



Credit Committee Quarterly Report: October – December 2011

Target Audience Credit Committee Members and BSC Parties

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Purpose of paper For Information

ELEXON produces this report on the Credit Assessment Price (CAP) review process every 3 months for the Credit Committee. This particular report covers October to December 2011. The purpose of these reports is to assist the Credit Committee in its obligation to keep the CAP Review process under review.

Summary

In summary:

- A CAP review was triggered this Quarter. The Credit Committee agreed to decrease CAP from £59/MWh to £51/MWh. The change was implemented on 16 January 2012.
 - CAP overestimated outturn SBP throughout the Quarter.
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1. Why we produce the Quarterly Report

1.1 ELEXON creates this report every 3 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 2011). 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 As these reports are primarily for the Committee, there is no explanation in these reports of how the CAP review process works or what CAP is used for. Further information can be found on the Credit Committee web page:

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

2. An overview of the CAP process from October to December 2011

2.1 A new CAP value of £39/MWh was implemented on 12 October 2011, following a review in September 2011.

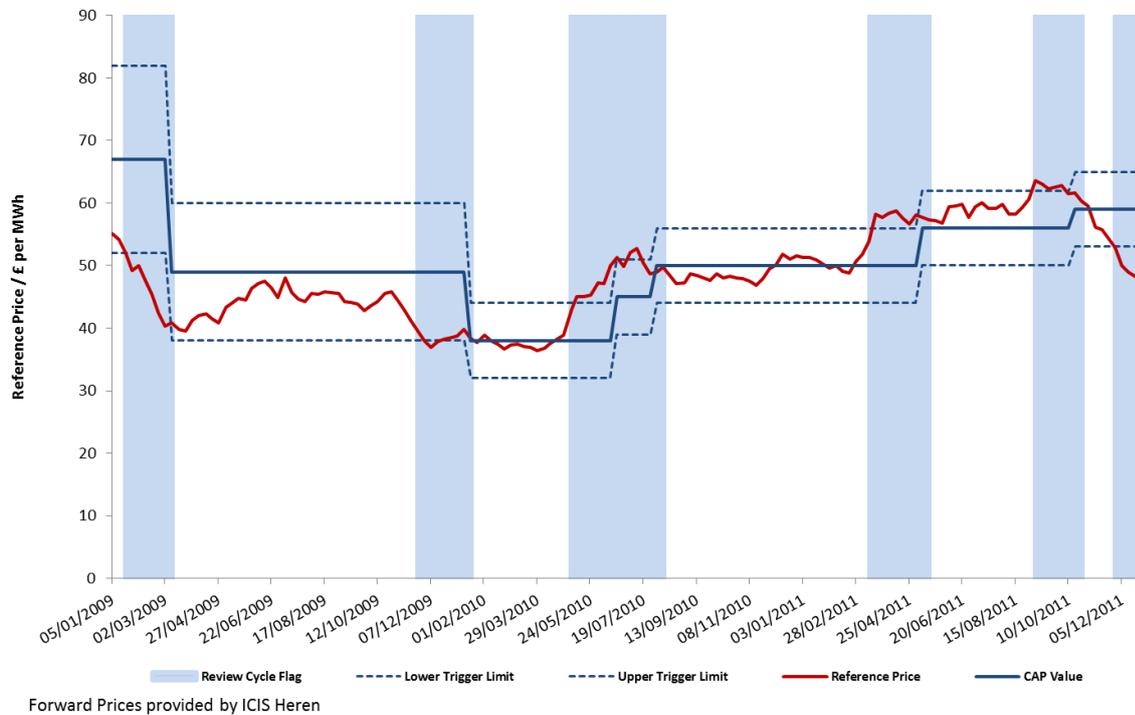
- 2.2 Another review was triggered on 28 November 2011. The Committee met on 8 December 2011 and agreed to decrease CAP to £51/MWh, effective from 16 January 2012.
- 2.3 It was determined that the trigger level should remain unchanged at £6/MWh.
- 2.4 CAP values and reviews in Q4 2011:

Date of Trigger Breach	Effective Dates	CAP Value actually implemented	CAP Value proposed in Consultation
05/09/2011	04/05/2011 to 11/10/2011	£56/MWh	£60/MWh
05/09/2011	12/10/2011 to 09/01/2012	£59/MWh	£59/MWh
28/11/2011	10/01/2012 to 22/02/2012	£51/MWh	£52/MWh

