



European Union Agency for the Cooperation
of Energy Regulators

Policy paper

on further development of the EU electricity forward market

Public workshop – 13 March 2023

Martin Povh

Thomas Kawam

Opening

14:00 – 14:05

**Mathieu Fransen, Team Leader – Market Codes,
Electricity Department, ACER**

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Forward electricity markets ...

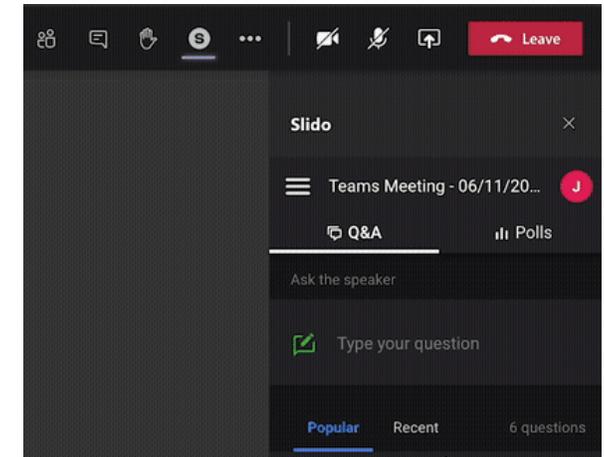
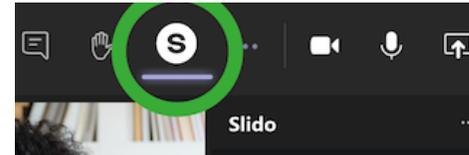
- Carbon neutrality and structural shocks increased the uncertainty of the future electricity prices
- Growing importance of forward electricity markets - crucial to provide some stability to stakeholders

... Assessed in an ACER policy paper

- The objectives of this policy paper are to:
 - identify the main problems experienced in the EU's electricity forward market
 - identify possible solutions that policy makers could introduce to address these problems

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 - ✓ At the end of the main sections we will address some questions, as time allows.



- The slide pack will be shared with you after the webinar via email and on the ACER website (including a recording of this webinar).
- Slido will remain active until Friday 17 March and open questions will be answered.

Indicative time	Agenda	Speakers
13:50-14:00	<i>Dial-in time</i>	
14:00-14:05	Opening	Mathieu Fransen, ACER
14:05-14:30	Session 1: <ul style="list-style-type: none"> • Problems statement and objectives • General recommendations • Preferred policy option 1: coordinated NRA decisions • Preferred policy option 2: improved access to LTTRs 	Martin Povh, ACER Thomas Kawam, ACER
14:30-14:40	<i>Q&A Session 1</i>	
14:40-15:10	Session 2: <ul style="list-style-type: none"> • Preferred policy option 3: zone-to-hub LTTRs • Preferred policy option 4: market making • Preferred policy option 5: FTR obligations with full financial firmness • Remaining risks and challenges 	Martin Povh, ACER Thomas Kawam, ACER
15:10-15:25	<i>Q&A Session 2</i>	
15:25-15:50	Session 3: <ul style="list-style-type: none"> • Stakeholders' view <ul style="list-style-type: none"> • ENTSO-E • Europex • Market participants 	Jim Vilsson, ENTSO-E Christian Baer, Europex H�el�ene Robaye, Eurelectric, J�er�ome Le Page, EFET, Micha�el Van Bossuyt, IFIEC
15:50-16:00	Next steps Closing session	Anne Radermecker, European Commission Christian Zinglersen, ACER

