

MIBEL consultation on liquidity in forward markets



EFET response – 29 January 2021

The European Federation of Energy Traders (EFET)¹ welcomes the opportunity to provide our comments to the MIBEL Board of Regulators (CR MIBEL) public consultation to the wholesale market participants about possible measures to improve the liquidity of MIBEL forward markets. As EFET, we follow closely the development of forward electricity markets across the EU and we shared our contributions in CR MIBEL meetings held with MIBEL market participants. This response consists of a re-elaboration of the materials previously shared with CR MIBEL².

General remarks

As a general note, the main EFET purpose is to promote and facilitate European energy trading in open and liquid wholesale markets, always advocating the use of market-based mechanisms. We support proposals aimed at increasing liquidity on the Iberian market whilst ensuring free formation of prices in the wholesale electricity markets.

Market participants should be able to take positions across the different segments of the market both in time as well as across borders to optimise their portfolios but also for proprietary trading. Proprietary trading is indeed also necessary to foster efficient price formation and liquidity across the different segments of the market. Liquidity generates more activity in the market, both in terms of active market participants, and number of bids. And the reverse is also true: lower liquidity will lead to a decline in the number of active market participants and bids, hence decreasing competition in the Iberian market.

Prices should be allowed to fluctuate freely and reflect the true value of scarcity during or in expectation of times of system stress and high demand for power; similarly, prices should reflect the value of surplus in times of low demand for power.

The volatility of electricity prices, when not induced by flaws in the market design, is a sign that the market reacts properly and fast to demand and supply signals. When flaws in market design are identified, removing these distortions to the free formation of prices should be a priority for Member States, National Regulatory Authorities (NRAs), Transmission System Operators (TSOs), Distribution System Operators (DSOs) and nominated electricity market operators (NEMOs).

Prices in the electricity market should reflect the value of energy in real time – or expectations thereof in the intraday, day-ahead and forward timeframes – in a transparent manner. Increasing the efficiency of the market will improve price signals in wholesale markets during

² See [EFET presentation to CR MIBEL on liquidity in forward markets](#)

¹ The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org

episodes of scarcity or surplus. This will ensure that all types of capacity (generation, demand and storage) can be used properly and valued based on a level-playing field.

Interventions in the market and in the free formation of prices should be avoided. In the event where certain interventions in the market are unavoidable, due consideration must be given to the impact of such interventions on the formation of prices³.

Apart from the measures addressed in this consultation, we encourage CR MIBEL to consider the merge between the Spanish and Portuguese bidding zones as an important step towards a greater liquidity in the forward market. The merge would eliminate the risk of Portuguese operators when hedging their positions: if the financial future can get a perfect hedge, the operators would be more inclined to use the forward market and it would increase the number of trades performed in XBID.

Comments on the MIBEL Study

Considering the time gap between the publication of the MIBEL comparative study and the launch of this consultation (18 months), we believe that including the last period (2019-2020) would lead to more accurate results compared to the ones obtained in the report. Hence, we would encourage CR MIBEL to perform the same analysis with the most recent data, incorporating the years 2019-2020 and updating the conclusions, as they might differ considering the increased regulatory stability in the Iberian energy market during the last two years.

Additionally, it is important to consider that the liquidity has shifted from OMIP & MEFF to EEX and that the vast majority of market participants who currently trade in the Iberian market have an account with EEX as well.

Please find below our detailed comments on the questions proposed by the consultation.

1. Market liquidity

i. Do you consider more necessary the injection of liquidity into the forward market on the buy or sell side?

The level of liquidity is a key indicator of the healthy functioning of a market. Regulatory stability is crucial for the confidence of market participants to operate in the market to hedge their positions.

In relation to this, the development of the MIBEL forward market has been affected by numerous regulatory interventions coming from Spanish authorities in the last decade, such as the new generation tax (Law 15/2012), the CESUR auctions, new renewables auctions (characterized by uncertainty, with market participants not being timely informed of the procedures and instructions for the auctions) or the clawback of generators incomes from CO2

³ See [EFET response to ACER consultation on barriers to efficient price formation and easy participation in European electricity markets](#)

allowances. In Portugal, the provisions in relation to CESE, Social Tariffs and clawback are still on-going with no clear outcome.

On the other hand, as mentioned in the introductory part, the fact that some indicators, such as churn rate, are lower than in other markets does not imply that they remain the same currently. Traded volumes from 2017 until now has progressively increased, and even if churn rate is below 1, the number of new suppliers and market participants has grown in the last years.