3. Detailed Analysis

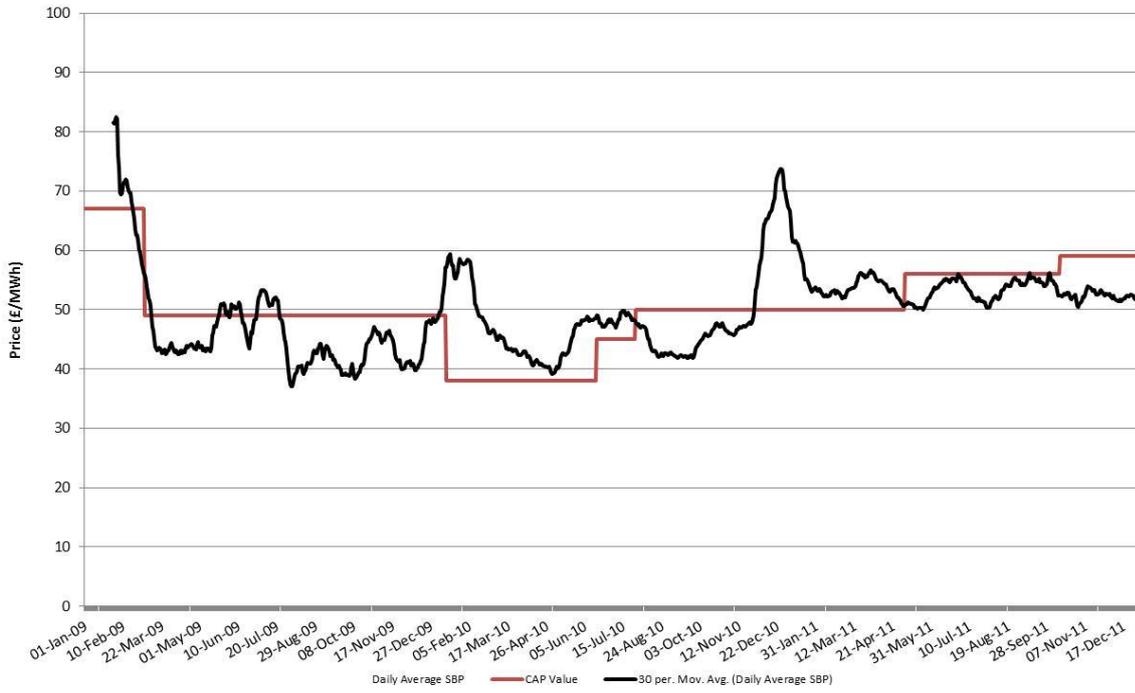
- 3.1 A CAP review is triggered when the reference price (which is derived from forward prices provided by ICIS Heren) breaches a certain level above or below the current CAP value. From 12 October 2011, CAP was set at £59/MWh, with a trigger level of +/-£6; i.e. a review would have been triggered if the reference price fell outside of a band £53/MWh - £65/MWh.

Graph 1: Reference Price and CAP

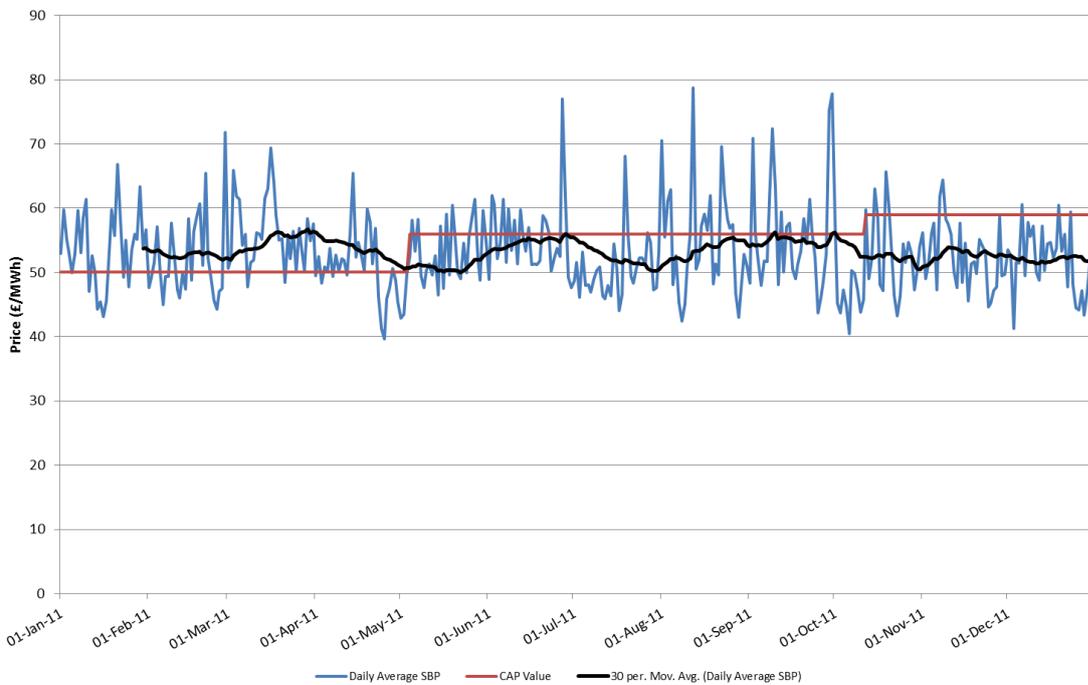


- 3.2 Graph 1 shows the variation in the reference price and the CAP value over the last 3 years (the process was started in October 2007). The graph also shows the upper and lower trigger levels, and the blue shaded areas indicate periods when the CAP value was under review.
- 3.3 The graph shows that the reference price began to drop around the same time as the £59/MWh CAP value was implemented, and the new review was triggered when the reference price dropped to £52.88 on 28 November 2011. The reference price continued to fall after this point. At the time of writing, it had dropped to such a level that a further review has taken place as the reference price was more than £6 below the £51/MWh value when it was implemented.
- 3.4 In Graphs 2 and 2a you can see the relationship between CAP and daily average SBP. We believe that this is the real measure of how good the current CAP review process is at predicting 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.