Problems statement and objectives

14:05 – 14:20

**Martin Povh – Senior Expert,
Electricity Department, ACER**

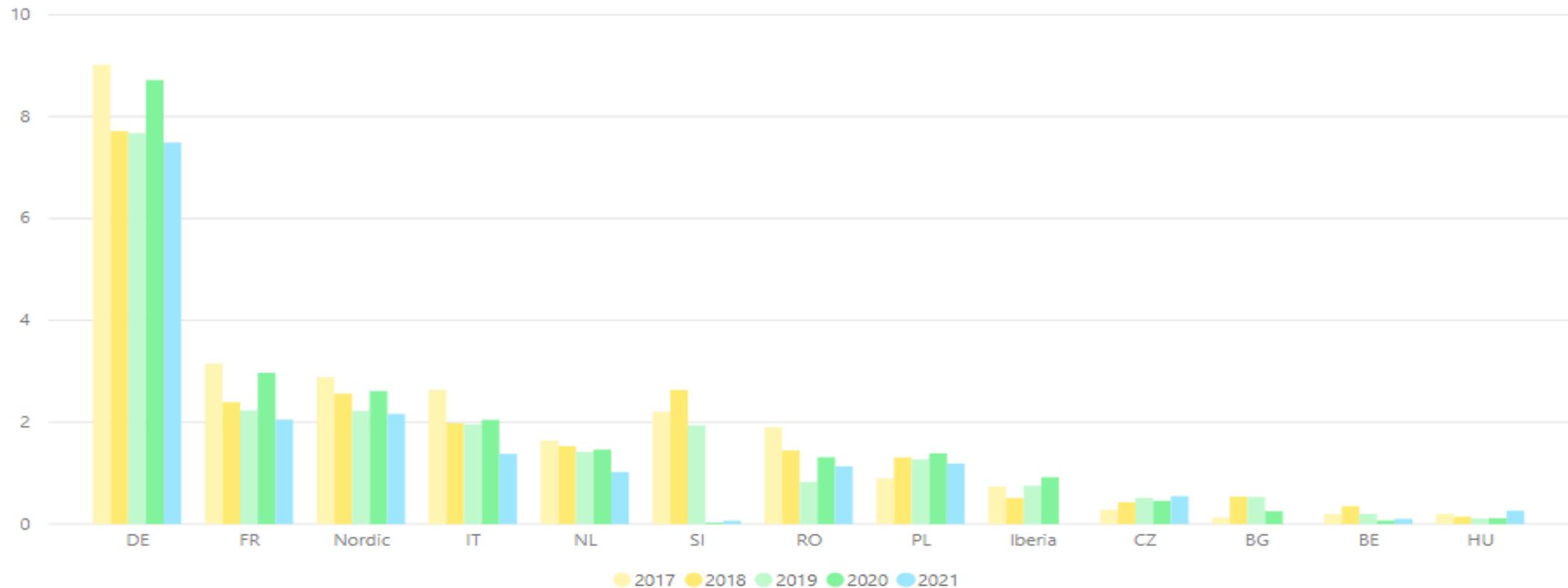
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Problem 1: Market fragmentation – unequal access across the BZs

Churn factors in major European forward markets – 2017-2021



Problem 2: Hedging disincentives

- *Policy measures (CRMs, CfDs, cap & floor, ...) reduce the hedging incentives*
- *Collateral requirements*

Problem 3: Market structure

- *High market concentration and supply/demand asymmetry strongly impact forward markets*
- *This leads to poorer order books and increased bid/ask spreads*

Problem 4: Vulnerability to bidding zone reconfiguration

- *Any discussion on bidding zone reconfiguration always stumbles upon forward market liquidity*
- *Good market design should not destroy liquidity when bidding zones are changed*

Problem 5: LTTRs contribute to market fragmentation

- *LTTRs can be used to satisfy hedging needs which can reduce the demand on organised markets*
- *LTTRs options further increase that behaviour by providing a product that do not provide a perfect hedge and cannot be combined with Futures for proxy hedging*

Problem 6: Accessibility of cross-border hedging products

- *LTTRs cannot be acquired on a continuous basis*
- *LTTRs are not able to satisfy demand for hedging when the exposure arises*

