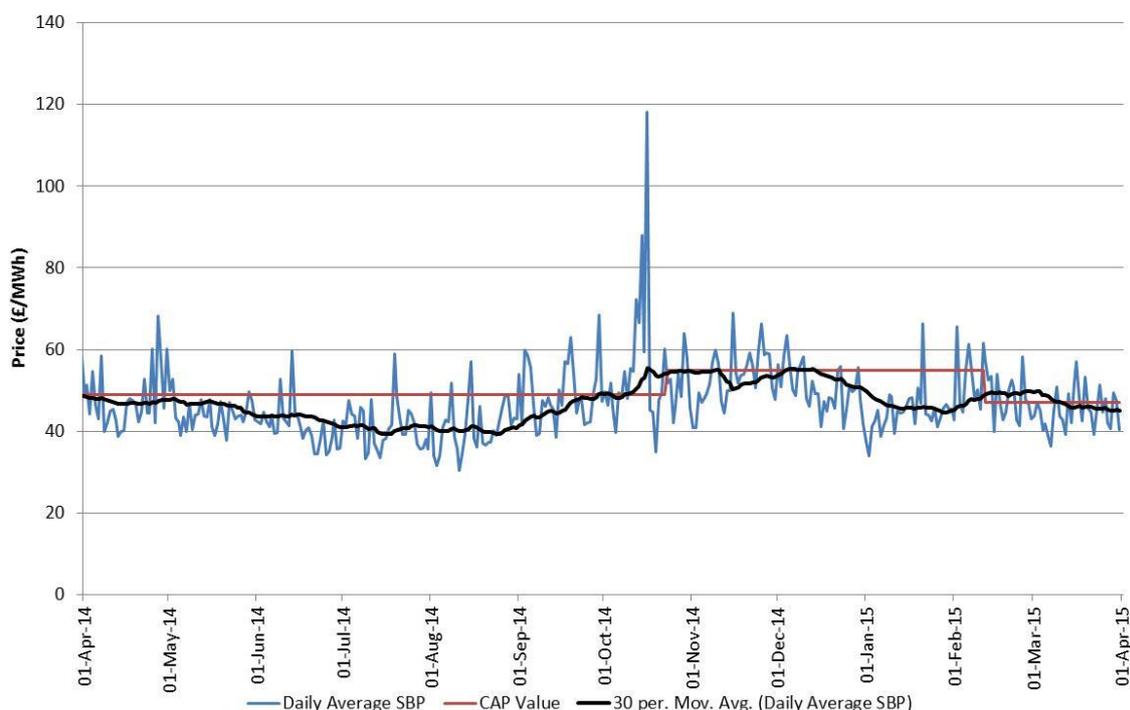
4.4 There are no other instances to report on for this quarter.

4.5 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 2a: Daily Average System Buy Price and CAP



- 4.6 The graphs shows the £55/MWh CAP value over estimated the outturn SBP until it was revised on 12 February 2015. The revised CAP value of £47/MWh has since followed more closely to the SBP with an occasional dip but then towards the end of the quarter.
- 4.7 The spike still in the graph from last quarter (October) was a result of expensive balancing actions accepted by National Grid; however this had little effect of the CAP reference price.
- 4.8 The table below shows the average SBP and variance from the CAP in each month of the Quarter.

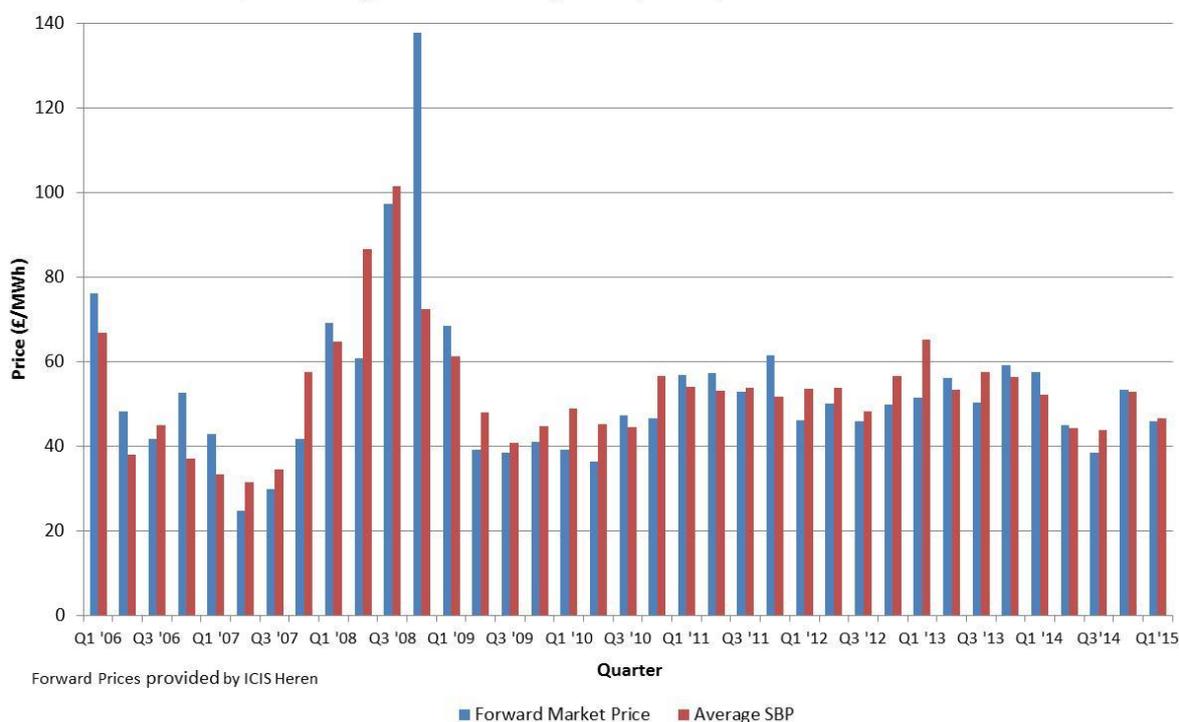
	Jan 2015	Feb 2015 (up to 11 Feb)	Feb 2015 (from 11 Feb)	Mar 2015
Average Outturn SBP (£/MWh)	44.72	52.34	48.47	45.08
CAP (£/MWh)	55.00	55.00	47.00	47.00
Average Outturn SBP – CAP (£/MWh)	-10.48	-2.66	1.47	-1.92

- 4.9 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

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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



4.10 In Q1 2015, the forward price overestimated the average outturn SBP by approximately £0.55.

## 5. Looking Forward

5.1 The CAP is currently set to £47/MWh with the upper and lower trigger levels which are now set as +/- £5 from the CAP value. There are no current signs of a trigger for either threshold. Although the CAP price at the time of writing this paper (April) sits at -3.275 below £47.00/MWh.

5.2 The reference price in the coming quarter will be calculated using Q3 2015 (April), two thirds Q3 2015 and one third Q4 2015 (May) and one third Q3 and two thirds Q4 (June). 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 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.

## 6. Conclusions

- The CAP was changed to £47/MWh within the review period.
- The CAP trigger was also changed to £5/MWh on 12 February 2015.
- The current CAP was a good estimate of SBP.

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- Currently, there are no signs that the CAP trigger level may be breached in the next quarter.

### **For more information, please contact:**

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