Graph 2 Daily Average System Buy Price and CAP



Graph 2: Daily Average System Buy Price and CAP



3.5 The graphs show that for almost the entire Quarter, SBP was below CAP. SBP was relatively consistent throughout the quarter, but began to drop in mid-December, at which point the CAP review had been triggered. Overall, the average SBP for the quarter was £51.66.

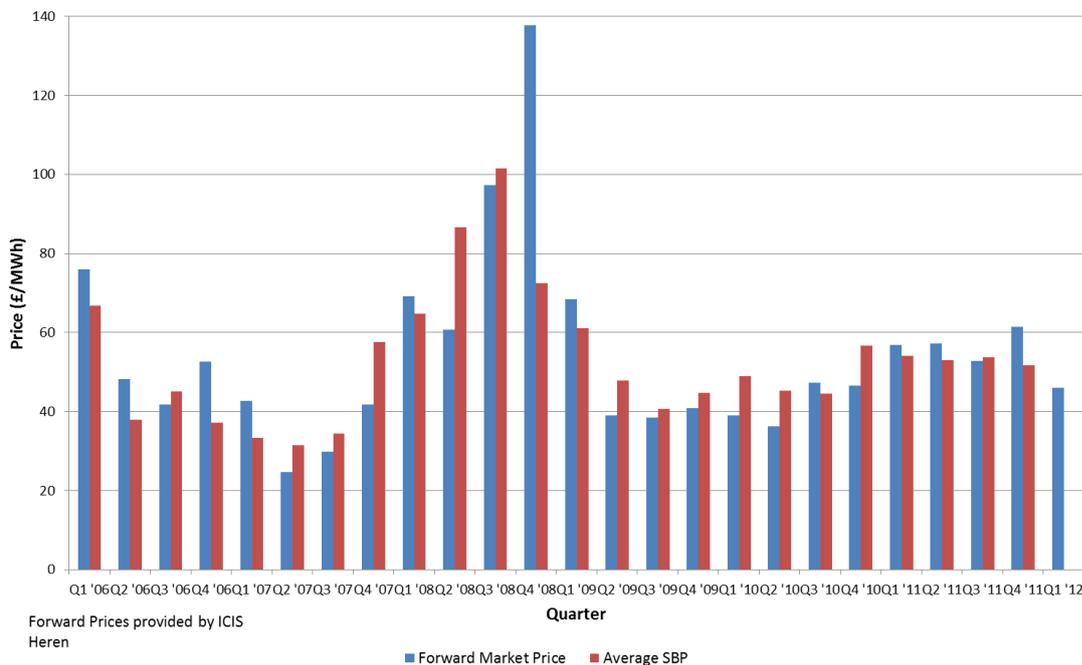


	October 2011	November 2011	December 2011
Average Outturn SBP	£50.72	£52.57	£51.72
Average Outturn SBP - CAP	-£8.28*	-£6.43	-£7.28

*CAP value implemented 12 October 2011 used

3.6 Graph 3 shows the average outturn System Buy Price (SBP) over each Quarter against the forward price for that Quarter. We have based this forward price on 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 with our current methodology, CAP will not reflect future SBP well either. Of course, we should make the point that 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



3.7 For Q4 2011, the initial prediction was higher than the actual average turned out to be. This was most likely due to the unseasonably warm weather that was experienced across the quarter.

4. Looking Forward

4.1 As previously noted, the reference price continued to drop following the conclusion of the December review, and another review was triggered on 16 January 2012. The Credit Committee met on 26 January 2012 and



agreed a new CAP value of £46/MWh to become effective on 23 February 2012. The reference price has begun to rise slightly again, and the current prices for Q2 and Q3, on which the reference price will be based on in the current quarter, a review seems unlikely before April.

4.2 At the Credit Committee meeting, it was noted that the reference price is not very responsive to current market conditions, and therefore rapid changes in SBP. The committee has therefore asked ELEXON to review the reference price calculation.

5. Conclusions

- A CAP review was triggered this Quarter. The Credit Committee agreed to decrease CAP from £59/MWh to £51/MWh. The change was implemented on 16 January 2012.
- CAP overestimated outturn SBP throughout the Quarter.

For more information, please contact:

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