

CC36/02 - PROPOSED CHANGES TO THE CAP REVIEW PROCESS 2017

MEETING NAME Credit Committee

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Purpose of paper For 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. Based on the Credit Committee's recommendations, we will present the chosen options to the BSC Panel at its April 2017 meeting for decision

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 have been reviewed in 2016 with some changes made to the reference price calculation and the membership condition to the Committee. Following a larger number of 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 two parts of the CAP review process:
 - To automatically setting the new CAP value to the breached threshold unless Parties request the Credit Committee to meet; and
 - To change the format of the consultation to an online questionnaire.

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 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

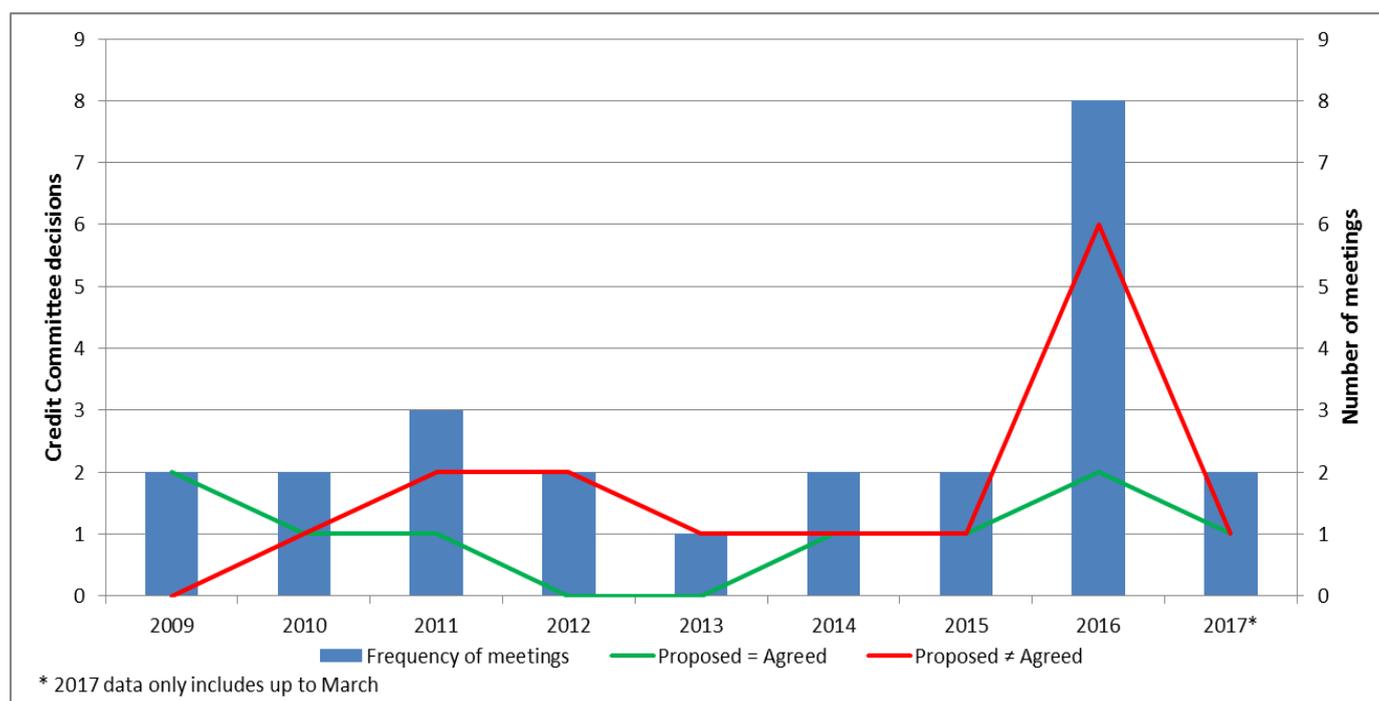
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and the latest market prices. The Credit Committee decides on a new value which will then be communicated to the industry via an ELEXON Circular and is implemented at least 15 Working Days after.

3. Can the process be more efficient?

- 3.1 Yes, two main changes are proposed below to move to an online survey for the consultation and to only hold 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 met at 10 occasions since 1 January 2016, which is as many times as 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 makes it more responsive to changes.
- 3.3 The graph below displays the number of meetings held each year since 2009 as well as the decision 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.

