

Secure and Promote **Energy UK response to the** **Ofgem proposal for ‘Market** **Making’**

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Stated objectives of Ofgem proposal

- ▶ Ensuring all parties have opportunities to trade in forward market
- ▶ Supporting the development of robust price signals along the curve
- ▶ Facilitating competition and entry from new players and between existing players

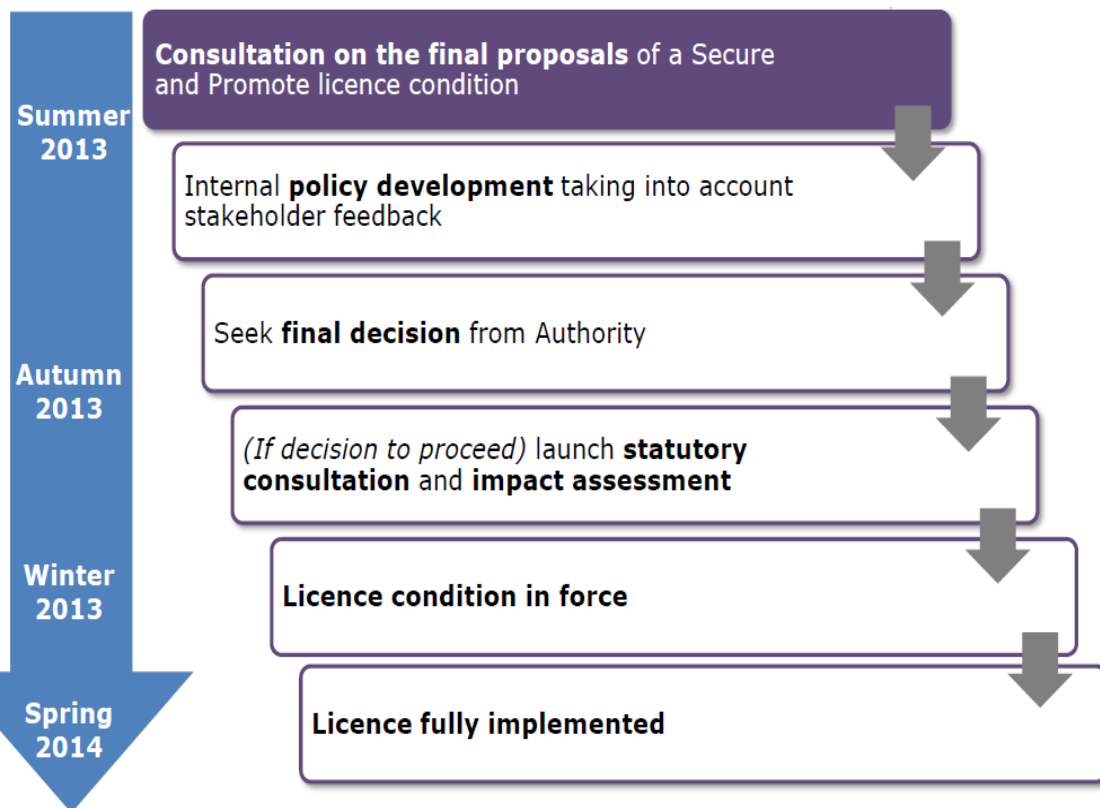
Key observations

- ▶ Objectives of both industry and Ofgem is to improve transparency and liquidity in the wholesale market
- ▶ Possibly the first time that a Licensee obligation for 'Market Making' has been mandated in a liberalised market
- ▶ The length of time this market is available or 'open' is directly linked to other specifications (such as bid-ask spread) of transparency and liquidity and visa-versa and as such should be viewed as a package
- ▶ Solution should not significantly disadvantage any one party or the longevity and/or sustainability of the solution will be compromised

To avoid delay and higher risk "big bang" implementation events it may be preferable to phase implementation and rollout incremental products as each phase is proven to be viable

