

CREDIT COMMITTEE QUARTERLY REPORT: JUL - SEP 2015

Target Audience Credit Committee Members and BSC Parties

Date Published October 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 July to September 2015. The purpose of the report is to assist the Credit Committee in its obligation to evaluate the CAP Review process.

Summary

In summary:

- The Reference Price did not breach the Trigger Level during that period.
 - 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 review the process over the last quarter (i.e. this report covers the months of July to September 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; and
- 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 by the Credit Committee.

3. History of the CAP process

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

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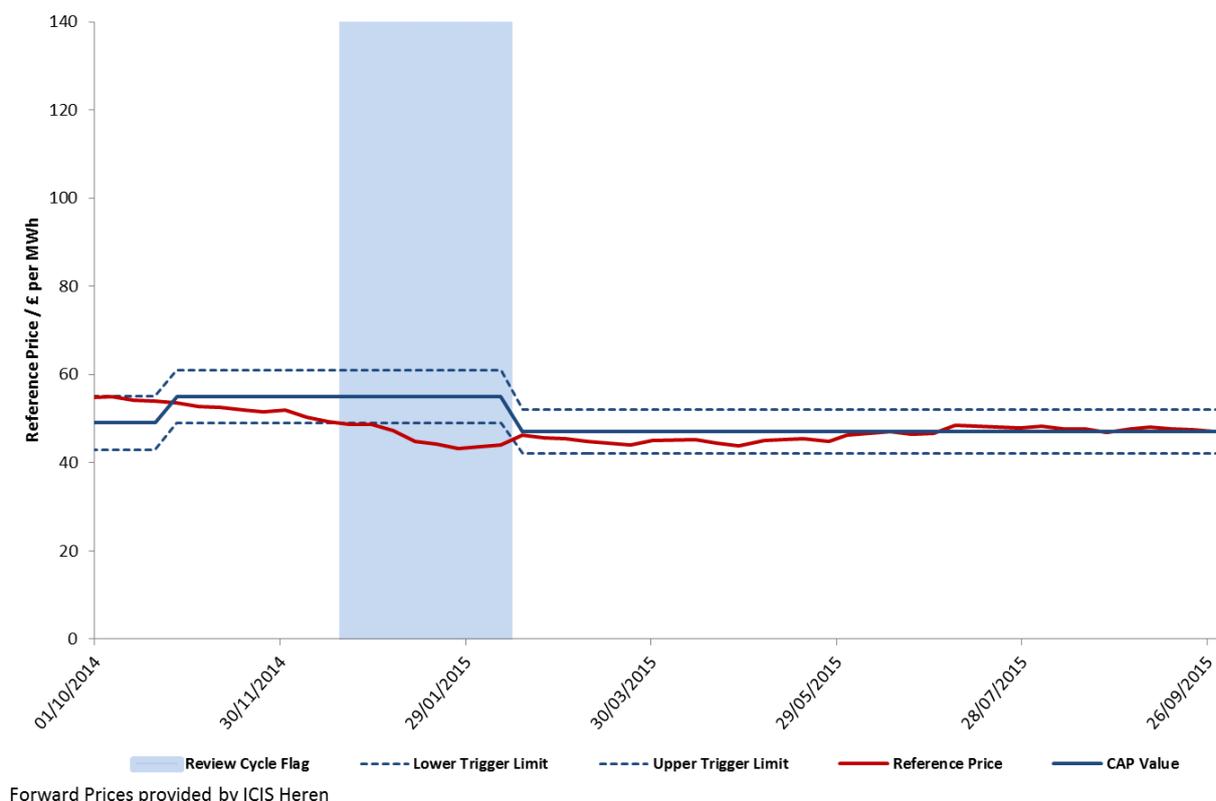
into account prevailing prices and expected future market conditions and forward prices. A flaw of the six-monthly review was that the market prices and the CAP could be unaligned, requiring a large adjustment.

