Market Participants views on ACER policy paper on forward market

MESC, 9 March 2023

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What we expect from the forward markets

- Forward markets should offer **efficient and effective hedging opportunities** to Market Participants and contribute to **investment incentives for a decarbonized power sector**. The goal is not to integrate market coupling like in short-term markets for flows determination.
- It is currently **sufficient to mitigate part of the exposure to short-term volatility** for a limited time horizon (1 or 2 years)
- **Better liquidity of forward market** is needed in several Bidding Zones and for longer time horizons

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Solutions to increase liquidity need to be completed

- We welcome the deeper analysis on forward markets liquidity

- Solutions proposed are still limited to Long Term Transmission Rights, are complex and/or disruptive (Zone-to- Hub FTRs obligation/CfDs) and come without a proper impact assessment

- The necessity of LTTRs is not related to the (absence of) liquidity of BZs but to the ability of Market Participants to hedge against market price spread volatility

- Drawbacks of LTFBA are pointed out without any solutions being proposed and risk to reduce liquidity

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Most of ACER preferred policy options got 21% or less of favorable opinion in the public consultation

Extract from the MESC slides of September 2022: Overall opinion of the policy paper options

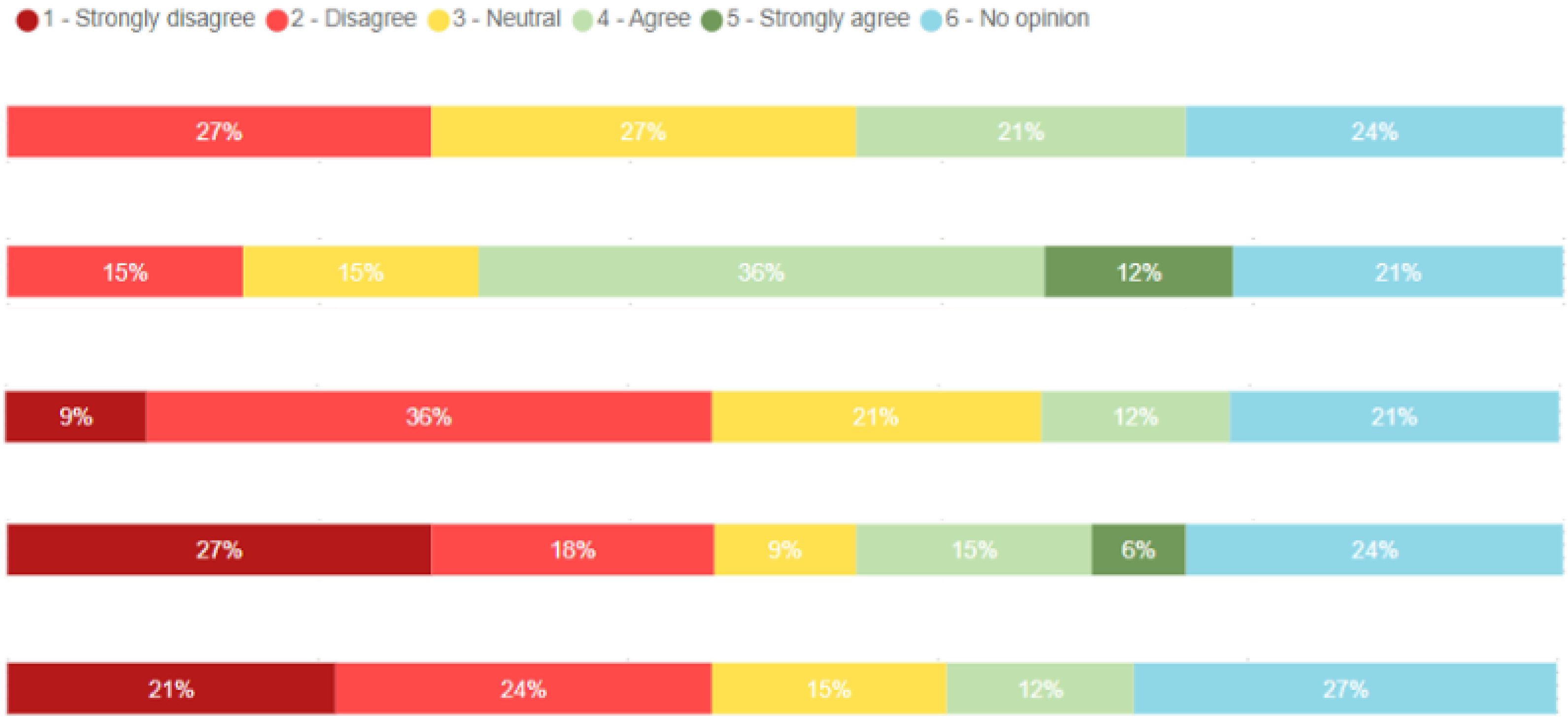
6.2 The need for intervention

6.3.2 – Option 1: increased number of allocation and product timeframes

6.3.4 – Option 3: Zone-to-hub LTTRs

6.3.5 – Option 4: Forward market coupling with CfDs

6.4 – Type of products offered by TSOs



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On the specific problems related to cross-border hedging (1/2)

ACER proposal		EFET/Eurelectric view
TSOs should by default issue financially firm LTTRs	✓	Regulators should define requirements, in line with the transmission capacities to ensure that enough LTTRs are offered, and their financial firmness guaranteed.
Improved access:		
Adequate allocation of XB capacities using statistical approach	✓	Fully support the increase of level of XB capacities. LTTRs are vital for market function and bring benefits to the system.
Undervaluation of capacities	✗	MPs bid according to their appetite in buying a protection against a spread variation. Global impact on forward market should be considered. Maximisation of congestion income should not become a TSO objective.
Longer maturities, more frequent auctions once greater volumes are made available	✓	Be careful not to add operational burden; frequency and dates of auctions should be carefully assessed and discussed with MPs.
