

Market making in the UK Power Market

Dear all

I am writing on behalf of the Power Trading Committee of the FOA to raise one particular issue with OFGEM regarding its option for market intervention through the introduction of a mandatory auction. We note that you are keen to receive constructive feedback on the proposals outlined in your two roundtables, but we understand that individual market participants will be responding to your questions. In the circumstances, we have confined our response solely to the issue of how to inject greater liquidity into the UK power market.

We, like OFGEM, recognise that the low level of liquidity in the UK power market has to be addressed as a matter of urgency. We would, however, urge OFGEM to consider the option of a market makers solution, which is used effectively in the financial markets, rather than exercising direct intervention in the market to improve liquidity. We have given some thought as to how this might work in the physical market and we would very much appreciate the opportunity of setting out our ideas in some detail.

In this context, we would make the following observations:

- any market maker arrangements must facilitate participation by small and medium size market participants;
- there must be sufficient market incentives to encourage firms to accept the risk of market making as well as the reward, particularly during times of market stress;
- low levels of liquidity in the UK power market are as much due to external factors over which little control can be exercised (e.g. low Spark Spreads, high correlation to NPP gas, costs of developing a much safer financial system resulting in a number of banks exiting commodity markets and, of course, the complexity of the power market itself as a differentiated market);
- the FOA proposal to move away from the EFA calendar should encourage greater participation in the market and bring it more in line with other related markets which do not use the EFA calendar;
- the market maker route is well established and would be better aligned with the idea of natural and continuous market dealings and liquidity that are commercially motivated unlike the understandable but more artificial approach of the mandatory auction option;
- in order to minimise costs to the industry as a whole, it would be better to approach the more professional market makers in the financial community rather than placing a market making obligation on all of the Big 6 – and, in this context, the FOA would be happy to support and assist OFGEM in developing and implementing a process for selecting market makers.

We hope this response is helpful to you in your deliberations and would welcome, as stated earlier, the opportunity of coming to discuss them with you in more detail.

Yours sincerely
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