- 3.2 At its August 2007 meeting, the BSC Panel approved the establishment of the Credit Committee, and a new trigger level-based methodology, with a view that this would allow the CAP value to be more responsive to the changes foreseen in market conditions. This methodology uses forward prices to determine when a CAP review shall be held. The Panel 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. It endeavours to ensure that the CAP sufficiently mitigates the exposure of BSC Parties to the Trading Charges of defaulting Parties, but also minimises excess credit cover.
- 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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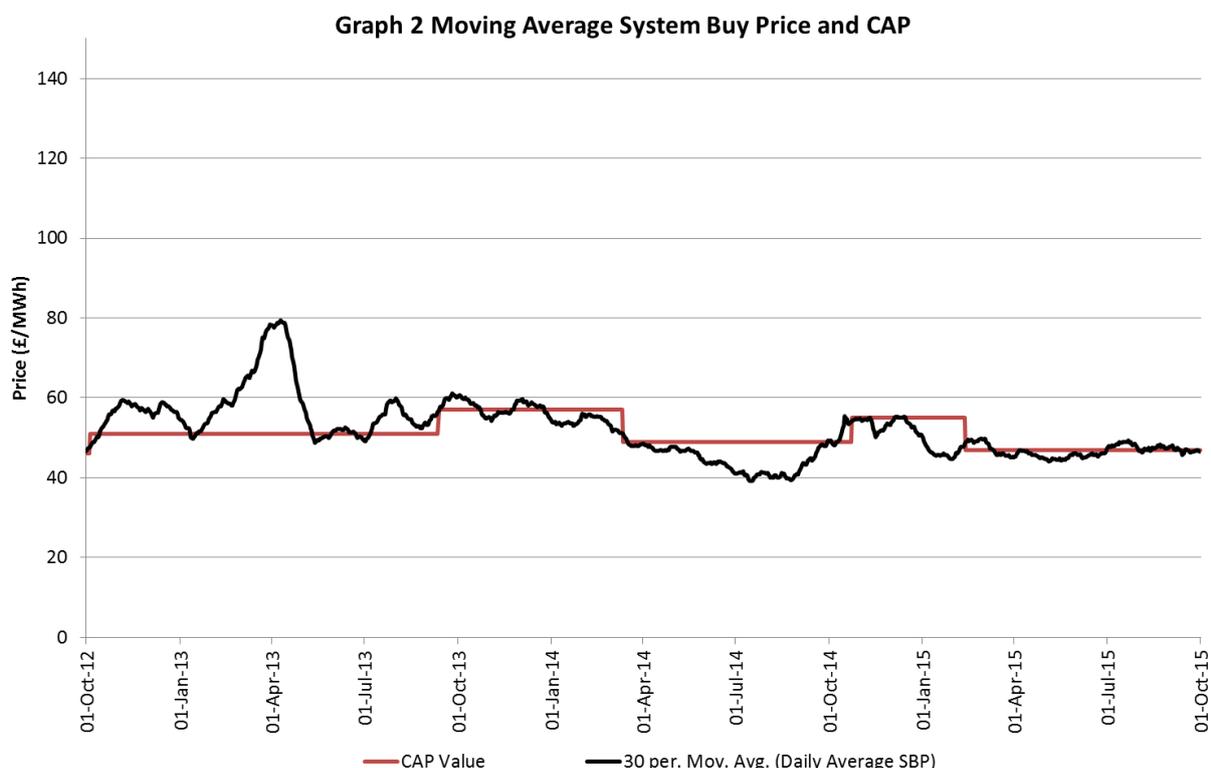
4.2 The CAP is calculated using a combination of quarterly average prices. The formula depends on which month the check date falls in and is determined as below.

- July: Q4
- August: $(2/3 * Q4) + (1/3 * Q1)$
- September: $(1/3 * Q4) + (2/3 * Q1)$

