ACER

European Union Agency for the Cooperation of Energy Regulators

Possible developments of the EU electricity forward market

MESC

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Problems

Pertaining to the EU forward markets

1. **Market fragmentation –** unequal access across the BZs
2. **Hedging disincentives –** unharmonised policies (CfDs, CRMs, …)
3. **Market structure –** high market concentration and supply/demand asymmetry
4. **Vulnerability to bidding zone reconfiguration**

Pertaining to cross-border hedging

5. **LTTRs contribute to market fragmentation** – by serving as hedging products on their own
6. **Accessibility of cross-border hedging products –** unfrequent auctioning
7. **Inadequate maturities –** not matching the participants' hedging needs
8. **LTTRs are continuously undersold –** negative risk premia
9. **Non-coordinated exemptions for TSOs to offer LTTRs –** national decisions on cross-border products

ACER preferred policy option: coordinated NRA decisions on TSOs' obligations

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1. **<u>Coordinated assessment and decisions on TSOs'exemptions</u>**

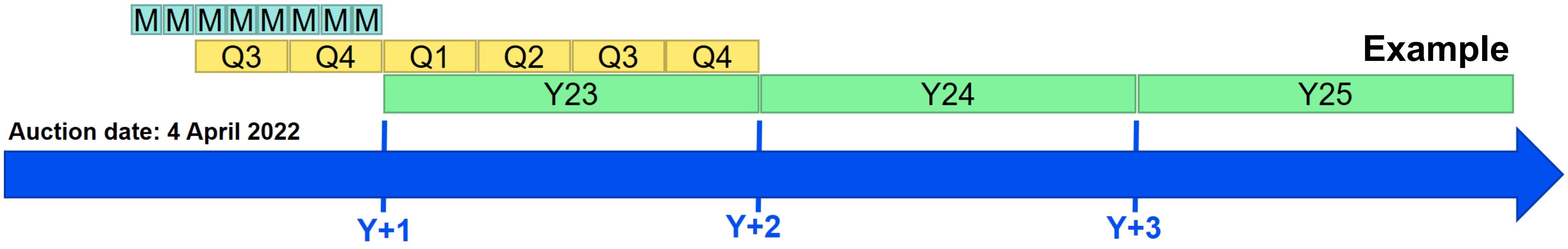
- TSOs are generally required to allocate LTTRs, however…
- …NRAs may decide that TSOs
  - (a) have equivalent measures in place; or
  - (b) are exempted from supporting the forward market, subject to assessment that forward markets work well without the TSO's support
- This option requires that NRAs in regions **jointly assess and decide** on possible exemptions for TSOs to issue LTTRs
- In case no support to the forward market is provided, an assessment is needed
- This assessment is based on a study determining the market's ability to provide such opportunities without the TSOs' support and backed by transparent and precise metrics

ACER preferred policy option: improve the allocation of capacity

2. Improved allocation

This policy option foresees that the allocation of LTTRs is improved through:

1. Longer term products (up to Y+3)
2. More frequent auction (weekly)
3. Statistical capacity calculation (based on average of DA offered capacity)
4. Continuous access to secondary market (including capacity leftovers)