Problem 7: Inadequate maturities

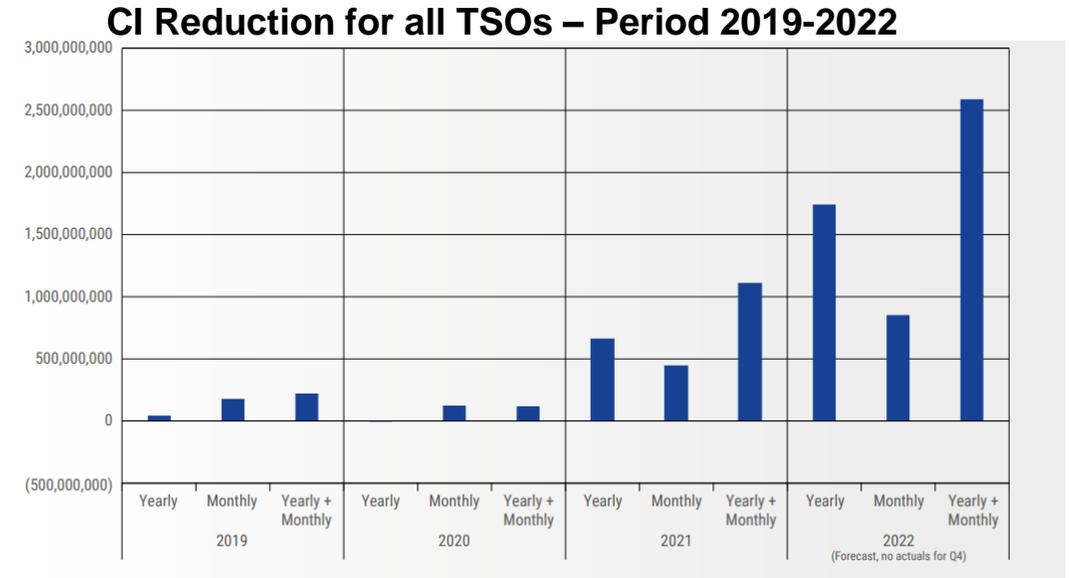
- *Existing LTTRs are able to support forward market only up to 1 year ahead*
- *There is significant hedging need at least up to 3 years ahead*

Problem 8: LTTRs are continuously undersold

- *If LTTRs are predominantly used for hedging, risk premia should be zero or positive*
- *LTTR auction prices generally below expected market spread – negative ex-post risk premia*
- *LTTR auction prices don't even reach forward spreads*

Problem 9: Non-coordinated exemptions for TSOs to offer LTTRs

- *Legal framework allows NRAs to exempt TSOs from offering LTTRs*
- *Application of this legal framework is not transparent and non-harmonised*



Source: ENTSO-E policy Paper on EU's Electricity forward Markets, December 2022

Table 5, ACER market monitoring report 2015 shows a similar trend over the period 2009-2015.

Consultation outcome:



Main consultation feedback:

Problem definition is too narrow, focusing only on LTTRs.

Evaluation:

Agree. Problem definition was significantly expanded

Forward market liquidity is not a barrier to reconfiguration but a criteria to carefully consider in the BZ definition process.

Disagree. Forward market liquidity endangers bidding zone review and vice versa, bidding zone change would significantly hamper forward market liquidity. Yet, it does not have to be that way.

LTTRs can only complement proxy-hedging strategies and are rather a tool to assist liquidity.

ACER agrees with this assessment based on the current functioning of LTTRs but considers it to be a problem to be addressed.

FTR options is a product that at minimum should be offered by TSOs. Obligations can be offered by exchanges.

ACER considers FTR obligations to be superior to options in terms of overall efficiency of forward market functioning.

Any LTTR valuation should be based on forward market spreads at the time of the auction and not on the ex-post risk premium.

Undervaluation is found in both ex-post risk premia as well as when looking at forward spreads. Ex-post risk premia is a suitable indicator when assessed on a sufficiently long duration (e.g. 5 years).

For the assessment of the different policy options, 6 objectives are defined, based on the specific context of the forward markets and Electricity Regulation Article 59(4):

1. **Effectiveness to enhance market integration** by contributing to establish common market rules and harmonisation
2. **Effectiveness to ensure non-discrimination** by setting out a non-discriminatory framework not only for market participants but for other stakeholders
3. **Effectiveness to increase competition** by reducing entry barriers and making the hedging products more competitive
4. **Effectiveness to enhance the efficient functioning of the market** allowing market participants to hedge their exposure both in an effective and efficient way
5. **Efficiency** from a cost-benefits perspective
6. **Coherency** with the other energy markets and other EU policy objectives

Problem identification - What are the general and cross-border problems that the electricity forward market currently face?

Objective definition - What are the key objectives that electricity forward market aim to achieve?

Policy option identification - What are the range of evolutions that could best address the problems?

Policy option evaluation - To which extent the identified policy option contributes to the defined objectives?

Stakeholder feedback was taken into account at all the steps of the approach.

