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Secure and Promote Review: Response to Consultation

Dear Matthew and Hannah,

Thank you for the opportunity to respond to this consultation.

For information, following a public offering in 2016 npower became part of Innogy SE, a company with its own listing of which RWE currently retains 25%. There is no managerial or operational vertical integration between RWE and npower. The views expressed within this response are of the Innogy group and RWE will respond separately.

The Market Making Obligation (MMO) has brought some benefits to the market, however, these benefits are at the cost of a sub set of market participants, which npower feels is unfair. We feel the current mandated MMO should be replaced with a fairer, competitive framework which would deliver lower and more accurate cost of the obligation, thus being more efficient. This could be achieved with 2 options:

1. By widening the obligation to other parties, not just vertically integrated companies, with a lower level of individual obligation, or
2. Perform a tender process to identify parties who would be willing to manage MMO with a consulted charging methodology in place

We also have some significant reservations with regards to the current structure of the MMO. While it has aided liquidity during certain times, that has been to the detriment of the market outside of trading hours. It has also been to the detriment of other products, whose liquidity and price quality has deteriorated as a result. Outside of the liquidity windows, our customers are unable to assess prices effectively, and thus cannot manage their costs effectively.

Our suggestion to reduce the detrimental impact would be changing the obligated windows to four 30 minute windows, causing no additional obligation time for the impacted parties, and would likely improve bridging liquidity for those periods in between. This would improve liquidity throughout the day bringing efficiencies to trading parties and enable traders to provide price quotes for more products.

I trust you find this response gives you the required information you seek, however, if you require anything further, please do not hesitate to contact me.

Yours sincerely,

Andy Baugh
Regulatory Developments Manager

Npower responses to the consultation questions

Question 1: Please comment on whether you think prices for forward delivery are robust. Please refer to prices in and out of the market making windows and comment on the current mandated bid-offer spreads.

Npower does feel the prices for forward delivery are robust during the liquidity windows. We are satisfied with the bid/offer spreads within the window; however, we are concerned with the lack of liquidity outside of the window. As a result of poor liquidity outside of the windows, which has been created by the windows themselves, our customers are unable to get robust prices when they would like to. We often have to request customers to re-contact us during the trading windows.

Question 2: Please comment on whether the windows promote greater availability of products needed to hedge. Please provide evidence you may have on the availability of products outside the windows.

As mentioned in our response to Question 1 we feel there is little issue within the window, however, we do have some significant reservations with regards to the current structure of the MMO. While it has aided liquidity during certain times, that has been to the detriment of the market outside of those hours. It has also been to the detriment of other products, whose liquidity and price quality has deteriorated as a result. Outside of the liquidity windows, our customers are unable to assess prices effectively, and thus cannot manage their costs effectively

One solution to reduce the detrimental impact on liquidity outside of the liquidity windows would be changing the obligated windows to be shorter and more frequent through the day. Such a change would create no additional obligation time for the impacted parties, but would likely improve bridging liquidity for those periods in between the windows. Our suggestion is four half-hour windows of 9 to 9:30, 11 to 11:30, 14 to 14:30, 16 to 16:30. We envisage that this would result in good liquidity throughout the morning and the afternoon, with trading parties able to trade more consistently through the day, rather than having to execute myriad complex transactions in a short period of time. This would also likely enable traders to provide price quotes for more products, as they would have the ability to assess the value of these products properly against mandated products, without having to also try and do this during the liquidity window, where bulk hedging may be the main focus.

Question 3: What are your views on how liquid the near-term market is? Please refer to any factors that you consider have contributed to the liquidity of the near-term market.

Npower feels the day ahead market is sufficiently liquid. We feel the short and near time markets do provide robust pricing that works well but this wasn’t mandated; it was a market development so demonstrates market solutions tend to be better than mandated ones.

Question 4: What are your views on our high-level analysis of the state of liquidity? Are there any factors not identified that we need to consider to assess liquidity or Secure and Promote? Please provide quantitative or qualitative evidence where relevant.

From reviewing the Ofgem analysis we conclude that the analysis does not suggest that the MMO has had a material impact on market liquidity overall. We caution against overstating the impact of liquidity through focussing on 2016 liquidity too much. Our view is that higher liquidity during that period was driven by the greater volatility seen during, in particular, Q4-16. In fact we have concerns that the Market Making Obligation may act to distort the pattern of trade, which in turn acts as a barrier to the entry of new players into the wholesale market.

