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Fostering an effective Irish forwards market

EEX's comments on the SEM Committee discussion paper on Market Power and Liquidity

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1. Introduction

The European Energy Exchange (EEX) appreciates the opportunity to comment on the SEM Committee's Market Power and Liquidity Discussion Paper and share the experience we have accumulated in operating power and commodity markets globally for 20 years.

Having supported the regulation of power markets across Europe since the liberalization of the EU energy market, we strongly agree with the SEM Committee approach to limit regulatory interventions and allow the market to develop organically.

EEX has been following the development of the Irish power market since its sister companies EPEX Spot and ECC successfully supported the Irish TSOs EIRGrid and SONI in setting up SEMOpx in 2017. Moreover, as Ireland auctions its emission allowances on the EEX platform, EEX is familiar with many Irish market players active in the EU ETS, which also happen to trade in the power market.

Our comments to the SEM Committee's Market Power and Liquidity Discussion Paper will focus on the "Forward Contracting and Liquidity" questions, where we feel we can contribute to SEM's Committee reflections with our experience from other markets, as well as suggesting concrete ways of creating greater forward contracting opportunities.

EEX will be pleased to meet with the SEM Committee at their earliest convenience to share our experience with running power markets globally and offer our help to further grow the Irish power market.

2. Answers to the questionnaire

vii. In the event of no regulatory interventions regarding forward contracting in SEM, how do market participants envisage the forwards market for SEM evolving in the short, medium and long term?

Connection to other markets and targeted product development is key. Although EEX is obviously no market participant, we believe a stronger connection to other European power markets would greatly support liquidity in the SEM. Also, the introduction of forwards products meeting market participants' needs contributes significantly to a market's success. In the below we outline how we see the future development of the Irish market, based off the success of other markets such as Spain.

Trusted long-term price signals. The degree to which a power market is successful in supporting economic growth is measured by the reliability and trustworthiness of its price signals. Long-term power prices are necessary to provide market participants visibility to plan their investments as well as effective benchmarks to base their hedging strategies on. Neutral und trusted marketplaces, such as power exchanges, are an appropriate partner to provide such transparent price signals by channeling supply and demand.

Uncovering the continental European power markets success story. From our experience, the success story of the European power markets is based off the valuableness of relevant power prices and sound hedges to market participants. That can be replicated by the Irish market.

More and more market actors have entered the continental power markets over the years because 1) they can access better prices (made possible by the competition between many market players) and 2) they are provided with a set of products that take better care of their business needs.

For instance, products with different time horizons allow customers to hedge in the short as well as in the long term, with initial liquidity being concentrated around monthly, quarterly and yearly products on our markets.

Base	Peak
Year	Year
Quarter	Quarter
Month	Month
Week	Week
Days	Days

Figure 1: Long- and short-term maturities on EEX

Such developments have allowed in particular the German market to become the reference point for all power markets in Europe.

The most recent example. Ireland could profit from the lessons learnt from a more recent success story: the Spanish power market. That market was relatively small back in 2015 and mainly over the counter, until EEX introduced more competition across energy exchanges by offering products meeting Spanish market participants' demands. That attracted international market participants and moved much of the trading volumes to the cleared market. As such, Spain has been able to grow its power trading volumes substantially over the past five years.



Figure 2: Volumes growth in the EEX Spanish power market, 2015-2020

From longer to shorter maturities. With growing liquidity, the needs of market participants for more flexible risk management tools develop as well.

For instance, in the Spanish market, futures contracts with monthly, quarterly and yearly expiries were introduced initially in 2015 to address the needs of market participants to hedge longer term price risks.

Once liquidity started to rise, the available product range was extended by introducing short-term futures like weekly and daily contracts. The number of tradeable maturities was also extended to allow market participants to hedge price risks up to 6 years in the future. This will be even further extended in 2020 and 2021 to allow hedging up to 10 years ahead.

