ACER

European Union Agency for the Cooperation of Energy Regulators

Policy paper

on further development of the

EU electricity forward market

MESC, 1 June 2022

Insert Sensitivity Marking

Further development of the EU electricity forward market

Process

1. January – February: Drafting of the policy paper
2. 1 June – 31 July 2022: Public consultation
3. 6 July 2022: Public workshop
4. June – September 2022: Finalisation of the policy paper
5. October - November 2022: Approval and publication
6. October – December 2022: Scoping of the amendment to FCA Regulation
7. January – December 2023: Recommendation on amendment to FCA Regulation

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Key objectives

1. Facilitate sufficient forward hedging opportunities
2. Each market participant should be able to hedge its exposure:
   (a) **effectively (objective 1)**, in the sense that the available hedging products:
      i. can provide effective hedge against the risk;
      ii. for each bidding zone (regardless of its size); and
      iii. in all timeframes ahead of delivery; and
   (b) **efficiently (objective 2),** in the sense that hedging products are available:
      i. at competitive prices (low bid-ask spread, low risk premium); and
      ii. in a way that is efficient for market participants to contract them.

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Identified problems

Identified problems of existing forward markets in EU

1. Problem 1: Low liquidity in small bidding zones – unequal market access
2. Problem 2: LTTRs are competing with zonal energy forwards/futures – split of liquidity
3. Problem 3: There is no secondary market for LTTRs – they can't be acquired at any time
4. Problem 4: Forward market is a significant barrier for bidding zone reconfiguration
5. Problem 5: LTTRs are issued only for one year ahead
6. Problem 6: PTRs/FTRs options offer only one sided hedge
7. Problem 7: LTTRs are continuously undersold – prices generally below expected market spread
8. Problem 8: Non-coordinated assessment and decisions of NRAs on when TSOs may not intervene

Policy options

No regrets

1. **Equalize CNTC and FB requirements in all timeframes**
   - Flow-based should become a standard in all timeframes
   - CNTC can be used in cases where there is no interdependence between borders
   - Already a fact on the field
2. **Introduce monthly products at 1YA auction**
   - Yearly PTR/FTR auction currently allocated only yearly baseload
   - To add 12 monthly baseload products at yearly auction

Policy options

Category 1: Should regulators (continue to) intervene?

Option 1.0: **Status quo: Regionally different approaches**

- Not solving Problem 8: Non-coordinated assessment and decisions of NRAs
- Legally feasible, but not preferred

Option 1.1: **Coordinated assessment and decisions on hedging opportunities**

- Largely solving Problem 8: Non-coordinated assessment and decisions of NRAs
- **Legally feasible and preferred policy option**

Option 1.2: **Mandatory TSOs' involvement:** Not compliant with Article 9(1) of Regulation 943/2019

Option 1.3: **No regulatory intervention:** Not compliant with Article 9(1) of Regulation 943/2019

Category 2: Type of TSOs' intervention

Option 2.0: **Status quo: Bidding zone border LTTRs**

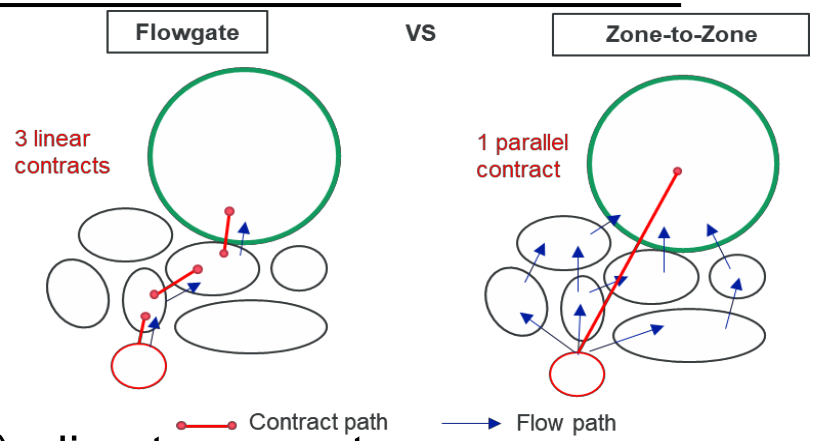
- LTTRs possible only on bidding zone borders
- All the identified problems remain

Category 2: Type of TSOs' intervention

Option 2.1: **Improved allocation and product timeframes**

- Introduce 3YA, 2YA 1YA allocation timeframes and products
- Introduce more frequent auctions: M auctions with Y products, W auctions with M products
- Introduce continuous/secondary market
- The problem of capacity calculation: statistical approach
- The problem of splitting of capacities between timeframes
- Can address Problem 5 (inadequate maturities)
- Indifferent to other problems

