

# 265/09 – PROPOSED CHANGES TO THE CAP REVIEW PROCESS 2017

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**MEETING NAME** BSC Panel Meeting

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**Date of meeting** 13 April 2017

**Owner/author** Thomas Routier

**Purpose of paper** Decision

**Classification** Public

**Summary** Historically, the Credit Assessment Price (CAP) was only reviewed once or twice a year, following seasonal changes in market prices. For the past two years, the number of reviews has significantly increased to the point that the CAP breaches the review trigger level as soon as a new one is implemented. There are a number of areas which could be amended to allow for a more efficient process. This paper sets out proposals to change the CAP Review Process. We invite the BSC Panel to approve the consultation that includes proposed changes to the CAP Review Process following recommendations from the Credit Committee.

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## 1. Background information

- 1.1 The Credit Assessment Price (CAP) is a parameter defined in [Section M1.4 of the BSC](#) as 'the price it would be appropriate to use to determine the equivalent financial amount of Trading Parties' Energy Indebtedness.'
- 1.2 The BSC Panel has delegated responsibility for reviewing and determining the CAP value to the Credit Committee. The process for reviewing the CAP is set in the [Credit Assessment Price \(CAP\) Review Guidance Document](#).
- 1.3 The [Credit Committee Terms of Reference](#) and the CAP Review Process Guidance Document were reviewed in 2016 with some changes made to the reference price calculation and the membership conditions of the Committee. Following a larger number of CAP reviews required in the past two years, the CAP review process could be further amended to improve its speed and efficiency without compromising on the amount of control from the Credit Committee and the industry over the CAP value.
- 1.4 This document sets out the proposal to improve the CAP review process to automatically set the new CAP value to the closest reference price unless Parties or a member of the Credit Committee request a meeting.

## 2. Current situation

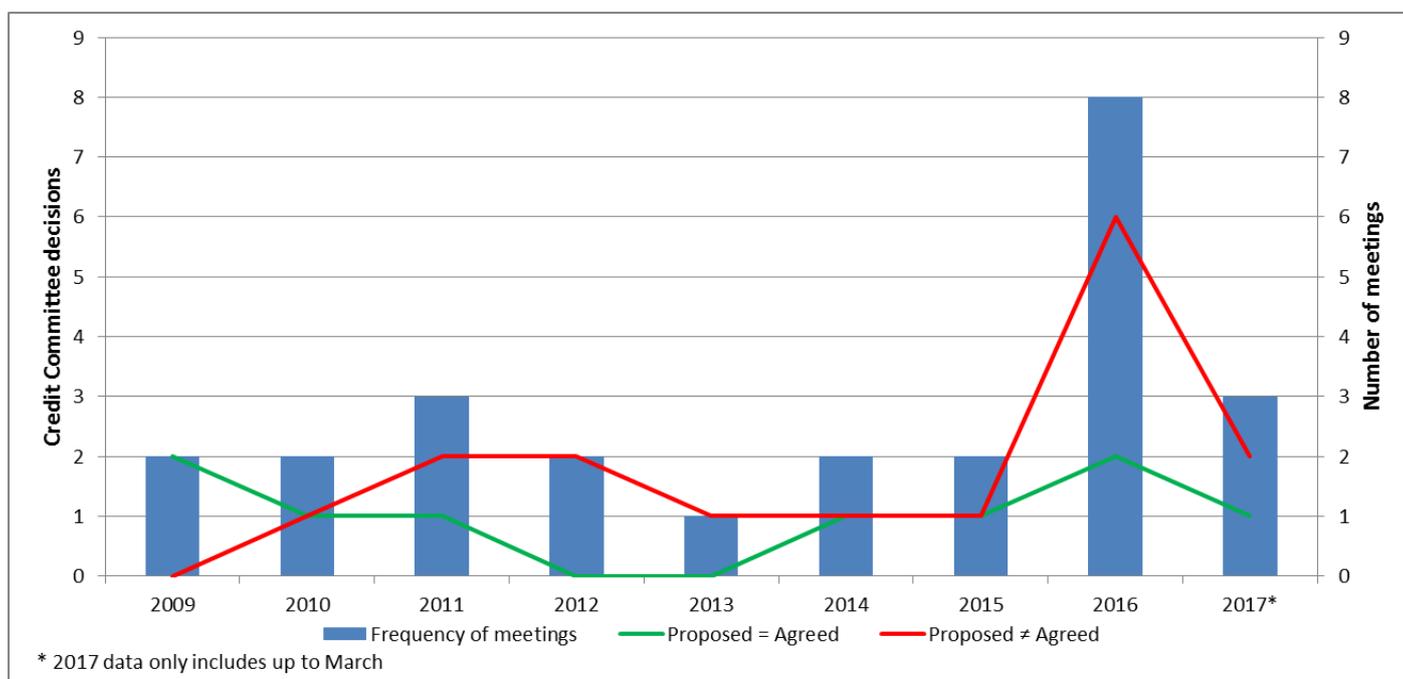
- 2.1 Currently, ELEXON performs a weekly check comparing the CAP to a reference price, which is calculated based on forward market prices taken from the ICIS report from Heren.
- 2.2 If the reference price diverges from the CAP, above or below, by a pre-determined value, the trigger level, a review of the CAP is initiated.
- 2.3 This implies sending out an ELEXON Circular with a Word format consultation to industry asking for their views on the new value of CAP for at least a week, after which we gather the Credit Committee to present the result of the consultation and the latest market prices. The Credit Committee decides on a new value which will then be communicated to the industry via an ELEXON Circular and is implemented at least 15 Working Days after.