Stated Policy Timeline and Industry Response

Stated policy timeline



Industry Response

- ▶ Decided at an early stage to leave **Schedule A: Suppliers Market Access Rules** to be negotiate directly between Ofgem and Obligated Parties
- ▶ Concentrated effort on agreeing **Schedule B : Market Making Obligation Rules** which comprise:
 - ▶ Phasing
 - ▶ Options around Availability
 - ▶ Analysis of current Bid/Offer Spreads
 - ▶ A Daily Volume Cap which is reset each day
 - ▶ Reload Rules
 - ▶ Fast Market/Force Majeure provision

Bid/Offer Spread Analysis (undertaken by RWE from readily available market information)

b/o Analysis	Base							Peak						
	Month+1	Month+2	Quarter+1	Season+1	Season+2	Season+3	Season+4	Month+1	Month+2	Quarter+1	Season+1	Season+2	Season+3	
Avg mkt b/o	0.24	0.46	0.46	0.30	0.31	0.36	0.45	0.68	0.93	0.94	0.66	0.70	1.19	
Ofgem b/o %	0.3%	0.3%	0.3%	0.3%	0.3%	0.5%	0.5%	0.7%	0.7%	0.7%	0.7%	0.7%	1.0%	
Avg bid price	47.36	47.59	48.14	49.66	51.27	52.40	53.77	54.15	54.53	54.98	56.27	57.99	59.60	
Implied Ofgem b/o	0.14	0.14	0.14	0.15	0.15	0.26	0.27	0.38	0.38	0.38	0.39	0.41	0.60	
Avg % of time mkt<= Ofgem b/o	30%	8%	7%	16%	18%	37%	23%	20%	6%	5%	17%	15%	8%	

Proposed Market Making Obligation Rules

Timings	Phase 1: Licence Condition Go Live + 3 Months; Phase 2: Licence Condition Go Live + 6 Months								
Nominating a third party	Phase 1: 6 obligated Licensees resulting in 3-6 Market Makers (Licensee or their representative) Phase 2: Develop Tender for [single/multiple] Third Party Market Maker(s)								
Platform Physical and/or Financial Cleared and/or Uncleared	Must be accessible to 10 or more licensees Note: must include reference to Compliance Monitoring and Reporting								
Products	Phase 1: Baseload : Months 1+2; Qtr 1; Seasons 1+2; Peak : Month 1+2; Seasons 1; Phase 2: Baseload : As above plus Seasons 3+4; Peak : As above + Qtr 1; Season 2+3;								
Availability with Fast Market / Force Majeure Rule	2 windows daily: [10h30 - 11h30];[15h30 – 16h30] Note: Majority Preference								
	Bid-offer spreads	Baseload			Peak				
		<i>Ofgem</i>	Phase 1 proposal implied from data sampled by RWE covering liquid & illiquid periods	The consensus* view Phase 1 and 2	<i>Ofgem</i>	Phase 1 proposal implied from data sampled by RWE covering liquid & illiquid periods	The consensus* view Phase 1	The consensus* view Phase 2	
	Month + 1	0.3%	[0.5 -0.8] %	0.5%	0.7%	[1.0 - 1.5] %	0.9%	0.9%	
	Month + 2	0.3%	[0.5 -0.8] %	0.5%	0.7%	[1.0 - 1.5] %	0.9%	0.9%	
	Quarter +1	0.3%	[0.5 -0.8] %	0.5%	0.7%	[1.0 - 1.5] %	N/A	0.9%	
	Season+1	0.3%	[0.5 -0.8] %	0.5%	0.7%	[1.0 - 1.5] %	0.9%	0.9%	
	Season+2	0.3%	[0.5 -0.8] %	0.5%	0.7%	[1.0 - 1.5] %	N/A	0.9%	
	Season+3	0.5%	N/A	0.6%	1.0%	[1.0 - 1.5] %	N/A	1.2%	
	Season+4	0.5%	N/A	0.6%	N/A	[1.0 - 1.5] %	N/A	N/A	*With the exception of one obligated party
Trade size	5 MW to a maximum 10MW offered at all times								
Daily volume cap	30MW Nett Reset each window per product								
Reload	Products reloaded within 5 minutes								