General recommendations

**Preferred policy option 1: coordinated NRA decisions
on TSOs' exemptions**

**Preferred policy option 2: improved allocation of LTTRs
14:20 – 14:30**

**Thomas Kawam – Seconded National Expert,
Electricity Department, ACER**

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Some problems can be addressed by energy regulators **directly**: these are discussed in the following slides with **concrete preferred policy options**

Other problems are outside of competence of energy regulators, or dedicated solutions already exist and just need to be applied. For these, ACER provides **general recommendations**:

1. **Improving market structure, promoting competition** – address high market concentration (vertical /horizontal), improve competition and remove entry barriers
2. **Reduce hedging disincentives** – design regulatory interventions (long-term contracts) in a targeted way which minimises the impact on hedging incentives – don't take away all the risk
3. **Re-configuration of bidding zones** – perform the bidding zone review process to assess all aspects of the bidding zone sizing
4. **Reduce barriers to trade at organised marketplaces** - reduce barriers to trade at organised marketplaces (e.g. non-fully backed bank guarantees)

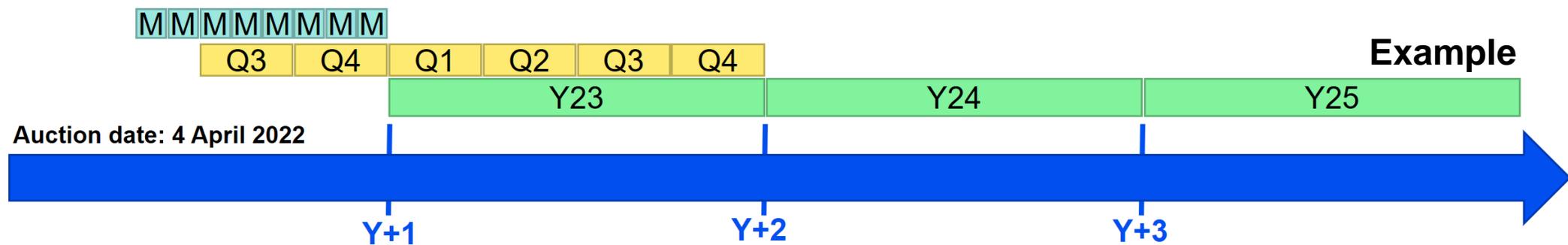
1. Coordinated NRA decisions on TSOs' exemptions

- TSOs are generally required to allocate LTTRs, however...
- ...NRAs may decide that TSOs
 - a) have equivalent measures in place; or
 - b) are exempted from supporting the forward market, subject to assessment that forward markets work well without the TSO's support
- This option requires that NRAs in regions **jointly assess and decide** on possible exemptions for TSOs to issue LTTRs
- In case no support to the forward market is provided, an assessment is needed
- This assessment is based on a study determining the market's ability to provide such opportunities without the TSOs' support and backed by transparent and precise metrics

2. Improved allocation

This policy option foresees that the allocation of LTTRs is improved through:

1. Longer term products (up to Y+3)
2. More frequent auctions (weekly, daily)
3. Statistical capacity calculation (based on historical distribution of DA offered capacity)
4. Continuous access to secondary market (including capacity leftovers)



Statistical approach

Based on the historical distribution of offered day-ahead capacity, draw the margin **X%** (e.g. 95%), ensuring that offered DA capacity greater than the offered LT capacity – this is to limit the risks of revenue inadequacy for the TSO.

Revenue inadequacy

There is one situation in which TSO will be faced with (hourly) revenue inadequacy:

1. If the offered LT capacity is higher than the DA capacity **and**
2. DA price is lower than LTTRs price

Mitigation of revenue inadequacy

- The parameters of the statistical approach are defined to minimize revenue inadequacy risk (if the risk is too high the X value above can be increased and LT capacity decreased)
- FCA Regulation should ensure full cost recovery comfort to TSOs in case of revenue inadequacy at annual level

Capacity calculation

1. LTTR capacity is computed through statistical methods (e.g. 95th percentile of historical distribution of DA capacities)
2. For every weekly auction occurring over the 3 years prior to delivery, an equal part of the capacity would be offered

Example (converted into NTC environment for easier understanding)

Border	Currently offered DA capacity (approx.)*	Current LTTR capacity	Proposed LTTR capacity (70% of DA capacity)	Proposed volume for weekly auction (as of Y-3)
BE ↔ FR	2460 MW	250 MW (Y) 200 MW (M)	1722 MW	11 MW
DE ↔ AT	2500 MW	2940 MW (Y) 1880 MW (M)	1750 MW	11 MW
AT ↔ CZ	1800 MW	250 MW (Y) 100 MW (M)	1260 MW	8 MW
HU ↔ HR	1200 MW	600 MW (Y) 100 MW (M)	840 MW	5.4 MW

*based on capacities offered during a typical day, example of 5 August 2022 has been chosen.