Additionally, if the data series were expanded until today, we could observe that risk premiums (and in consequence volatility) have not only decreased⁴, but are below the level of German and French ones.

Therefore, we consider that any kind of regulatory intervention that would affect the efficient price formation in the market should be avoided: we would rather recommend that all the measures aiming to foster liquidity and competition on the MIBEL forward market remain voluntary (no obligations for the demand side to buy, nor obligations for generators to sell). In case the Iberian authorities would proceed with the introduction of regulatory measures, these should be market-based and affect bids and offers equally in order not to interfere in the price equilibrium and price formation process.

ii. In your opinion, the bilateral physical contracting carried out mainly by vertically integrated groups, reduces liquidity in the forward market or not?

From our point of view, bilateral physical contracts concluded by vertically integrated groups do not reduce liquidity.

First of all, the possibility to conclude bilateral physical contracts is not restricted to these groups, on the contrary it is open to all market participants. Furthermore, the hedging risk between generation and supply portfolios is one of the options that any company with liberalised activities in a liberalised market can and should use to ensure they provide electricity to end-consumers in the most economical manner.

Finally, market participants need to hedge net positions, i.e. the difference between their generation and demand, independently from the market in which this net position arise. Any measure with the intention of avoiding bilateral physical contracts would interfere with open interests of market participants (i.e. already concluded contracts) and affect the liquidity of forward market.

Rather than imposing local restrictions, we envision MIBEL developing a long-term vision of a market model in Iberia, across the different market timeframes and aligned with the EU target model.

2. Intervention of market makers in contracts

i. How relevant do you consider the role of market makers in more long-term products?

⁴ "Informe de seguimiento de mercados a plazo de energía eléctrica en España (Agosto 2020)".

As EFET, we believe in the importance of market makers' contribution to foster liquidity in the forward market as counterparty for both buyers and sellers. They contribute to giving a reference price for the entire forward curve.

ii. Do you think that the existence of more market makers would boost the forward market in a very relevant, moderate or not very relevant way?

The market should decide how many market makers should exist without any limitations *ex-ante*. However, we believe that the existence of more market makers is not going to substantially boost the existing liquidity in Iberia.

iii. What are the maturities in which the existence of a market maker would be more relevant?

Currently market makers make a difference in the most demanded product maturities, i.e. from M+1 to Cal+2.

iv. Do you identify a specific type of market participant that should act as a market maker?

We do not think that market makers need to match a specific profile. Market makers have diverse risk appetite and should be identified on a voluntary basis through market-based mechanisms.

v. What benefits should be associated with the market maker activity?

Traditionally, market makers are exempted from paying exchange fees and/or may receive discounts on exchange fees.

vi. Do you think that the remuneration of the market maker activity would have to vary according to the market participant profile to act as market maker?

No, there should not be any difference in market maker benefits based on their profile. The benefits should depend on the benefit they provide to expand liquidity in the market, especially on tenors where liquidity is lower.

vii. If so, do you think that market makers should be required to have a minimum volume of trading?

There should not be any restriction or minimum volumes imposed, every participant should be free to decide its volume of trading, based on the risk appetite and the agreement with the relevant exchanges on the appropriate bid/offer spread. Traditional benefits like exchange fees waiver are largely linked to trading volumes in any case.

3. Auctions for Vertically Integrated Groups

i. Do you believe that it would be appropriate to establish a forward auction mechanism such as Virtual Power Plants, in which the sale of energy was made by vertically integrated groups?

As mentioned in our answer to question 1, we believe that any kind of regulatory intervention that would affect efficient price formation in the market should be avoided: all the measures should be voluntary (no obligation for demand side to buy, nor obligations for generators to sell).

In the European context, regulated auctions for vertically integrated groups have been exceptionally implemented as a precondition for the approval by competition authorities in merger/concentration case, or as a remedy imposed by competition authorities in case of proven abuses of dominant position.

This kind of intervention should not be imposed in order to increase liquidity in the markets. The interventionist character of this measure led in the past to an important number of litigations in courts, many of them still pending of court sentences, and others with the obligation to pay for patrimonial damage to companies obliged under these auctions.

ii. If so, in what forward period should the contracts be auctioned?

iii. The auctioned products settlement should be physical or financial?

It is disproportionate and inadequate to establish this kind of auctions to promote the liquidity of a forward market. The development of liquidity in forward markets is linked to the trust of market participants in the necessary regulatory stability that allows them to perform their trading activity based on criteria that are not unexpectedly modified by regulatory interventions.