Policy options

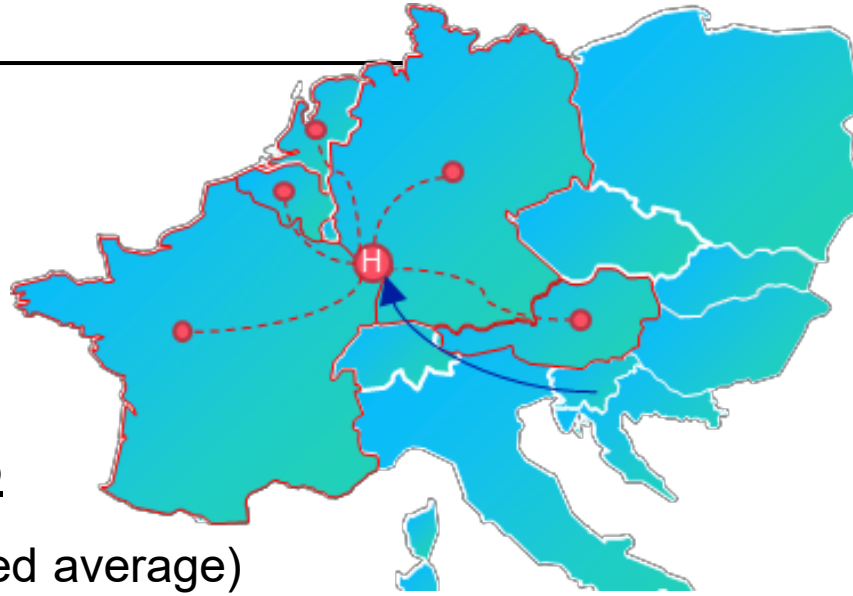


Category 2: Type of TSOs' intervention

Option 2.2: **Zone-to-zone LTTRs**

- LTTRs possible between any two bidding zones
- Can partly address Problem 1 (discrimination of small bidding zones): direct access to more bidding zones
- Can partly address Problem 7 (underselling of capacities): more competition between bidding zones
- Can worsen Problem 3 (no continuous/secondary market): more fragmentation of products
- Does not address other identified problems
- While the additional Z2Z feature is supported, this option in overall is not preferred

Category 2: Type of TSOs' intervention



Option 2.3: **Zone-to-hub LTTRs (1)**

- All LTTRs are issued from a zone to a common hub
- Bidding can be Z2Z or Z2H, in case of Z2Z the holder gets **FTR combo**
- Hub price defined as aggregation of several bidding zones (e.g. weighted average)
- Can address Problem 1 (discrimination of small bidding zones): Small zones can build a common forward market linked to a hub which can become more liquid, big zones can still rely on existing zonal futures market if already liquid
- Can address Problem 2 (hampering forward markets): Z2H FTRs do not eat away the liquidity in small zones – they strengthen the hub liquidity

Category 2: Type of TSOs' intervention

Option 2.3: **Zone-to-hub LTTRs (2)**

- Can partly address Problem 3 (no continuous/secondary market): Z2H FTR obligations are financially equivalent to CfDs and market participants can resell them at PXs as CfDs without incurring any risk
- Can address Problem 4 (barrier to bidding zone reconfiguration): reconfiguration of bidding zones does not hamper the forward market liquidity concentrated at a common hub – price of such hub largely unaffected
- Can partly address Problem 7 (underselling of capacities): more competition for LTTRs between zones, but still relies on explicit auctioning and may not address the problem entirely
- **This option is among the preferred policy options**

Category 2: Type of TSOs' intervention

Option 2.4: **Forward market coupling with CfDs (1)**

- Products are standardised CfDs offered by PXs/NEMOs in each biding zone: Y, Q, M
- TSOs provide long term cross-zonal capacities
- Market coupling operator organise market coupling by simultaneously matching CfDs and cross-zonal capacities at yearly, monthly and weekly auctions + continuous trading in between (with capacity leftovers without pricing)
- Implicit allocation of long term cross-zonal capacities
- Relies on liquid forward market at the hub
- Able to unify market model across EU (Continental vs. Nordic)

Category 2: Type of TSOs' intervention

Option 2.4: **Forward market coupling with CfDs (2)**

- Can address Problem 1 (discrimination of small bidding zones): Same as Option 2.3
- Can address Problem 2 (hampering forward markets): Same as Option 2.3
- Can address Problem 3 (no continuous/secondary market): Relies on PXs to facilitate trade with CfDs, which can be done based on auctions as well as continuous trading
- Can address Problem 4 (barrier to bidding zone reconfiguration): Same as Option 2.3
- Can address Problem 7 (underselling of capacities): more competition for cross-zonal capacities and implicit auctioning is always more efficient than explicit auctioning
- **This option is among the preferred policy options**