4.3 There were no CAP breaches during the report period.

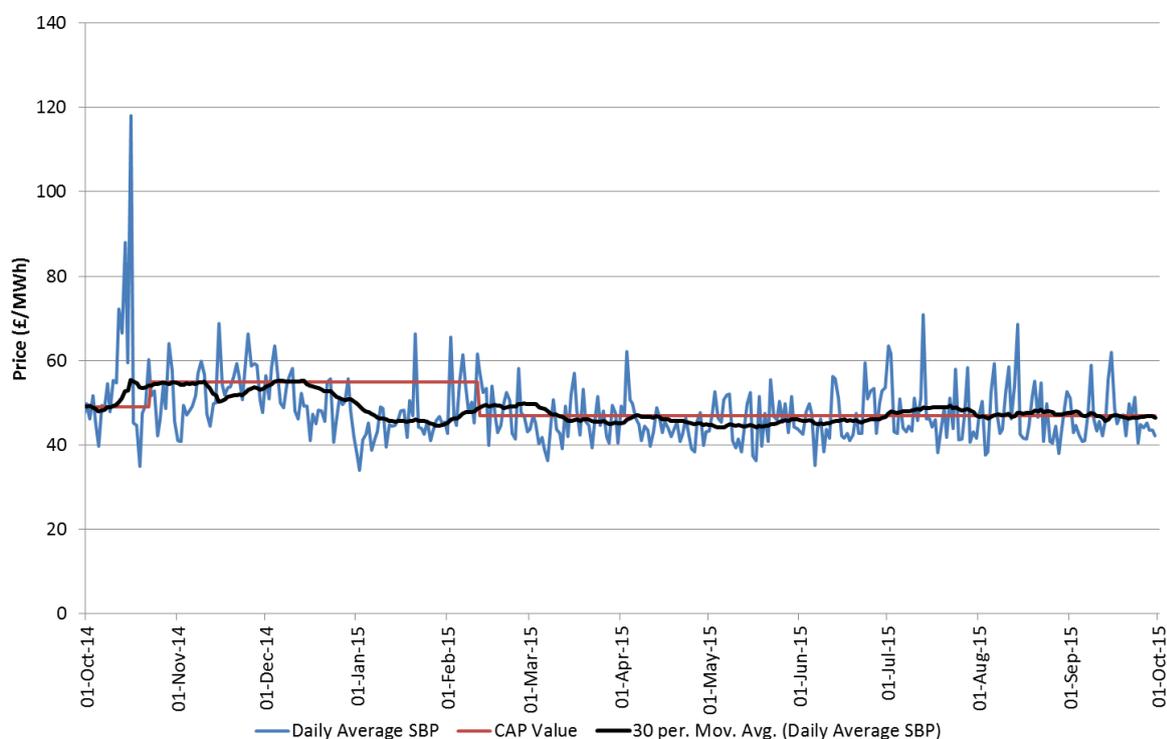
4.4 There are no other instances to report on for this quarter.