4. Specific mechanisms designed for renewables

i. Do you consider beneficial, as a complementary approach to the capacity auctions foreseen in Spanish and Portuguese regulations, a competitive energy mechanism, aimed at more mature technologies, with the participation of both market participants from the offer side, articulated through the renewable facilities, and from the demand side?

A developed forward market with sufficient depth and with bid/offers on longer tenors facilitates risk coverage for all agents fosters competition and financing of Renewable Energy Sources (RES) projects. In order to improve the liquidity in forward markets in MIBEL, we would rather propose the following regulatory changes:

- We suggest removing the prohibition of closing bilateral contracts by the owners of the plants who have been awarded a capacity contract via the auction, as established by the draft Royal Decree regulating the remunerative framework applicable to new renewable energy facilities in Spain. This provision unnecessarily

restricts contracting options and it is not consistent with the promotion of long-term contracts for RES-E.

- We suggest using the forward market price, instead of the hourly price of the daily and intraday markets, as a reference for the calculation of the difference with the auction award price. The settlement against the forward market price would be easy to determine in advance, since the price reference would be fixed. This means that the risk of variation in the market price (which affects the surplus or deficit of the settlement) would cease to be fully assumed by the consumer and would be transferred to the plant owner (who could easily hedge it in forward markets).

ii. If the answer to the previous question is affirmative please specify:

- a. *What are the maturities for products to be implemented? (5, 7, 10 years or other maturities)?*
- b. *Should those contracts be physically or financially settled?*
- c. *In the energy mechanism, do you consider necessary that guarantees of origin (GOs) are linked to the respective energy, with allocations to the tenderers? Or could the products be traded autonomously from the GOs?*

No comments.

5. Smaller agents participation in the forward market

i. How could the participation of smaller market participants (suppliers, producers or consumers) in the forward markets be encouraged or simplified?

Participation in forward market is still considered too complex by smaller market participants, hence we would suggest simplifying the compliance burdens and reducing the costs. In fact, smaller agents face unnecessary entry barriers due to excessive IT Costs and requirements.

ii. Do you consider necessary, for example, to launch contracts with smaller dimension or with other profiles?

The contracts have a minimum volume of 1 MWh with a wide range of maturities. In consequence the product size does not seem to be a problem nor a barrier. Offering new profiles – such as long-term small granularity products – could be tested by MIBEL to see if it attracts the attention of market participants.

iii. Do you consider the creation of the figure of an independent aggregator relevant to encourage the participation of smaller market participants?

As EFET, we support the entry of all kinds of market participants in the market, including independent aggregators. We welcome the participation of aggregators in all market time

frames, including forward, as they facilitate access of smaller market participants. However, we believe they will not contribute to a significant boost in liquidity to forward markets in Iberia.

The main entry barrier for smaller market participants is embedded in the functioning of financial markets and it is constituted by collateral requirements for forward transactions. Smaller parties are usually not rated by credit agencies, nor they can make use of large credit lines and this makes their participation more difficult.

iv. How could the figure of an independent aggregator be operationalized in the forward market?

Independent aggregators should be treated like any other market participant with equal rights and equal obligations.

v. What mechanisms could be created to attract the participation of more financial institutions in the forward market in order to encourage the participation of smaller market participants?

The main mechanism to promote the development of liquidity in forward markets and the participation in this market is to avoid unnecessary regulatory interventions with impact in the free formation of market prices.

Initiatives developed under the umbrella of sustainable finance should provide incentives to financial institutions providing liquidity in electricity markets by the mean of lower capital requirements/reserves because through this activity they support the decarbonisation of the economy serving the 'real economy'.

6. Training courses and seminars about forward markets

i. Do you consider necessary to carry out specific training courses and seminars about forward markets (operation, goal, available contracts, risks, etc.)?

First of all, we would like to express our appreciation for the publication of the MIBEL study and consultation in both English and Spanish. As EFET, we support CR MIBEL commitment in the organisation of workshops, training courses and seminars about forward markets. We suggest having these educational initiatives held in English in order to allow better contribution from international market participants, which would facilitate their participation and increase the attractiveness of the Iberian market. We recommend also a multidisciplinary approach allowing experts in various areas e.g. finance, accounting, credit, risk, to gain a better understanding of all the aspects related to forward markets.

ii. What are the biggest doubts related to the forward contracts or the participation of financial entities in the referred markets?

No comments.