

25 August 2020

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Commission for the Regulation of Utilities  
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Utility Regulator  
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Dear Rory and Gary,

**RE: Market Power and Liquidity Discussion Paper – SEM-20-045**

We refer to the above discussion paper and provide these comments in the context of a broker arranging forward power contracts in the ISEM market.

Our comments are based on our observations of the bidding and offering behaviour of market participants, particularly around the time when the Directed Contracts process is underway and market participants' discussions with us, as to the barriers which are preventing their companies from increasing the number/amount of forward power contracts which they can transact.

Marex Spectron Europe commenced voice and screen broking of ISEM Contracts for Difference (CFDs) just over a year ago and to date twelve counterparties have signed up to use the service and eleven companies have traded on the screen. We are seeing between 10 and 25 CfDs transacted each month with trades completing for the Front-Month out to Winter 2021. Notwithstanding the above, we estimate the total volume of power traded in the forward OTC market is somewhere between 10% and 20% of total demand which is very low compared with other European<sup>1</sup> markets. However, we see no reason why liquidity couldn't develop to levels experienced in other European markets of similar scale.

In overall terms, we believe the single most effective measure the SEM Committee could take to improve liquidity in the forward market is to start measuring and publishing the amount of CfD trades that are transacted in the forward market as this will provide a 'baseline' liquidity level. As CfD trades must be reported to financial regulators under EMIR legislation, we think it should be possible for this data to be made available to energy regulators. Given the number of participants active in the generation, trading and retail market on the island, we believe it should be possible to achieve a churn rate of at least 1.0<sup>2</sup> in the forward market. We think that statistics about the level of CfD trading need to be published by the SEM committee on a regular basis, in a similar

<sup>1</sup> The following publication by Ofgem indicates that between 200% and 300% of electricity is traded in the forward market in GB: <https://www.ofgem.gov.uk/data-portal/electricity-trading-volumes-and-churn-ratio-month-and-platform-gb>

<sup>2</sup> Expressed as the volume traded under forward contracts divided by all-island electricity demand.

manner to Ofgem<sup>3</sup>. The publication of churn rates for forward trading will provide a framework for the SEM Committee to set targets for liquidity in the forward market.

Our experience is that the Directed Contract (DC) process is hindering liquidity developing in the forward market as it acts as a distraction in the traded market for a two to three week period every three months and there is usually a major price dislocation between DC prices and prices offered in the market (the price dislocation can either be positive or negative). The current DC process therefore confuses the market price for power and reduces the volume that could be traded on the OTC market as both the buyers and sellers of DC volumes are uncertain as to whether volumes will be allocated through the DC process. As a result, the volume of power offered in the DC process is substantially reducing the volume of power that could be traded in the OTC market. It is our view that electricity suppliers would have a greater incentive to trade CfDs either on a screen or bilaterally in the absence of the DC process and therefore a liquid forward market in electricity CfDs will not develop fully while the DC process continues.

Based on the above analysis, our recommendations to improve liquidity in the forward market are as follows:

1. The SEM Committee should set a target churn rate for the forward market that it would like to see achieved.
2. The SEM Committee should collect and publish data on the quantity of CfD trades that are transacted each quarter and compare this to its target churn rate.
3. The SEM Committee should suspend the Directed Contract process for a two-year period and monitor how liquidity grows in the market. If liquidity is not growing in the market, then the SEM Committee should consider a regulatory intervention such as the DC allocation process or competitive auctions. If the SEM Committee views that suspending the DC process is too much of a step change in the development of the ISEM at this stage, we recommend the SEM committee reduces the volumes available in the DC process to zero over a two-year period to give market players time to adjust their trading strategies.

We would be happy to discuss any of the above points with you at your convenience.

Yours sincerely,



Martin Regan  
Head of Energy Sales

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<sup>3</sup> <https://www.ofgem.gov.uk/data-portal/electricity-trading-volumes-and-churn-ratio-month-and-platform-qb>