ACER preferred policy option: Zone-to-Hub LTTRs

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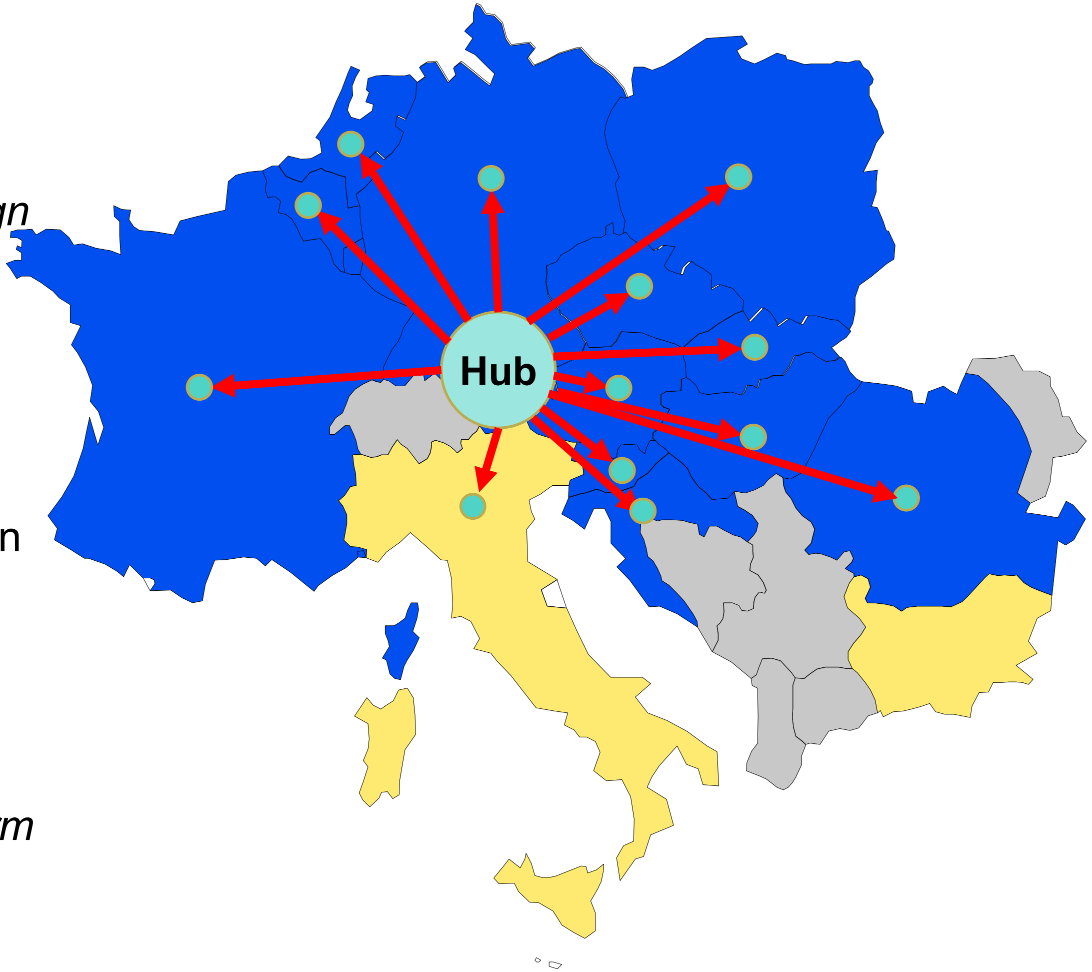
3. Zone to Hub LTTRs

1. Transition to **hub-based hedging** complemented with **accessible Z2H TRs**
   - *Transition is voluntary, implicitly incentivised with TR design*
2. Z2H TRs issued preferably as obligations.
3. Hub defined at regional (CCR) level, but two regions can form the same hub
5. A regional decision could allow for a Coupling with CfDs design (changing the counterparty from the SAP to a MCO)
2. Coupling with Z2H CfDs would require a governance setup similar as in CACM
   - *Complex, burdensome, but could be the step after this reform*



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Summary of policy options

- By default are required to issue LTTRs zone-to-hub with “improved allocation”:
  a) Towards a hub in own CCR, or
  b) Towards a hub in neighbouring CCR
- Regional alternative: TSOs/NRAs have two alternatives
  a) Support forward market in some other equivalent ways (e.g. issue CfDs instead of LTTR)
  b) Do not provide any support to the forward market (if supported by assessment showing no support is needed)
- National complement: TSOs/NRAs may complement forward market through market making
- National choice: TSOs/NRAs belonging to more than one CCR have the possibility to issue LTTRs towards one or multiple hubs

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Main benefits of the proposed hub model

1. **Pooling liquidity:** Instead of many national (illiquid) forward markets we gather all liquidity at regional hub
2. **More efficient hedge:** Hub Futures are better hedge for most zones than e.g. German Futures (better correlations)
    - this means less need for TRs to cover the basis risk
4. **Market beyond 3YA:** a hub makes the development of a market beyond 3YA a bit more likely
5. **Independent on the changes/size of zones:** Forward market liquidity is no longer a barrier to changes of bidding zones
6. **No force needed:** Power exchanges can still offer zonal Futures, MPs can still trade Z2Z TRs, yet we expect that much of the demand will switch to a hub due to Z2H TRs

Main benefits of the proposed Z2H LTTR with improved access

1. **More continuous access:** TRs auctioned daily/weekly
2. **Less fragmentation:** a single product per bidding zone
3. **More liquidity:** market participants can also sell TRs, matching inside a zone or across zones
4. **TRs support hub Futures up to 3YA:** they are needed only in case of low correlations to a hub
5. **Reduce undervaluation:** move to FTR obligations, easier valuation, regional competition, regular adjustment of offered capacity based on undervaluation

Next steps

- On 13 March, ACER organises a public workshop to present the policy paper to which several stakeholders are invited to share their views
- In its presentation, ACER will address the main elements shared by stakeholders through the public consultation
- This paper constitues ACER’s initial impact assessment for a potential recommendation of a revision of the FCA Regulation

Thank you.
Any question?

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