Proposed Market Making Obligation Rules Explained

- **Timings** - Whilst some Members initially preferred a 'Big Bang' approach views changed as the overarching Market Maker Rules took shape and it was agreed that phasing over a short period would enable the process to bed down;
- **Nominating Third Party – Tender Process** - This feature may or may not be triggered once we receive clarification around how MiFID I, II and/or EMIR rules are to be applied and have assessed the impact for the Obligated Parties. As part of a risk mitigation plan Parties may decide to undertake development of an industry tender to be issued at some point post Phase 1;
- **Platforms** – Participation prescribed by Ofgem as a minimum of 10 Licensed Participants. Ofgem to consider what might happen if the platform is liquid but has less than 10 participants consistently or from time to time
- **Products** - Members believe the product range could be phased and developed a mix between baseload /peak across both tranches
- **Availability** – The majority favour 2 windows probably running from [10:30-11:30] and [15:30-16:30] as this will concentrate market activity and possibly also increase liquidity in the periods before and after window opening/closure. At present a small minority believe the original 50% Availability rule should remain as they are concerned that any additional liquidity that arises is not removed from most periods across the day.
- **Bid/Offer Spreads** - RWE provided analysis to assist in the setting of an achievable Bid/Offer spread. By a majority, a single figure is preferred.
- Note: The table includes data collected under current market rules, through liquid and illiquid periods. An aspiration would be to create liquid windows which may produce tighter bid/offer spreads. Ofgem to apply reasonableness test to assess appropriate values. In addition there is information explaining the thought process around the development of a single percentage spread;
- **Daily Volume Cap** - Reset each window per product. The cap has been suggested to aid risk management. Ofgem to monitor activity for each product and time period to ensure that the cap has been set at an appropriate level

Market Making Tender Options

Discussions ongoing to assess interest in the development of an industry led Market Making Tender. If pursued, development will be undertaken alongside Ofgem and would include:

1. Detailed specification requirements schedule definition
2. Invitation to Tender published and Platform Providers Bid
3. Platform Provider(s) selected
4. Fast track platform implementation
5. Ofgem to approve compliance reporting schedules
6. Market makers test new platform
7. Go live

Outstanding Issues

- ▶ Any solution has to be MIFID compliant. On-going dialogue is required to assess the impact of MiFID I, MiFID II and EMIR
- ▶ The industry is yet to respond to the Ofgem assessment of the £1.8m to £10.2m pa anticipated costs associated with the various Market Making Options identified to date.
- ▶ Both fast Market and Force Majeure Rules will need to be agreed. A reasonableness test and associated penalties (which will be linked to fast market conditions) should apply in a manner that is proportionate to the Objectives as set out in the Ofgem document
- ▶ Compliance Monitoring and Reporting requirements will need to be developed with Ofgem. The industry also proposes a semi annual review process measured against the Ofgem objectives.
- ▶ Monitoring process of the Daily Volume Cap is required to assess whether it is set at an appropriate level to be agreed
- ▶ Trialling and Testing Programme will need to be developed with Ofgem
- ▶ An assessment of Bid/Offer spread levels and associated change process to be clearly set out by Ofgem
- ▶ Definitions will need to be agreed

Next Steps

- ▶ Dialogue to continue in respect of:
 - Monitoring and Reporting rules
 - The creation of triggers for amending Bid/Offer spread constraints.
 - The application of MiFID I, MiFID II and EMIR
 - Ofgem to clarify the rules that dictate which firms are obligated parties, that is if a generator has a domestic supply business, the point at which it would be captured by Market Making obligations needs to be set out.
 - Design of the proposed Tender