Q&A for Session 1

14:30 – 14:40



**Moderator: Mathieu Fransen, Team Leader,
Electricity Department, ACER**

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Preferred policy option 3: zone-to-hub LTTRs

Preferred policy option 4: market making

14:40 – 14:55

**Thomas Kawam – Seconded National Expert,
Electricity Department, ACER**

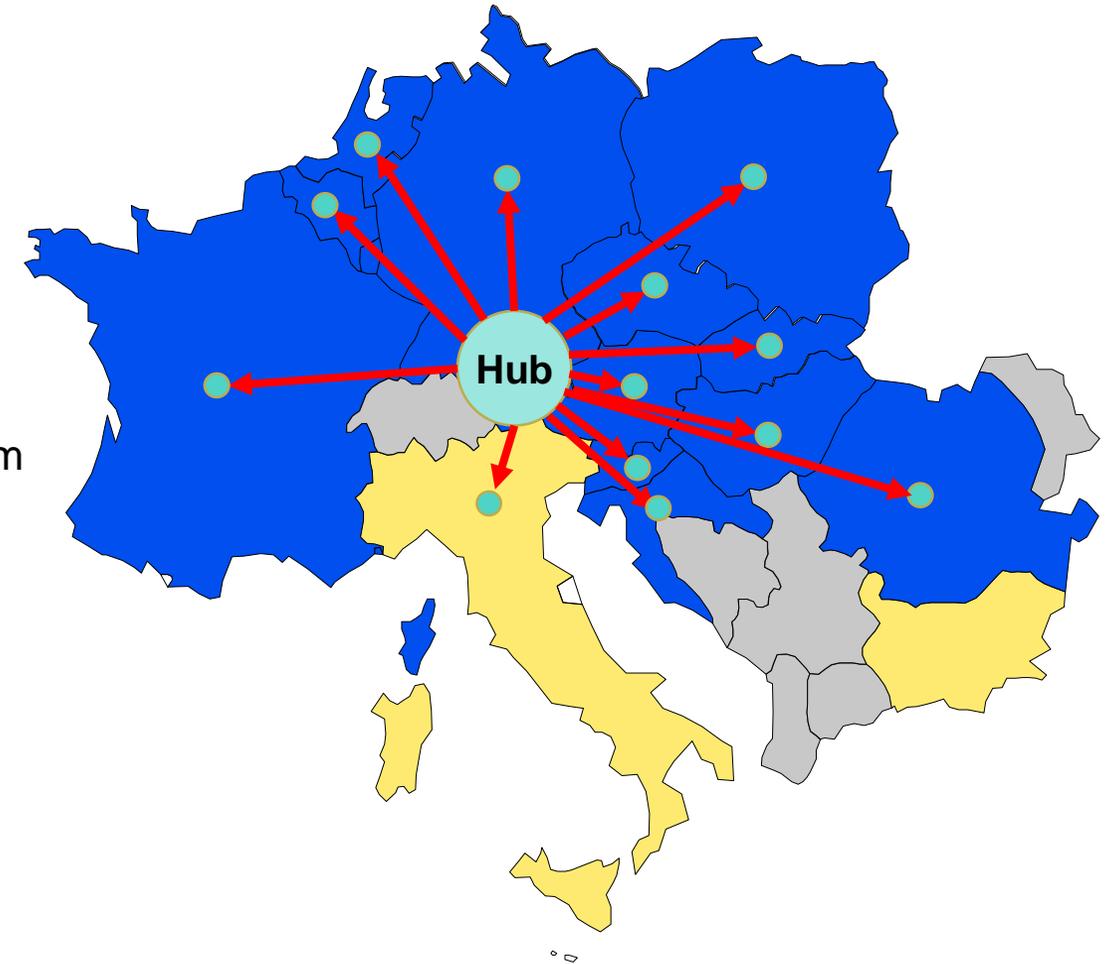
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3. Forward market coupling Zone to Hub LTTRs

