

CC26/01 – PROPOSED CHANGES TO THE CREDIT ASSESSMENT PRICE PROCESS

MEETING NAME Credit Committee 26

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Purpose of paper For decision

Classification Public

Summary At its last meeting, on 12 January 2016, the Credit Committee asked ELEXON to provide a set of options to be considered to improve the Credit Assessment Price (CAP) process. Based on the Credit Committee members' recommendations, we will present the chosen options to the BSC Panel at its February 2016 meeting for decision.

1. Introduction

- 1.1 Recent low oil prices and unusual seasonal weather conditions have led forward electricity market prices to go down significantly in the past few months. This has driven a drop of the Credit Assessment Price reference price which has breached its lower Trigger Level twice in the past two months. It is set to breach again as soon as the new CAP value is implemented, on 12 February 2016. The CAP reference price at the time this paper was written is £34.22/MWh on Monday 1 February. In comparison the average System Price was £39.60/MWh in January 2016.
- 1.2 The implementation of [BSC Modification P305 – Electricity Balancing Significant Code Review Developments](#) on 5 November 2015 made the imbalance prices more dependent on the length of the Transmission System. The prices do not reflect the forward market prices in the same way that they have historically. Up to November 2015 the current method used to calculate the CAP reference price had been successful.
- 1.3 For those reasons, at its last meeting on 12 January 2016, the Credit Committee asked ELEXON to present options to improve the CAP setting and review process. ELEXON highlighted three elements that need to be reviewed:
 - The products used in the reference price calculation
 - The 'reference quarter' used in the reference price calculation
 - The notice period for implementing a new CAP value
- 1.4 Changing each of these parameters will require changes to several documents which will need the BSC Panel's approval.

2. Products in the calculation

Solely use peak prices

- 2.1 When prices peak, the trading charges faced by BSC Parties can suddenly increase, which in turn increases the risk of credit default. Currently, the reference price is calculated using the average baseload and peak prices over the past five days. There is a possibility that we only account for peak forward market prices. Based on historical prices since the implementation of Modification P305 in November 2015, using peak prices only to calculate the reference price would increase it by an average of £2.35/MWh. On Monday 1

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February, the reference price calculated only using peak prices was £35.89/MWh, £1.67/MWh above the reference price calculated using the current method.

- 2.2 Peak prices are already included in the current report used by ELEXON to calculate the reference price and it would not be necessary to acquire additional reports.
- 2.3 In order to change this parameter, a change to the [Credit Assessment Price \(CAP\) Review Guidance Document](#) is necessary. This can only be approved by the BSC Panel but the Credit Committee can recommend a change to the Panel to support its decision.

Use historical System Prices

- 2.4 Because the changes in the Imbalance Price calculation brought by the implementation of Modification P305, Imbalance Prices became more volatile depending on the length of the Transmission System. In effect, based on values since 5 November 2015, the average price when the System is short (40% of the time) is £55.55/MWh and when it's long (60% of the time), £27.15/MWh.
- 2.5 To take into account market length and the gap between long and short prices, the CAP reference price could be calculated based on a rolling 29 day period of actual imbalance prices. This corresponds to the period covered by the Credit Cover process and would ensure the reference price perfectly reflects prices charged to Parties in their Trading Charges. By applying this method, on Monday 25 January 2016, the reference price would have been £38.85/MWh compared to £33.97/MWh with the current method.
- 2.6 This method would make the process more accurate, taking into account market lengths, but more volatile and would potentially require the Credit Committee to meet more often to amend the CAP value.

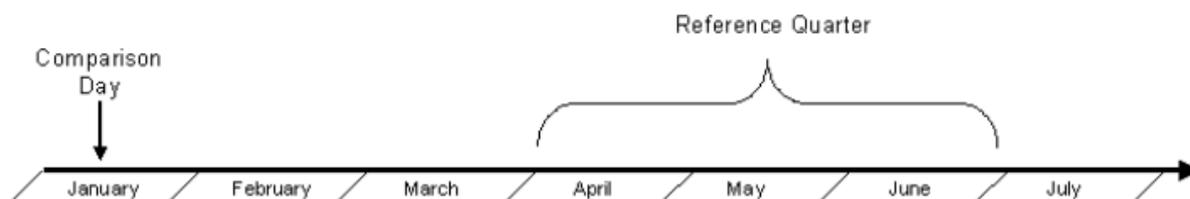
3. Implementation notice period

- 3.1 According to BSC Section M.1.4.2 (b), a new CAP value shall not be implemented earlier than the 20th Working Day following the notification to BSC Parties and the Panel. There is an opportunity to raise a Modification to cut down the implementation notice period from 20 working days to 10, cutting the change of CAP value process length from an average of 6 weeks to less than a month from the trigger event to the implementation day.
- 3.2 Because this parameter is embedded in the BSC, a Modification will need to be raised by either the BSC Panel or a BSC Party in order to amend the Code.

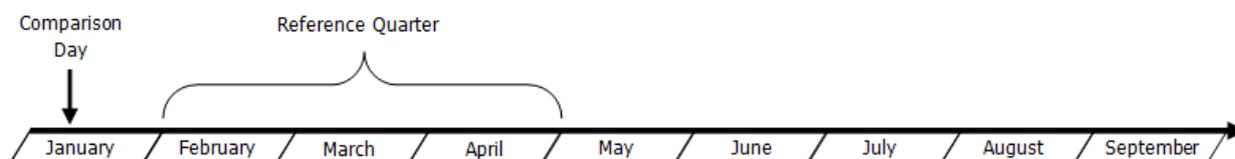
4. Reference Quarter

- 4.1 When calculating the CAP reference price, data taken from the coming two quarters is used. The rationale for using data so far ahead is that the timescales for implementing a new CAP value drives the process to look at what prices would be by the implementation time in case of a breach. If the implementation timescales were to be reduced, as suggested above, there is an opportunity to bring the reference period forward and to look at the coming two months instead.
- 4.2 The timeline below represents the data currently included in the reference price calculation. The Reference Quarter is made of rolling three-months which change every month depending on the day the check is carried out.

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4.3 The timeline below represent the proposed changes to the data used to calculate the reference price.



4.4 This change would make the reference price calculation more relevant to the affected time of the year. For instance, seasonal effects can have a significant influence on forward market prices which may not necessarily reflect prices for the present period covered by Parties for Credit purposes.

4.5 Similarly to peak prices, the next three months prices are already included the current report used by ELEXON to calculate the reference price and additional reports would not be necessary.

4.6 Changing this parameter would also require changing the [Credit Assessment Price \(CAP\) Review Guidance Document](#) and the Panel's approval.

5. Next step

5.1 Based on the Credit Committee's discussions, ELEXON will present recommended options to the BSC Panel at its meeting on 11 February 2016 for decision. The proposed changes will be made to the relevant documents and presented to the Panel for its decision.

6. Recommendations

6.1 We invite you to:

- a) **NOTE** the options available to accommodate the CAP calculation and implementation process; and
- b) **AGREE** on the changes to the CAP calculation and implementation process to recommend to the BSC Panel for its next meeting, on 11 February 2016.

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