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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

3.4 Additionally, the fact that the consultation is only available in a word format reduces the likelihood for industry to participate. Finding a better way to collect Parties' views is essential to increase the response rate to these consultations so the industry is confident that its view is taken into consideration when setting the new CAP value as it can have an impact on its level of Credit Cover with ELEXON.

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

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 consultation process.

The consultation process

4.1 When the CAP breaches the upper or lower threshold, an online survey is sent to industry via an ELEXON Circular. The consultation will invite Parties to agree that the CAP should be set to the trigger level that was breached. If Parties think it is necessary, they can ask for the Credit Committee to meet and discuss a

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different value. The responding Parties will also be given the opportunity to suggest a CAP value for the Credit Committee to consider and if at least one Party feels that the Credit Committee should meet, a Credit Committee meeting will be held. The rule could also be amended to require a majority of respondents asking for the Credit Committee to meet for the meeting to happen. If all respondents agree that the CAP should be set to the breached trigger level, 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 The proposed CAP value could either be the breached level or the closest rounded value if the reference price has increased/decreased quickly. For example, if the upper breach is £48/MWh but, the reference price is £50.20/MWh at the time the consultation is sent, a CAP value of £50/MWh could be proposed rather than £48/MWh.
- 4.3 A provisional implementation date will be proposed as well, along with the new value of CAP. If the Credit Committee were to meet to decide on the CAP value, the implementation date will be changed and agreed at the meeting. It will 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 To make the process even more efficient, a Credit Committee meeting will be scheduled from the trigger event and cancelled if no Party objects to the suggested value. The difference between Proposed and Agreed CAP value highlighted in Table 1 suggests that 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.

Credit Committee meetings could be requested by its members at any point and held to ensure the automated CAP setting process is following its due course and that the implemented CAP values are in line with market prices.

Adopting this process would reduce the frequency of Credit Committee meetings, reduce the lag time between trigger and implementation, increase participation from industry and reduce resource required from the committee members and ELEXON.

What other changes could be considered?

- 4.6 The Credit Committee could also consider amending the process differently when the CAP goes up or down as it affects BSC Parties differently. One of the points to consider would be to adopt the automated process on the way down but keep the meetings on the way up.
- 4.7 However, depending on their portfolio, trading strategy, recent Imbalance Prices and due to the indebtedness calculation, BSC Parties may not necessarily benefit from a decrease of CAP and may benefit from an increase of CAP. Therefore, only establishing a process for one direction of change would increase or decrease the Credit requirement faster for one part of the industry compared to the other.
- 4.8 A fully automated process could be considered on the longer term where Imbalance Prices would be used as soon as available in the Credit Cover calculation, which would remove the need for a CAP. This change would require a BSC Modification and significant changes to the Credit process and systems. We recommend implemented the 'semi-automated' process first as this would only require a change to the [Credit Committee Terms of Reference](#).

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5. Recommendations

5.1 We invite you to:

- a) **NOTE** the proposal for changing the two areas of the CAP review process;
- b) **APPROVE** the usage of an online form for consulting on a CAP and trigger level change; and
- c) **AGREE** on the changes to the CAP review process to recommend to the BSC Panel for its next meeting, on 13 April 2017.

Appendices

Appendix 1 – Example of the structure of the online form proposal

For more information, please contact:

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Appendix 1 – Example of the structure of the online form proposal

This is an example of the steps the online survey could have. Responses to questions could trigger different following steps.

1. The reference price has breached the upper CAP trigger level of £52/MWh. The CAP value will be changed to £52/MWh on 21 April 2017 if unanimous agreement is received through this consultation.
2. The CAP trigger level will be maintained at its current level of +/- £5/MWh.
3. Do you believe the CAP should be set to a different value to the proposed one of £52/MWh? If yes, the Credit Committee will be convened to discuss the new value of CAP.
 - Yes
 - No (go directly to question 6.)
4. If you answered 'Yes', what value of CAP do you believe the Credit Committee should consider?
 - £..../MWh
5. Provide your rationale for the proposed CAP value:
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6. Do you think the Credit Committee should review the current trigger level value of +/- £5/MWh? If yes, the Credit Committee will be convened to discuss the new value of the trigger level.
 - Yes
 - No (go directly to question 8.)
7. If yes, what value do you think would be appropriate to set the trigger level?
 - +/- £..../MWh
8. Do you have any further comments?
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