Question 5: What are your views on the impact of the market making obligation on liquidity in different market conditions, including in benign times and in times of price volatility?

When the market is volatile it has been helpful to have MMO to reset price levels and give customers price certainty. However, the MMO proves a hindrance to customers and market participants having robust prices outside of the liquidity windows. During periods of significant market volatility in related markets, such a gas markets, there are no robust indications of price levels for power.

As a result, we do not feel the current framework from MMO is appropriate and should be reviewed. We believe a MMO framework that provided for shorter windows spread across the day would provide a higher level of market quality overall. Such a change would create no additional obligation time for the impacted parties, but would likely improve bridging liquidity for those periods in between the windows. Our suggestion is four half-hour windows of 9 to 9:30, 11 to 11:30, 14 to 14:30, 16 to 16:30 as explained in the response to Question 2

Question 6: What are your views on the fast market and volume cap rules, in particular on reducing risk for licensees when needed?

We do not feel the fast market and volume cap rules have had a significant impact on reducing the risks to the obligated parties. Significant costs have already been incurred by the time that these provisions are triggered.

Question 7: What are your views on how the SMA part of the licence condition has helped smaller suppliers to access the wholesale market?

We agree that SMA has helped smaller suppliers to access the wholesale market; however, we feel the policy could be significantly streamlined by removing the obligations around a "request to trade" without a material impact on small suppliers.

Question 8: What in your view are the additional relevant external policy factors we should consider in our assessment of Secure and Promote?

Npower agrees with Ofgem that MIFID II is unlikely to have a material impact and we share Ofgem's view that more economic and efficient cash-out prices provide market participants with the right incentives to hedge appropriately.

We would request Ofgem further consult with the industry on their guidance to legitimate trading behaviour as it is somewhat unclear and would benefit from being more transparent.

Question 9: What are your views on amending the licence condition to allow flexibility during certain market conditions?

Npower feels additional periods of MMO suspension would cause issues when providing customers with certainty of prices. Any proposed changes should be progressed through industry consultation.

In addition, it is worth noting that it is not necessarily the case that mandating the MMO on certain parties results in the most robust and economic cost solution overall. If MMO is to remain a part of the market, our view is that it should not be mandated on the five current parties. We feel it should be opened up to more parties or a tender process carried out to identify 1 or 2 parties willing to manage the MMO and put in place a suitable charging methodology. See response to question 10.

Question 10: What are your views on the costs and benefits of complying with the policy either as an obligated licensee or as a general participant? Please provide evidence and detailed costs/ benefits per annum.

We recognise that overall the MMO has provided some benefits to the market as a whole through providing periods of certainty where liquidity is available and, to a limited extent, has created additional liquidity. It has also provided robust reference prices for customers during the liquidity window periods.

Whilst we have seen some benefits from MMO, we feel it is not appropriate for the obligation to be placed on a small number of parties. These benefits are at the cost of a sub set of market participants, and additionally at the cost of the effective functioning of the market outside of the liquidity windows, which is to the detriment of customers.

Npower feels the current MMO should be replaced with a fairer, competitive framework which would deliver lower and more accurate cost of the obligation, thus making further assessment of the effectiveness and cost efficiency of the obligation more effective. This could be achieved with 2 options:

1. By widening the obligation to other parties, not just vertically integrated companies, with a lower level of individual obligation, or
2. Perform a tender process to identify parties who would be willing to manage MMO with a consulted charging methodology in place

In addition, it is also important to note that, the fact the MMO is mandated does cause concern. Mandation indicates shortcomings in the regulatory design of the market intervention and we feel a competitive market solution would be more cost effective.

Question 11: How can liquidity be improved without the costs of the policy increasing significantly? Alternatively, how can costs of the policy be reduced without significantly reducing liquidity?

Npower feel the costs of the policy can be reduced significantly while increasing liquidity by extending the market making windows to four windows of 30 minutes in duration. We feel this could dramatically change liquidity between window and non-window periods. Our suggestion for the windows would be 9 to 9:30, 11 to 11:30, 14 to 14:30, 16 to 16:30 as explained in responses to earlier questions.

Question 12: Is there any other relevant stakeholder feedback we haven't captured that we should consider?

Not at this time

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