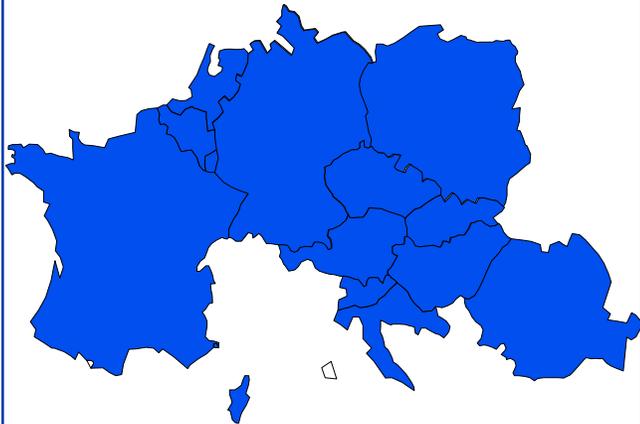
1. Transition to **hub-based hedging** complemented with **accessible Z2H TRs**
 - *Transition is voluntary, implicitly incentivised with TR design*
2. Z2H TRs issued as **obligations**
3. Hub defined at regional (CCR) level, but two regions can form the same hub
4. A regional decision could allow for a Coupling with CfDs design (changing the central counterparty from the SAP to a MCO)



Zoom on Z2H LTTR– Hub price formation

Market set-up

Hub – Core CCR



Hub price formation

- The hub price formation would be subject to a methodology, approved by the relevant regulators
- In the example, the hub price is computed as the volume-weighted average of the day-ahead price based on hourly volumes

Correlation to [%]	AT	BE	CZ	DE	FR	HR	HU	NL	PL	RO	SI	SK
Core hub 2022	96.8	95.8	97.9	98.1	92.5	94.6	94.4	95.2	71.4	89.8	94.7	94.9
DE hub 2022	93.2	95.1	97.4	100	84.5	89.6	89.8	94.9	71.9	84.6	89.7	90.9

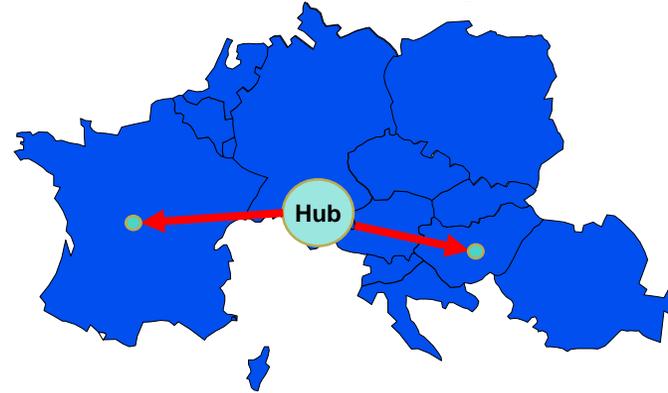
Core hub presents better correlations for all BZs (except DE and PL) compared to DE hub

Zoom on Z2H LTTR – Qualitative example

Stakeholders



Market set-up



Expected market conditions

	DE	FR	HU	NL
Correlation to Core hub				
Price difference to Core hub [€/MWh]	~0	+8	-3	~0

Example

- MP1 (producer) in DE has good price correlation to HUB → MP1 sells hub futures and does not need FTRs
- MP2 (producer) in HU does not have good correlation to HUB. Forecasted HU price is 3€ below the forecasted hub price → MP2 sells hub futures and sells FTRs $Hub \Rightarrow HU$ at -3€/MW
- MP3 (consumer) in NL has good price correlation to HUB → MP3 buys hub futures and does not need FTRs
- MP4 (consumer) in FR does not have good correlation to HUB. Forecasted FR price is 8€ above the forecasted hub price → MP4 buys hub futures and buys FTRs $Hub \Rightarrow FR$ at 8€/MW
- Cross-zonal capacity from HU to FR is allocated due to matching bids of MP2 and MP4 and respecting the capacity constraints between those zones. TSOs receive 11€/MW of congestion income from this allocation.