Secondary market through continuous access	✓	e.g. having power exchanges easing the exchange of LTTRs between MPs at a price agreed between them (commercial transaction).

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On the specific problems related to cross-border hedging (2/2)

ACER proposal	EFET/Eurelectric view
Zone-to-hub model, CfDs	How liquid can a virtual hub with no fundamentals be vs. existing bidding zones with fundamentals? How to hedge the price differential between the liquid hub and each zone? Are TSOs willing to offer instruments, and in sufficient volumes? Impact assessment is needed not to jeopardise the attractiveness of forward markets.
Type of products change: FTR obligations with full financial firmness	TSOs ensure that optional products are offered: should there be a willingness to offer FTR obligations in addition to FTR options, then TSOs should allocate both obligation and option products to maximize allocation surplus
Market making with TSOs' support	Voluntary market making by PXs or on OTC markets can help boost liquidity

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Long-Term Flow-Based auction (LTFBA)

→ We strongly oppose the need to introduce competition between borders for allocation of LTTRs and remind the lack of added value

Drawbacks of LTFBA

Why flow-based in a timeframe not dealing with flows?

Current optimisation proposals will reduce capacity to little or zero at certain borders

Collateral for pan-CCR auctions will limit participation and de-optimise allocation

Way forward

Update/publication of **impact assessment** with detailed view per border of volumes allocated. If the benefit of FBA is not proven and commonly recognized, we strongly recommend to abandon its implementation.

Our recommendations to improve hedging opportunities

1.
Remove regulatory disincentives

Such as:
- Regulatory intervention that increase uncertainty e.g. Iberian price control, cap on inframarginal rents
- Specific regulatory frameworks e.g. support schemes linked to spot prices

2.
Widen collateral options

- by diversifying the types of eligible non-cash collateral
- recent EC proposal for EMIR review (Art. 46.1) is promising when it comes to easing collateral requirements

3.
Ensure FTR options are issued by TSOs in greater volumes and for longer maturities

Ensure simplicity and transparency, notably assess carefully the impact of product design changes (such as virtual trading hubs)

4.
Facilitate secondary trading of transmission rights

e.g. having power exchanges easing the exchange of LTTRs between market participants at a price agreed between them (commercial transaction)

5.
Stimulate voluntary "market making"

These services should be contracted by a market-based process, with voluntary participation

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