Options. Depending on the maturity of the futures/forward market, the product suite for futures contracts may be accompanied by corresponding option contracts, to provide market participants with additional risk management tools for more sophisticated hedging strategies. Furthermore, the share of anonymous and transparent order book trading could increase with liquidity, compared to bilateral or brokered trade registrations.

Products that help market participants and liquidity pooling across markets. The availability of a set of hedging solution that suits the needs of the market participants is key to foster liquidity in power markets. Also, the connection to market participants based across Europe and beyond can further foster liquidity by providing access to more liquidity pools.

For instance, a marketplace provider such as EEX operates several markets, offering simple access to new markets and products to an existing, global client base. That goes hand in hand with a growing number of active participants that contribute to the joint liquidity pool.

Ultimately, the overall process efficiency of power trading can be improved, e.g. by reduced transaction costs through better bid-ask spreads. The difference between the best bid price and the best ask price

is commonly understood as an indicator of a market's liquidity level, as it represents the costs to open and close a position without a changed market price.

Making power markets resilient through clearing. Alongside liquidity, resilience is a fundamental enabler of markets' success. European legislation codifies the role clearing houses shall play to safeguard the integrity of the economic and financial system.

Successful markets also feature registration and clearing services for market participants, which guarantee the successful and safe finalization of transactions. Clearing becomes even more of a necessity amid the credit risk the COVID-19 pandemic has brought, and its effect in particular on financial funding of assets as well as the fulfilment of closed contracts (such as bilateral power purchase agreements).

Linking the spot and derivatives market. Hedging solutions traded on the derivatives market are based on the underlying spot market, which already successfully cleared by ECC in Ireland. Providing a direct link between the spot and the derivatives market is key to enable both financial and physical focused market participants to successfully manage their market risks.

Physical fulfillment is offered in other established power markets: when a weekly or monthly future expires, holders of a future position can decide to turn the financial contract into a physical one on the related spot market. If the respective market operator is active in both markets, e.g. EPEX Spot for the spot market and EEX for the derivatives market, market participants can benefit from further efficiency such as reduced conversion fees.

viii. What actions could be taken by market participants to create greater forward contracting opportunities? Is there scope for natural growth or innovation in the forwards market, and if so, how can this be progressed? Can renewable supported generators offer hedges?

Connecting to other markets. Connection to other European markets offers the SEM large margins to further grow. The listing of Irish power products on an international trading platform for more market participants and brokers to trade and register transactions for clearing would grant the Irish market access to huge liquidity across Europe.

For instance, Irish Power Futures could be added to a global trading and clearing platform such as EEX, whereby existing EEX members could get immediate access to the Irish power market and brokers could register transactions in such products for clearing.

A high-standard technical solution is key for new market players to enter the Irish market. Trading screens by trading technology provider Trayport can be adjusted to feature Irish power.

Spread products. Spread products to other power markets could link independent orderbooks and increase liquidity in both involved markets. For instance, a spread between Irish and UK Power could be introduced to enable further hedging solution for clients active in both markets.

Markets powering renewable energy expansion. Ireland has long been a European leader in renewable energy, particularly in wind energy, with over 4 GW of installed capacity. Renewable energy

is already competitive with fossil fuels power plant around the globe and it can further be supported by meaningful markets.

Futures markets can effectively sustain renewable energy expansion in Ireland by offering reliable hedges to renewable energy operators. EEX currently offers the possibility to hedge for as many as six years into the future, which we are currently extending to 10 years. This helps clearing PPA contracts on the exchange by improving the reliability of hedges, for instance for wind farms, as the individual counterparty risk is mitigated by the exchange and a daily, transparent, price assessment is available for the single maturities.

The final touch: clearing as gate to greater liquidity. The measures stated above will lead to more market participants entering the market, steering higher trading volumes and in turn growing the attractiveness of the marketplace. This comes with the need for market participants to hedge their deals against a trusted third party which also ensures the correct administration of transactions.

