

Submission by Bord na Móna PowerGen

to the

SEM Committee's Discussion Paper

Forwards and Liquidity

(SEM – 15 – 010)

March 2015

Introduction

Bord na Móna welcomes the opportunity to respond to the SEM Committee’s Discussion Paper on Forwards and Liquidity (SEM-15-010). Furthermore, Bord na Móna acknowledges and appreciates the publication of an early ‘discussion paper’ with the stated aims of regulatory consistency with other elements of the I-SEM project, provision of long-term price signals to market participants, cost-effectiveness and, ultimately, greater market liquidity.

Please find outlined below our initial feedback; noting, however, that these responses should be viewed in the same spirit as the ‘discussion paper’ and as such comments put forward should be considered as conceptual rather than a firm Bord na Móna position at this moment in time. Obviously, as visibility of the final I-SEM Trading Arrangements and Markets Design begins to emerge, Bord na Móna will continue to engage and develop a more definitive position.

Within Zone Forward Market Liquidity

Lessons Learnt from Forward Trading in the SEM

The discussion paper contains a comprehensive analysis of possible causes for low liquidity in the SEM forwards market including, but not limited to, the levels of collateral required by participants, lack of trading opportunities, and the limited number of available products. It is anticipated that the introduction of enhanced trading platforms in the I-SEM could significantly reduce the transaction costs, provide increased market visibility, have a positive impact on participant’s cash flow and thus attract greater participation in the financial forwards market.

However, as the I-SEM forward market will be exclusively financial in nature, it will not eliminate the scheduling risk for generators, which suggests that the interaction of the forwards market with the DA & IDM will need to be carefully considered so as not to discourage participation.

Nature of Forward Products in the I-SEM

Analysis provided in the discussion paper indicates low participation rates for the long-term forward contracts in the SEM market (relative to other European markets). The new market design, increased economic activity and demand growth may act as a catalyst to re-invigorate the forwards market. If such a scenario did come to pass, there may be merit in looking at the tenor of I-SEM forward contracts; e.g. financial products whose duration is aligned to forward commodities contracts associated with power production, such as longer term contracts (greater than 1 year) for I-SEM power, the purchase of carbon and fuel on the international markets.

Secondly there might be some appetite for products that will suit variable generation – such as products to be delivered within a short period of time – when the forecast tools improve substantially to warrant forward market contracts.

Also, considering future regional integration, it may be beneficial to design products aligned with those available in the GB market.

Market Maker Arrangements

As illustrated by the introduction of the “Secure and Promote” licence condition in GB, the implementation of market maker arrangements has potential to increase liquidity in the forwards market, as well as encouraging participation from smaller non-integrated participants. Bord na Móna would be of the opinion that further investigation into the role that ‘market makers’ could deliver in the I-SEM be included in the formal consultation process on arrangements for forward trading.

Interactions with Market Power Mitigation

It is interesting to observe whether in the medium to long-term the entry of larger GB market players into all island market will materially affect the levels of market concentration and what further impact there would be on forward market liquidity. Thus, it may be prudent for the RAs to continue monitoring market power and consider adopting appropriate mitigation measures, if required, in the I-SEM market. In this regard, Bord na Móna supports RA’s endeavours to learn from the available international experience and encourages reviewing markets with similar characteristics to the I-SEM (relatively small-size and geographically isolated, but interconnected, markets).

Mediums for Trade and Trading Institutions

On its face, it would appear that the most efficient solution for the forward trading platform is an I-SEM screen on an existing exchange, however, costs associated with development and maintenance (which would manifest itself as membership fees for participants) would need to be robustly assessed. Perhaps it may prove useful for the RAs to publically invite comments from potential service providers as to what facilities they could offer and the cost of same.

As regards what conditions are needed to support the effective functioning of an I-SEM futures market place, the primary concern must be compatible with requirements of the European Network Codes and the ability to transition to a harmonised auction platform.

While it would be ideal if the market spontaneously provided the most efficient market place together with a suite of products that matched the requirement of all participants, there may however be a case for the RAs to offer evidence based ‘guidance’ as to the design of the platform and the products offered.

Cross-Border Financial Instruments

Bord na Móna has not been an active participant in cross border trading to date, and is still developing its thinking on the matter. However, in terms of response to the questions raised in the discussion paper, much of the general comments cited above for the within zone market are broadly applicable to the Single Allocation Platform, such as minimisation of transactional costs for participants (e.g. collateral requirements), alignment of benefits & obligations of I-SEM participants with cross-border counterparties, market transparency and evidence based RA guidance for the allocation requirements etc.

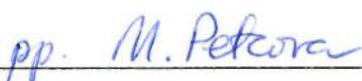
In addition, and specifically in regard to the ‘firmness of transmission rights’, Bord na Móna would be of the opinion that the ‘firmness’ risk should exclusively lie with those best positioned to absorb and mitigate this risk, namely the IC owner.

In terms of Cross Border market power concerns, it is critical that this issue be further examined in the formal consultation phase. As noted above, Bord na Móna has not to date been active in this area and would welcome the future publication of quantitative analysis of the potential risks associated with cross border market abuse. Obviously, the design of the allocation platform must be such that the I-SEM participants are not disadvantaged relative to their cross border counterparties.

Finally, as noted in our recent submission on the Building Blocks paper, the transition from a market with a single ex-post price (i.e. a robust reference price for all future contracts and CfDs) to a market where the ‘standard’ reference price for support mechanisms and ROs is still not formally decided introduces new layers of complexity. At a high level the ‘interactions’ which will need to be considered include basis risk in terms of the timeframe for the reference price, potential for exposure where financial futures back off against physical delivery, exposure to an RO strike price, as well as the interaction with RES CfDs in Northern Ireland.

We hope that you find these comments helpful and look forward to further engagement on the abovementioned topics. If, however, you have any additional queries or require clarification on any of the above points, please do not hesitate to contact Bord na Móna.

For and on behalf of Bord na Móna PowerGen,



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