## 3. Can the process be more efficient?

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- 3.1 Yes, some changes are proposed below to move to only holding the Credit Committee meeting when industry or Credit Committee members believe it is necessary.
- 3.2 Historically, market prices that were used to calculate the reference price have fluctuated within a certain range and only led to a limited number of breaches and reviews each year. Over the past two years, the number of breaches and, therefore, reviews, have significantly increased to the point that the Credit Committee is gathered almost on a monthly basis to decide on a new CAP. Frequently, by the time the new value is implemented, it has already breached the upper or lower trigger level, requiring another review to take place. The Credit Committee has met on 11 occasions since 1 January 2016, which is more than it met between 2011 and 2015 combined. This can be explained by volatile market conditions, seasonal variations and the change in the reference price calculation which made it more responsive to changes.
- 3.3 The graph below displays the number of meetings held each year since 2009 as well as the decisions taken by the Credit Committee to set the CAP to the same value as the one consulted on.

**Graph 1 – Frequency of Credit Committee meetings and decisions**



The below table shows, for each of the CAP reviews since 2009, the value consulted on ('Proposed CAP') and the value set by the Credit Committee ('Agreed CAP'). It also shows the difference between the two values. Apart from two occasions in 2016, the differences between Proposed and Agreed CAP values were within a £4/MWh range. This represents 97% of instances.

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**Table 1 – CAP review meetings and decisions**

Meeting date	Proposed CAP	Agreed CAP	Difference
Feb-09	49	49	0
Dec-09	38	38	0
May-10	45	45	0
Jun-10	51	50	-1
Mar-11	60	56	-4
Sep-11	59	59	0
Dec-11	52	51	-1
Jan-12	47	46	-1
Sep-12	52	51	-1
Aug-13	58	57	-1
Feb-14	51	49	-2
Sep-14	55	55	0
Jan-15	49	47	-2
Nov-15	42	42	0
Jan-16	37	38	1
Mar-16	33	33	0
Jun-16	37	38	1
Aug-16	42	42	0
Sep-16	51	53	2
Oct-16	68	98	30
Nov-16	110	106	-4
Dec-16	88	63	-25
Jan-17	57	57	0
Feb-17	52	49	-3
Mar-17	44	43	-1

3.4 Finally, for every review of the CAP, the resource requirements for ELEXON are significant with two papers to write, a consultation, a meeting, minutes, headline reports, circulars and newscast articles.

## 4. What changes could be made to improve the review process?

In order to reduce the number of meetings whilst maintaining a level of control of the CAP value, there is an opportunity to amend the review process and partly automate it.

### The consultation process

4.1 When the CAP breaches the upper or lower thresholds, a consultation would be sent to industry via an ELEXON Circular. The consultation would invite Parties to agree that the CAP should be set to the closest latest reference price value. If at least one Party thinks it is necessary, it can ask for the Credit Committee to meet and discuss a different value. The responding Parties will also be given the opportunity to suggest a CAP value for the Credit Committee to consider. If all respondents agree that the CAP should be set to the

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proposed value, the new CAP will be communicated to industry and BSC central systems for implementation in accordance with the current timescales (at least 15 Working Days after it is communicated).

- 4.2 In order to maintain an appropriate level of control over the process, Credit Committee members will also be able to call for a meeting even if all respondents agree with the proposed value. Also, Credit Committee meetings could be requested by its members and held at any point to ensure the automated CAP setting process is following its due course and that the implemented CAP values are in line with market prices.
- 4.3 A provisional implementation date will be proposed along with the new value of CAP. If the Credit Committee were to meet to decide on the CAP value, the implementation date would be changed and agreed at the meeting. It would have to follow the minimum timescale required in the CAP Review Guidance Document of 15 Working Days after the decision is communicated to industry.
- 4.4 The difference between Proposed and Agreed CAP value highlighted in Table 1 suggests that partly automating the process, with a mechanism to call for a meeting when judged necessary, will not put the industry at risk of over or under collateralisation in most instances.

## What about the trigger level?

- 4.5 As well as proposing to set the CAP at the breached trigger level value, the online consultation will suggest keeping the CAP trigger level to its current value. If the respondent disagrees, a Credit Committee meeting will be held to review it.
- 4.6 Adopting this process would reduce the frequency of Credit Committee meetings, reduce the lag time between trigger and implementation, potentially increase participation from industry when volatility increases and reduce resource required from the committee members and ELEXON.

## 5. Credit Committee recommendations

- 5.1 Having considered the proposed changes made to the CAP review process, the Credit Committee agreed on the proposed changes and suggested asking industry members for their views on the matter. A consultation proforma is included in Attachment A. Should the Panel approve the questions it includes, we will send it out for 10 Working Days. We will then bring the results back to the next Panel meeting in May including recommended changes to the [Credit Assessment Price \(CAP\) Review Guidance Document](#).

## 6. Recommendations

- 6.1 We invite you to:
  - a) **NOTE** the proposal for changing the CAP review process;
  - b) **APPROVE** the questions included in the consultation proforma regarding the proposed changes to the CAP review process.

## Attachments

Attachment A - CAP review process changes Consultation Proforma

## For more information, please contact:

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