

Response to Consultation 02/2012 on the Proposed Changes to Settlement Timing in the Electricity Market

EFET (the European Federation of Energy Traders)¹ welcomes the GME proposal to align the settlement timing in GME's day-ahead and intraday electricity market with the rest of Europe in order to enable market coupling. EFET has previously expressed the view that changing the settlement timing from the current m+2 to the European standard d+2 is necessary to enable market coupling.² In line with this, we strongly encourage the change.

Furthermore, we strongly recommend that GME aligns the settlement timing in GME's day-ahead, intraday and ancillary services (MSD) markets, i.e. the settlement time within the ancillary service market should also be shifted to d+2.

The preferred way forward would be to shift the settlement timing to d+2 for all borders and all market participants on 1 January 2013 (Solution A). We would like to stress that having two different settlement cycles, one in d+2 and one in M+2 (Solution B and C) would be highly complex operationally. Due to that fact, the only option EFET supports is Solution A and EFET is strongly opposed to both Solution B and C.

Our responses to the consultation questions, here below, explain this in detail and highlight the pros and cons of the three options.

S.1 In your opinion, which are the main advantages and disadvantages of each of the proposed solutions?

Solution A: Preferred

GME will need to align its settlement cycle with neighbouring markets, in order to enable market coupling on all of the Italian borders; this has to be done within 2014 according to the objectives set by the European Commission.

For market participants, it is better to make the change in one go, as proposed by Solution A – rather than to operate with two different settlement cycles simultaneously. Under Solution B and C, market participants will not have the full control of invoices received from (or sent to) GME because, depending on the daily financial position of the Shipping Agent, they could receive, for the same day, one invoice in d+2 and one in m+2. Operating two different settlement/invoicing cycles, as per Solution B and C, would be highly complex and would increase the operational burden on market participants *significantly*. It is therefore better to make the switch in one go, on all borders and for all market participants, as proposed by Solution A.

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. EFET currently represents more than 90 energy trading companies, active in over 27 European countries. For more information: www.efet.org

² EFET expressed this view in EFET's presentation on the changes needed in the Italian market, in the day-ahead timeframe, at the Central South Electricity Regional Initiative Stakeholder Workshop on 15 May 2012.

We do not fully agree that the operational changes necessary to implement a settlement and invoicing cycle within d+2 would be *significantly* burdensome, as suggested by the consultation, or take a considerable amount of time. We estimate that the operational change would take from two to three months, in the worst case, to be implemented by Italian market participants and, in addition, as mentioned in the consultation by GME, European cross border traders (including also several Italian market participants) already work with a daily settlement cycle on other borders (i.e. the CWE region). Moreover, compared to the operational burden of having to operate with two different settlement cycles, implementing a switch to a d+2 settlement cycle is less burdensome.

We would, however, strongly suggest that GME aligns not only the timing of settlement, but also the settlement process with that of other European exchanges. That is, it is easier for market participants to operate daily settlement via direct debit, to an account set up in a clearing bank, according to the process followed by other European exchanges that operate daily settlement.

For these reasons, and when taking into consideration that the change in settlement timing is further not planned until 1 January 2013, EFET strongly suggests that a final decision is taken on the solution that will be implemented and that this is communicated to market participants before the end of September 2012. This will give sufficient time for market participants to implement the necessary changes.

Besides these operational aspects, we also note that a d+2 settlement cycle will promote liquidity on GME's market. It will reduce the financing costs for participants and lead to greater participation on the exchange. Solution B and C, where most volumes will still be settled in m+2 and which imply high operational complexity, will achieve the contrary.

Solution B and Solution C – Can absolutely not be implemented

Solution B

As noted, having two settlement/invoicing cycles would be highly complex. Market participants, that select the d+2 settlement cycle and sell electricity directly in the Italian market, would get paid partly in d+2 and partly in m+2.

Second, the option to select either the d+2 or the m+2 settlement cycle makes it likely that most payments will be made in m+2 as currently– but with added cash flow uncertainty for market participants that have selected d+2 settlement. That is, given that market participants that are generally net debtors will opt to maintain the settlement cycle in M+2 and that market participants that are generally net creditors will select the payment cycle in d+2, it appears unlikely that GME would be able to collect sufficient payments in d+2 to be able to pay the shipping agent or net creditors that have selected the d+2 option. However, despite effectively maintaining most payments in m+2, Solution B will still not give market participants that select the d+2 option any certainty as to the timing of cash flows.

Though we do not consider Solution B (nor C) as acceptable alternatives, we would like to note that in terms of the interest rate applied to m+2 payments under Solution B, our preference would be for a rate that is set *ex ante*.

Solution C

GME will need to implement the d+2 settlement cycle on all borders when market coupling is implemented in either case. Implementing the change now, for all borders, in one go, will make future harmonisation easier – and will be operationally easier for market participants.

As noted, having two settlement/invoicing cycles would be highly complex. Market participants that operate across multiple borders would get paid partly in d+2 and partly in m+2, depending on implementation of market coupling between Italy and the neighbouring country.

In addition, as noted under Solution A, a d+2 settlement cycle reduces the financing costs for participants. In this regard, implementing the change only on the Slovenian border, where market coupling is implemented, would be discriminatory.

Moreover the net creditors in the Italian day-ahead market will not have any certainty of cash flows, because, depending on the results of the market coupling process, they will, within d+2, have to pay *on a pro quota basis* the net debit of the Italian market towards foreign markets (initially only Slovenia). In m+2, net debtor participants will receive the payment of the difference between its net debit and the pro quota amount already settled within d+2. As already discussed under Solution B, these double invoicing cycles will be extremely difficult to control - with direct negative impacts on the daily activities of the back offices of market participants - and with negative impacts on market participants' ability to foresee the timing of forecasted cash flows.

S.2 Among the proposed solutions, which one may be implemented on 1 Jan. 2013?

EFET supports the implementation of Solution A, but as already explained, GME should give trading and retail companies operating in the Italian day-ahead market sufficient time to modify their internal processes and procedures of by informing market participants about the solution that will be implemented two or three months in advance. This means that, if GME wants to implement the new payment limit starting from 1 January 2013, market participants shall be informed at the latest in September/October 2012.

S.3 If solution A may not be implemented on 1 Jan. 2013, do you think that solution B or solution C may be introduced in preparation for the subsequent adoption of solution A?

EFET is strongly opposed to the introduction of any other option than Solution A. Having to operate with two settlement cycles, one in d+2 and one in m+2, as the other two options suggest, would be extremely complex and could have negative effects on the liquidity of the Italian day-ahead market. EFET prefers to implement the switch in one go.



S.4 If you have answered “yes” to question S.3, which solution - B or C - is preferable in view of a transition towards solution A and within which timeframes?

EFET cannot support any other solution than Solution A.