Such third party, in the European financial markets is called a Central Counterpart (CCP). If market participants choose to register trades on a power exchange or to directly trade in the order book, their deals are automatically hedged against a CCP represented by the responsible clearing house (for instance ECC). Hence, the presence of a CCP allowing cleared business enables access to the much larger liquidity pool of a power exchange (compared to bilateral exchanges), which again attracts new market participants to join – “liquidity follows liquidity”.

It is for this specific reason that in Spain the ratio of cleared against uncleared volumes moved from less than 50% to almost 100% over the last five years.



Figure 3: Development of cleared/uncleared volumes in the Spanish power market, 2015-2020

ix. On what public interest grounds should the SEM Committee decide to intervene in the forwards market in the future? In the event that the SEM Committee decide to intervene in the future, what impacts should be considered prior to intervening in the market?

Regulatory interventions should be performed only to correct clear manipulations of market dynamics such as excessive market power by some participants. What is more important is ruling out market distortions that can in turn affect the effectiveness of forwards markets.

Subsidies. Well-functioning power markets are the most efficient basis for the market integration of increasing shares of renewables. Market parties can trade highly granular products very close to delivery, and thus accurately balance forecast errors and properly handle generation ramps. Transparent price signals and the possibility to trade ever closer to real-time across coupled markets in Europe have allowed increasing amounts of renewable energy, in particular variable sources like wind and solar, to be efficiently integrated into the system whilst ensuring production and consumption needs are met at all times.

Market-based mechanisms for renewables support, such as direct marketing and tendering, will remain the most cost-effective instruments. Risk management tools sustaining renewables' increasing exposure to markets are already available, such as exchange-based hedging options.

Rather than falling back to direct subsidies, the Irish public administrations should build on these achievements and focus on fully implementing the Clean Energy Package requirements to foster market-based renewable energies' integration into the power system. This would both prepare the European economy to the future of the energy sector and promote economic development through investments in clean jobs.

Regulated prices. Regulated prices harm meaningful price signals. Abolishing counterproductive regulated prices represents a critical milestone towards making price signals meaningful. This will both facilitate the development of the Irish power market towards climate resiliency, as well as spurring market competitiveness for economic resurgence after the pandemic.

By way of an example, the ARENH regulated tariff in France allows electricity suppliers access to energy produced by EDF's nuclear power plants at a price of €42/MWh in France. As electricity demand has decreased sharply during the COVID-19-induced lockdown, electricity market prices have fallen largely below the ARENH price. This has prompted alternative electricity suppliers who had contracted power from EDF to require their contracts to be discontinued.

ARENH is a clear example of the inflexibility of regulated tariffs, something that will go against the correct development of the internal market and the economic recovery. Ruling out regulated prices increases liquidity and reinforces the price signal on the power market, to the benefit of Irish consumers.

Carbon markets as underlining power market enabler. Along an effective and sensible regulation of the power market, carbon markets are a critical complimentary set-up supporting the development of the power market itself.

The EU ETS, in fact, provides one single carbon price across industries, delivering transparency and long-term visibility to businesses and policymakers alike. The more effective the ETS as a system gets, the more relevant its price is for investors and market participants alike. An extended and more comprehensive ETS would benefit Ireland and its power market, especially in the context of the designing and execution of recovery plans.

3. About

The European Energy Exchange (EEX) is the leading energy exchange in Europe which develops, operates and connects secure, liquid and transparent markets for energy and related products. EEX is part of EEX Group, a group of specialised companies providing market platforms for energy and commodity products across the globe.

The offering of the group comprises contracts for Energy, Environmentals, Freight, Metals, Natural Gas and Agricultural. The group offers market access and tailor-made solutions to trading participants as well as integrated process handling with its own clearing houses. The companies belonging to the group are specialised for the different markets and provide on-site support for their customers.

EEX Group consists of the trading venues European Energy Exchange (EEX), EEX Asia, EPEX SPOT, Power Exchange Central Europe (PXE) and Nodal Exchange as well as the registry provider Grexel Systems and the clearing houses European Commodity Clearing (ECC) and Nodal Clear. EEX Group is based in 17 worldwide locations and is part of Deutsche Börse Group.

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