ENTSO-E Policy Note on Forward Markets – Hedging Analysis

ENTSO-E calls for sound economic justification to support hedging in forward markets

Key message: TSOs propose reversing the current hedging analysis approach: instead of mandatory long-term transmission rights (LTTR) issuance, National Regulatory Authorities (NRAs) should first assess hedging needs and opportunities within each bidding zone, considering both power and non-power products, before deciding upon which financial instruments to be used in order to support markets.

Introduction

The forward electricity market is a core component of the EU internal energy market. It supports price risk management, market confidence, and efficient investment signals. It also contributes to security of supply and system stability. An appropriate balance between market-based hedging and regulatory intervention is therefore required.

Transmission System Operators (TSOs) are entrusted with a public service mandate to develop and operate the transmission system in a secure and efficient manner. This role includes supporting well-functioning markets without distorting them. This responsibility must be recognised at European level. ENTSO-E and its members therefore have a duty to inform policy makers about the feasibility, costs, and consequences of regulatory choices affecting forward markets and hedging arrangements, and to challenge approaches that may undermine market efficiency or increase costs for end consumers.

Within this context, ENTSO-E proposes revising Article 30 of the Forward Capacity Allocation (FCA) Regulation[1] and introducing a new approach to long-term hedging. Therefore, the objective is to address the identified issue of allegedly insufficient hedging opportunities in a more targeted and effective manner, rather than relying by default on long-term transmission rights (LTTRs). LTTRs and other equivalent measures should be treated as regulatory interventions whose necessity and effectiveness must be demonstrated, as their systematic application can create additional costs on certain borders without clear benefits in terms of hedging.

Status Quo – Process and Problem Description

Currently, the Forward Capacity Allocation Regulation (FCA) aims to support forward electricity markets for price risk mitigation (hedging), with TSOs offering LTTRs, mostly as financial transmission rights (FTRs). However, TSOs argue that cross-zonal hedging should complement—not replace—zonal forward markets and should be based on actual market needs rather than default provisions. TSOs propose reversing the current approach: instead of mandatory LTTR issuance, National Regulatory Authorities (NRAs) should first assess hedging needs and opportunities within each bidding zone, considering both power and non-power products. Based on this assessment, authorities would then decide on introducing LTTRs or other market-based measures to improve hedging opportunities.

[1] Commission Regulation (EU) 2016/1719 of 26 September 2016 establishing a guideline on forward capacity allocation (FCA Regulation

TSOs thus propose not to offer hedging products simply for the reason of being owners of interconnector capacity, but to analyse the market fundamentals for both zonal and cross-zonal hedging and to assess the demand for hedging in the first place.

