

To all interested stakeholders

Email: wholesalemarketoperation@ofgem.gov.uk

Date: 30 May 2019

Dear Colleagues,

Update – Wholesale Market Liquidity Policy

This letter provides an update on our developing market liquidity work programme. It provides information on the process we expect to follow and next steps, and seeks stakeholder views to inform a policy options assessment.

Background

In November 2018, we published our decision that it would not be in consumers' interests to suspend the Secure and Promote Market Making Obligation (MMO) immediately¹. This followed consideration of stakeholder feedback to our August 2018 open letter², which suggested that immediate suspension of the MMO could lead to a significant disruption of the market.

Our decision noted that market participants should prepare for the suspension of the MMO if planned corporate transactions by three of the remaining obligated parties completed. These transactions had the potential to reduce the number of obligated parties to one, which could make the policy less effective. In December, it was announced that the planned SSE and N-power merger would not take place. Our decision in January 2019³ to remove Schedule B of Special Condition AA from ScottishPower's electricity generation licence, following the completed sale of thermal generation units to Drax, reduced the number of obligated parties from four to three.

Forward Work Plan

Liquidity is an important feature of a well-functioning market. Measures that can improve the relatively low level of liquidity in the GB wholesale electricity market can benefit consumers by supporting effective competition. Our Forward Work Plan⁴ for 2019/20 highlighted that we would continue to review the effectiveness of the MMO in light of changing market structure and consider potential action if evidence suggests that this would be in the interests of consumers.

¹ <https://www.ofgem.gov.uk/publications-and-updates/november-2018-update-secure-and-promote>

² https://www.ofgem.gov.uk/system/files/docs/2018/08/ofgem_open_letter_-_secure_and_promote_update.pdf

³ https://www.ofgem.gov.uk/system/files/docs/2019/01/request_for_modification_of_special_condition_aa_of_scottishpowers_electricity_generation_licences.pdf

⁴ https://www.ofgem.gov.uk/system/files/docs/2019/03/ofg1132_fwp_2019_21_programme_post_consultation_w eb.pdf

To support this, we now plan to undertake an options assessment to consider whether current policy interventions designed to support liquidity continue to be required and, if so, whether they can be improved upon. This will place us in a position to decide on the future of liquidity policy for the GB wholesale electricity market. Continued engagement and further consultation with stakeholders will be integral to this process.

How we plan to achieve this:

- An options assessment will consider the objectives of any liquidity support policy and assess a short list of alternatives to the MMO. It will also include the options “do nothing” (retain the MMO) and “suspend without replacement” to assess whether policy change and continued intervention is in the interests of consumers.
- We will hold a stakeholder workshop to discuss and refine outputs from the options assessment.
- In the event the options assessment indicates that change would be in the interests of consumers, we will then look to consult on a ‘minded to’ position.

Next Steps

As part of our November 2018 decision letter, we sought stakeholder views on the appropriate objectives of any future liquidity support policy and longer-term alternatives to the MMO. To help scope the options assessment further, we now welcome stakeholder views on the following questions:

1. Are the original objectives of Secure & Promote appropriate for the next phase of liquidity policy development?

In 2013, we identified three liquidity objectives for the market⁵. The electricity wholesale market must:

1. Ensure the availability of a range of longer-term products to support hedging of risk of exposure to large changes to prices
2. Support robust reference prices that are widely available to market participants
3. Promote an effective near term market which enables all companies to buy the power they need for their customers.

The MMO was designed to help achieve 1 and 2 by:

- Providing regular opportunities to trade for all market participants
- Enabling the development of a series of robust prices along the curve and
- Encouraging competition.

We welcome views on:

- i) whether the original objectives of Secure & Promote are appropriate for the next phase of liquidity policy development, and
- ii) whether the role of a market making mechanism in supporting these objectives remains appropriate.

2. What criteria should policy options be assessed against, and how should these be ranked?

Stakeholder feedback has been used to develop an initial set of criteria for assessing different policy options. Against a ‘Do Nothing’ counterfactual (maintaining the MMO), the following criteria could be used in any options assessment:

⁵https://www.ofgem.gov.uk/sites/default/files/docs/2013/11/wholesale_power_market_liquidity_statutory_consultation_on_the_secure_and_promote_licence_condition.pdf

- **Liquidity:** an appropriate level of liquidity should be maintained to meet the relevant liquidity objectives.
- **Future-proof:** The policy should be resilient and flexible to changing market conditions.
- **Proportionality:** The costs of intervention should have a proportionate impact on market participants.
- **Cost-effective:** The policy objectives should be met at lowest cost to consumers.

We welcome views on:

- i) whether the criteria set out above are appropriate and exhaustive, and
- ii) how the criteria should be prioritised and ranked in accordance of importance.

We welcome stakeholder views on these questions and expressions of interest in attending a summer workshop to wholesalemarketoperation@ofgem.gov.uk on or before 01 July 2019.

As we progress with the options assessment, we will continue to monitor market liquidity and respond proportionately to changing market conditions. We welcome continued engagement with all interested stakeholders. If you would like to discuss further, please contact Heather.Stewart@ofgem.gov.uk.

Yours sincerely,

Cathryn Scott
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