Category 2: Type of TSOs' intervention (2)

Option 2.5: **Forward market coupling with Futures (1)**

- Products are standardised Futures offered by PXs/NEMOs in each biding zone: Y, Q, M
- TSOs provide long-term cross-zonal capacities
- Market coupling operator organise market coupling by simultaneously matching Futures and cross-zonal capacities at yearly, monthly and weekly auctions + continuous trading in between (with capacity leftovers without pricing)
- Implicit allocation of long term cross-zonal capacities
- Does not require on any new products or hubs
- Unlikely to be suitable for Nordic region – market design remains non-unified

Category 2: Type of TSOs' intervention

Option 2.5: **Forward market coupling with Futures (2)**

- Can address Problem 1 (discrimination of small bidding zones): Same as Option 2.3, 2.4
- Can address Problem 2 (hampering forward markets): Same as Option 2.3, 2.4
- Can address Problem 3 (no continuous/secondary market): Same as Option 2.3, 2.4
- Can partly address Problem 4 (barrier to bidding zone reconfiguration): Same as Option 2.3, 2.4, but less suitable to very small zones, nodes, nodal pricing
- Can address Problem 7 (underselling of capacities): Same as Option 2.3, 2.4
- **This option is among the preferred policy options**

Category 2: Type of TSOs' intervention (2)

Option 2.6: **Market making (1)**

- TSOs organise a tender for market making function
- Selected market makers are obliged to facilitate order books for forward products at PXs (Futures, CfDs)
- They will charge a fee for this service which is covered from network tariffs
- The financial risk for TSOs is limited by the tendering outcome
- Can address Problem 1 (discrimination of small bidding zones): except in case of structural lack of generation or consumption
- Can address Problem 2 (hampering forward markets): supports forward market without hampering it

Category 2: Type of TSOs' intervention

Option 2.6: **Market making (2)**

- Can address Problem 3 (no continuous/secondary market): facilitates secondary market
- Does not address Problem 4 (barrier to bidding zone reconfiguration): if a bidding zone relies on zonal futures, reconfiguration is still a problem
- Can address Problem 5 (Problem 5 - inadequate maturities): market makers can facilitate order books with longer maturities, but they may charge higher fees
- Can address Problem 7 (underselling of capacities): no capacity allocation - no underselling
- This option is suitable for targeted intervention in specific cases to support national forward market,
- It is not recommended for EU-wide application to integrate forward markets together

Category 2: Analysis and conclusion

Summary of the options on the type of TSO intervention

	Option 0	Option 1	Option 2	Option 3	Option 4	Option 5	Option 6
Problem 1	0	0	+	++	++	++	+
Problem 2	0	0	0	++	++	++	++
Problem 3	0	+	-	+	++	++	++
Problem 4	0	0	0	++	++	+	0
Problem 5	/	+ +	/	/	/	/	++
Problem 7	0	0	+	+	++	++	++

Problems 6 and 8 are not included in the table as they are addressed respectively by the type of products offered by the TSO and the need for intervention.

Policy options

Category 3: Which LTTRs?

Option 3.0: **Status quo (PTRs and FTR options)**

- This option is not preferred

Option 3.1: **PTRs and FTR options with reduced firmness**

- Significantly undermine the very objective of hedging products – effective hedge
- If NRAs conclude that forward market needs intervention it would be counterproductive that offered do not achieve the purpose of intervention to provide effective hedging opportunities
- This option is not preferred

Option 3.2: **FTR obligations**

- Works better in Z2H settings
- **This option is preferred**

Recommendations and proposed actions

Recommendations and proposed actions

- The main shortcoming of existing forward markets is that they do not function as a **single integrated forward market**
  - Existing LTTRs are not integrating the forward markets in an efficient way, like SDAC or SIDC does
- **ACER and CEER recommend to:**

1. **Harmonise the assessment and decisions** by regulatory authorities by which the need for regulatory intervention in the electricity forward market is identified and decision on intervention is made
2. **Improve the allocation of long-term cross-zonal capacities** in a way that integrates national forward markets into a more integrated EU forward market:
   i. Longer allocation horizons, more frequent auctioning, strengthening of continuous/secondary market
   ii. Three promising design options: zone-to-hub FTRs, market coupling with CfDs and market coupling with Futures
   iii. These are largely able to address the main problems, but further investigation and analysis is needed on the final choice
3. If TSOs allocate LTTRs, these should be allocated in a form of **FTR obligations**