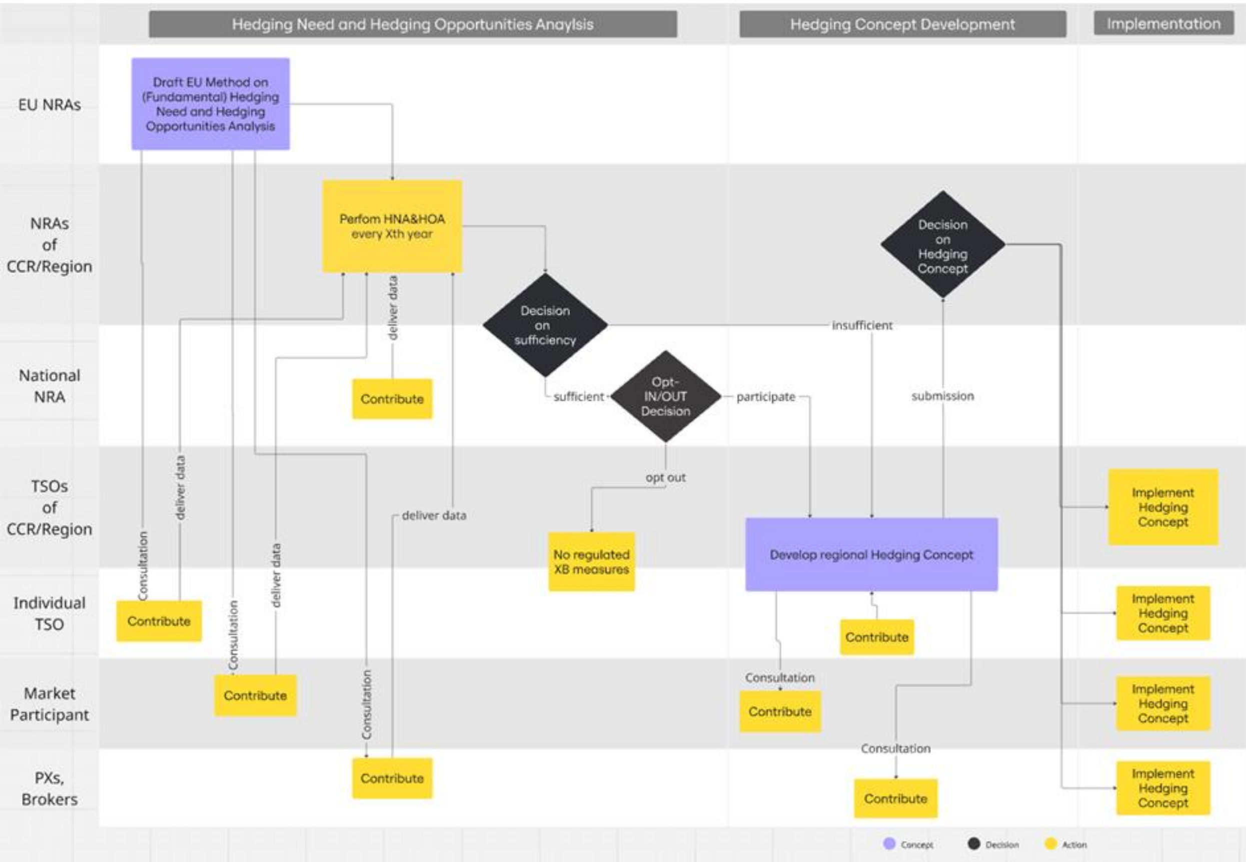
To support market participants' hedging in long-term markets, NRAs should establish a harmonised method for analysing both hedging needs and existing hedging opportunities. This analysis will guide decisions on whether additional support from TSOs or regional hedging concepts is required.

Proposed Changes to Art. 30 – Regional Hedging Concept

To develop a proper concept to support the hedging of market participants in long-term markets, a recurring analysis of both the hedging needs and the existing opportunities needs to build the starting point.

Therefore, the NRAs should draft a harmonised method for these two analyses, also defining the roles and responsibilities for its conduction further (see diagram below). The decision (marked with black diamonds in the diagram) of the individual NRA on the need to further support the market with the help of TSOs and on the participation at the regional hedging concept should be based on this analysis.

The process is proposed to be based on six distinct steps; (1) The hedging needs analysis, (2) The hedging opportunities analysis, (3) An effectiveness and sufficiency valuation, (4) The NRA individual decision to opt-in or opt-out, (5) TSOs proposal for a (regional) hedging concept and (6) the decision on a regional hedging concept by regional NRAs.



The Hedging Needs Analysis quantifies what market participants require, while the Hedging Opportunities Analysis evaluates current possibilities using key performance indicators (KPIs) such as market liquidity, proxy hedging, and cross-zonal measures (e.g., LTTRs and EPADs – Electricity Price Area Differentials). In addition, hidden barriers and disincentives to hedging shall be evaluated. The results of these analyses should be published in an EU-wide report.

Three complementary approaches are proposed for assessing hedging needs:

- **Fundamental analysis**, based on factors such as production data and hedging ratios.
- **Market equilibrium approach**, comparing expected net trade flows to hedging volumes.
- **Market surveys**, capturing participants' preferences.

Based on these analyses, each individual NRA decides if existing opportunities suffice and whether to join the regional hedging concept development. Opting out of one NRA does not prevent other TSOs/NRAs from proposing/deciding on a cross-border product in the regional hedging concept towards the bidding zone that opted out, taking over the financial responsibility for it.

Hedging concepts should be regional (not national), aligned with FCA measures (e.g., LTTRs and EPADs) and additional tools such as market making. Regional TSOs draft the concept and shall propose measures, including those outside the regulatory scope, provided they do not increase costs for grid customers. Regional NRAs approve measures within the hedging concept and the estimated implementation plans.

After NRAs' final approval of the hedging concept, TSOs update the implementation plan. Relevant actors shall then implement the approved measures and consider the recommended measures if any.