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# EFET reaction to DNV GL study on impact of BZR on liquidity and transaction costs

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# Preliminary statement

- We highly welcome the efforts of ACER to improve the general understanding of how to capture elements of market efficiency in the context of BZR
- The DNV GL study is an excellent starting point to incentivise TSOs to properly quantify the effect of BZR on market liquidity and identify appropriate metrics

# Principal concerns with the study

- Metric used to calculate changes in risk premiums, which leads to the conclusion that liquidity losses have only redistribution effects and do not affect welfare.
- Hasty analysis of the interaction between liquidity and competition losses vs. potential cross-border transmission capacity availability in the general context of market participants' ability to hedge positions and enter into transactions

# Assessing impact of liquidity losses on market efficiency and social welfare – the metric

- Risk premiums can be assessed only *ex-ante* at the time of the hedging decision:  
*price of energy at the time of transaction (forward) minus expected price of energy in DA at the time of the transaction (forward) + transaction costs (broker/PX fees + margining/clearing)*  
*+ hedging instrument for cross-border hedging, as the case may be*
- Risk premiums constitute a cost for both parties involved in a hedging transaction. Therefore, increases in risk premiums constitute a net welfare loss
- Whether a forward transaction turned out to be a profitable deal compared to a similar one in DA gives no indication of the actual cost of hedging, or the overall welfare effect in the market
- Stating that liquidity losses do not increase the cost of trading unless competition dwindles is wrong. Liquidity losses create a welfare loss as such, worsened when competition drops
- Alternative ways of calculating change in risk premiums: changes in bid-ask spreads

# Liquidity and competition losses vs. possible increases in XB capacity – digging deeper in MPs' ability to hedge and trade

- We are, of course, supportive of seeing XB capacities increase and making the maximum of such capacity available to the market
- However, increased XB capacities do not necessarily compensate for liquidity losses:
  - Liquidity losses lead to competition losses
  - Price convergence in DA says little about convergence (and ability to hedge) in forward or local ID
  - Cross-border capacity increases after a BZ split need to be assessed in comparison to the overall ability of market participants to trade before the split, within and beyond the previously joined markets
- Considering that liquidity and competition losses are automatically and equally compensated by XB capacity increases is an opinion, not backed by proper analysis

# Liquidity and competition losses vs. possible increases in XB capacity – lessons from practical experience

- 2018 DE-AT split
  - Significant bid-ask spreads (when bids are present at all!) and reduced competition on the Austrian forward market remain
  - Unpredictable DE-AT price spreads
  - High level of XB capacity (guaranteed by redispatch agreement) cannot compare with previous unlimited ability to hedge and trade between AT and DE
- 2011 Swedish zone split
  - Dwindling liquidity of the futures market
  - Dwindling liquidity of cross-border hedging instruments (EPADs) between the zones
  - Low intraday market liquidity
- DA price convergence generally observed in Sweden, more infrequently between DE/AT: no indication that the welfare losses incurred due to the lack of forward liquidity (including across the borders of newly separated zones) are compensated in any manner.

# Recommendations

- Take due consideration of the forward timeframe in assessing market efficiency: while dispatch efficiency concentrates on DA operations, **the forward timeframe is important for the analysis of market efficiency** (majority of trade volumes, all hedging activities)
- Use a **metric that captures properly the cost of trading and hedging** for the analysis of welfare effects of changing liquidity in the forward timeframe: the bid-ask spreads
- Carry out further analysis of the **impact of liquidity changes on the efficiency of intraday and balancing markets**
- Properly compare the effects of liquidity and competition losses on the one hand, and that of possibly increasing XB transmission capacity on the other hand, based on **MPs' overall ability to hedge and trade**, and taking account of lessons from past BZ redelineations
- Analyse and quantify the **evolution of competition levels in individual markets post-BZ redelineation**. Such quantifications of liquidity, competition and other market efficiency indicators should allow a balanced comparison with dispatch efficiency indicators, with the objective of reaching an optimal BZ configuration for both market and system

[secretariat@efet.org](mailto:secretariat@efet.org)  
[www.efet.org](http://www.efet.org)

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