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



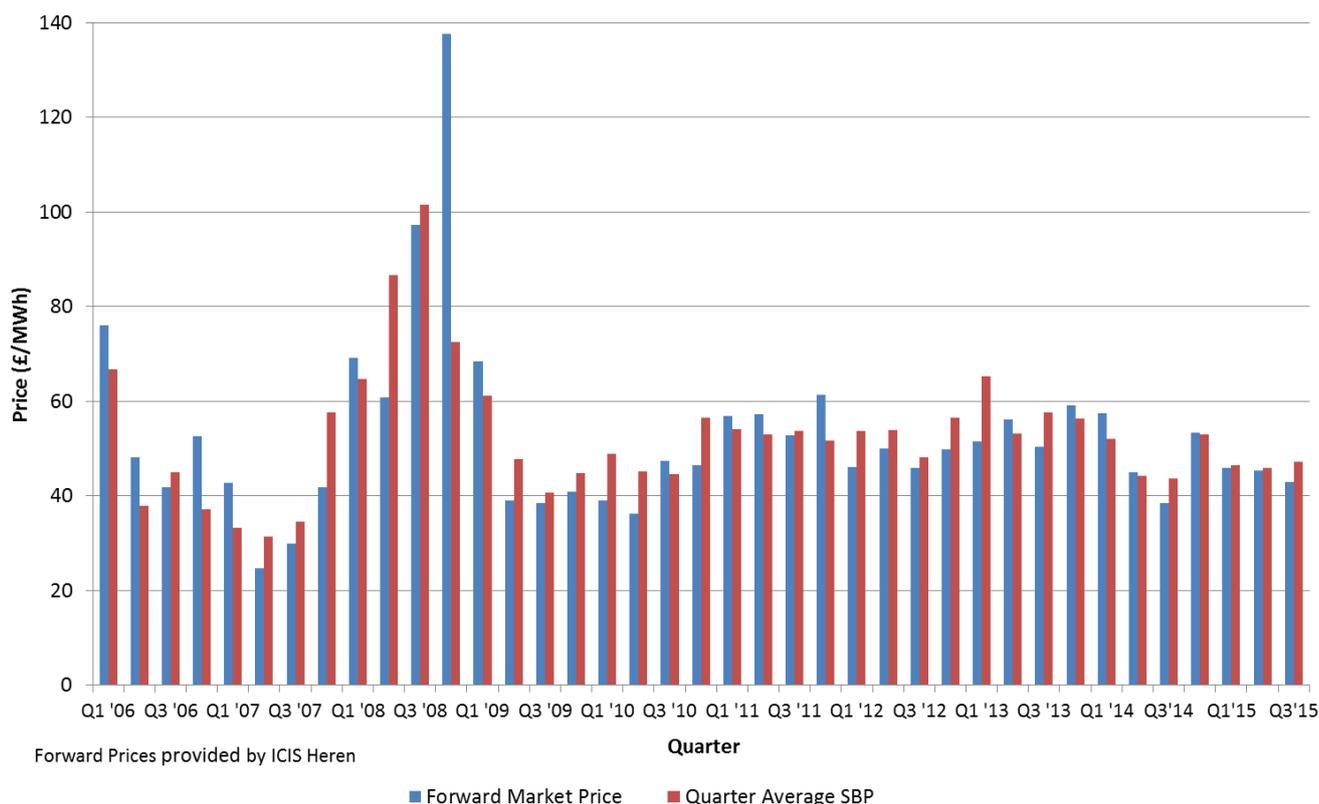
- 4.6 These graphs show that the £55/MWh CAP value over estimated the outturn SBP until it was revised on 12 February 2015. The revised CAP value of £47/MWh has since followed the SBP more closely with occasional variances above and below.
- 4.7 The spike still in the graph (October 2014) was a result of expensive balancing actions that National Grid had to take in order to balance the system at times of high demand. The most expensive instances were on the 16 October when the SBP reached £429.10/MWh for a single Settlement Period, driven by accepted balancing actions priced up to £500/MWh.
- 4.8 The table below shows the average SBP and variance from the CAP in each month of the Quarter.

	Jul 2015	Aug 2015	Sep 2015
Average Outturn SBP (£/MWh)	47.63	47.62	46.40
CAP (£/MWh)	47.00	47.00	47.00
Average Outturn SBP – CAP (£/MWh)	0.63	0.62	-0.60

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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 the overall accuracy of the CAP review process. This is because, if the forward price does not predict outturn future SBP movements accurately then, under the current methodology, the CAP will not reflect future SBP accurately either. Forward prices are not necessarily used by the markets in the forecasting of SBP prices, but we have previously found strong correlation, as can be seen over the years in Graph 3.

Graph 3: Average Outturn SBP against Quarterly Forward Market Prices



4.10 In Q3 2015, the first forward price underestimated the quarterly average outturn SBP by approximately £4.2/MWh.

5. Looking Forward

5.1 The CAP is currently set to £47/MWh with the upper and lower trigger levels being +/- £5 from the CAP value. There are no current signs of a trigger for either threshold. The CAP price at the time of writing this paper (October 2015) is at £1.030 below £47/MWh.

5.2 The reference price in the coming quarter will be calculated using first Q1 2016 (October), then two thirds Q1 2016 and one third Q2 2016 (November) and finally one third Q1 2016 and two thirds Q2 2016 (December). Forward prices are expected to be higher as a result of using higher winter prices. Since the last Credit Committee meeting, the CAP reference price has continually stayed above the CAP value although it has been steadily decreasing, becoming closer to the CAP, in September. ELEXON will closely monitor the reference price and notify the Committee when we envisage a breach is likely to happen in the future.

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6. Conclusions

- The CAP was £47/MWh within the whole review period.
- The current CAP was an accurate estimate of the SBP.
- Currently, there are no signs that the CAP trigger level may be breached in the next quarter.

For more information, please contact:

Thomas Routier, Market Analyst

Thomas.Routier@elexon.co.uk

020 7380 4378