Products

Single Allocation Platform offers trading with Z2H FTR Obligations for each bidding zone

Market participants can place the following bids:

- Buy **Z2H FTR**
- Sell **Z2H FTR**
- **Buy Zone A to Zone B:** this translates into a linked bid for sell H2A and buy H2B.

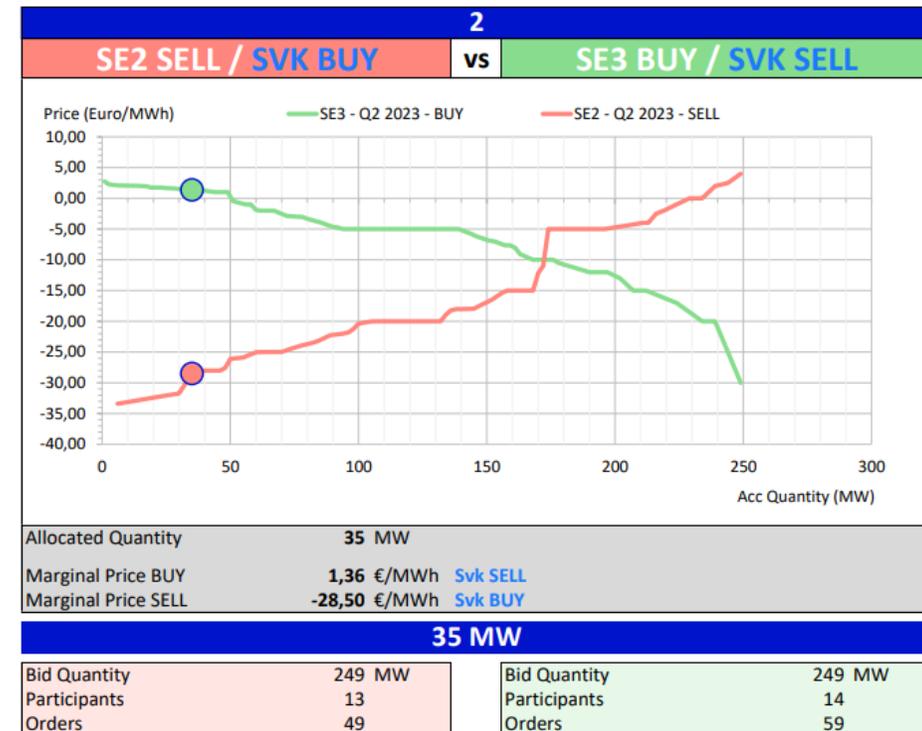
Matching

- **Z2H products** are cleared if:
 - A buy order is matched by a sell order in the same zone **OR**
 - A buy order is matched by a sell order in a different zone by allocating cross-zonal capacity
- **Z2Z equivalents** are cleared if:
 - A linked Z2Z bid is more competitive (leads to higher surplus) than bids competing for the same capacity **AND**
 - Enough cross-border capacity is available between the concerned zones
- Market participants **don't receive FTRs from TSOs**, but from other market participants.
- Cross-zonal capacity is used **only to allow matching** between two participants in different zones.
- **One auction** is organised **each week** with new capacity, leftovers and resold capacity
- **Daily auctions** are organized with capacity leftovers and resold capacity

Zoom on SvK CfD coupling pilot project

- Svenska Kraftnät has launched in February 2023 a pilot project to support the liquidity of the EPAD markets.
- Cross-border capacity is allocated to bridge the supply/demand asymmetry of the different SE bidding zones.
- First results indicate that **the allocated transmission capacity successfully supports the EPAD market**
- Results in line with the parallel continuous market prices.

Auction results 28 Feb 2023, Q2 2023 quarterly product



Consultation outcome:



Main consultation feedback:

The proposal is unlikely to solve the problem of liquidity in individual bidding zones. The hub will be liquid but market participants will still continue to have exposure in the bidding zones.

Evaluation:

- Many bidding zones will have good correlations to hub – no need for FTRs
- More capacity can be used to facilitate liquidity of FTRs between non-correlated zones
- Allowing MPs to buy and sell FTRs and TSOs can match FTRs across the border – this will significantly boost liquidity of FTRs.

Looking at the Nordic market, this solution proved itself not to be suitable considering the price differences between the different zones.

- Hub is the only viable solution for hedging in the Nordic market
- Nordic market is currently deficient because TSOs do not facilitate liquidity of EPADs

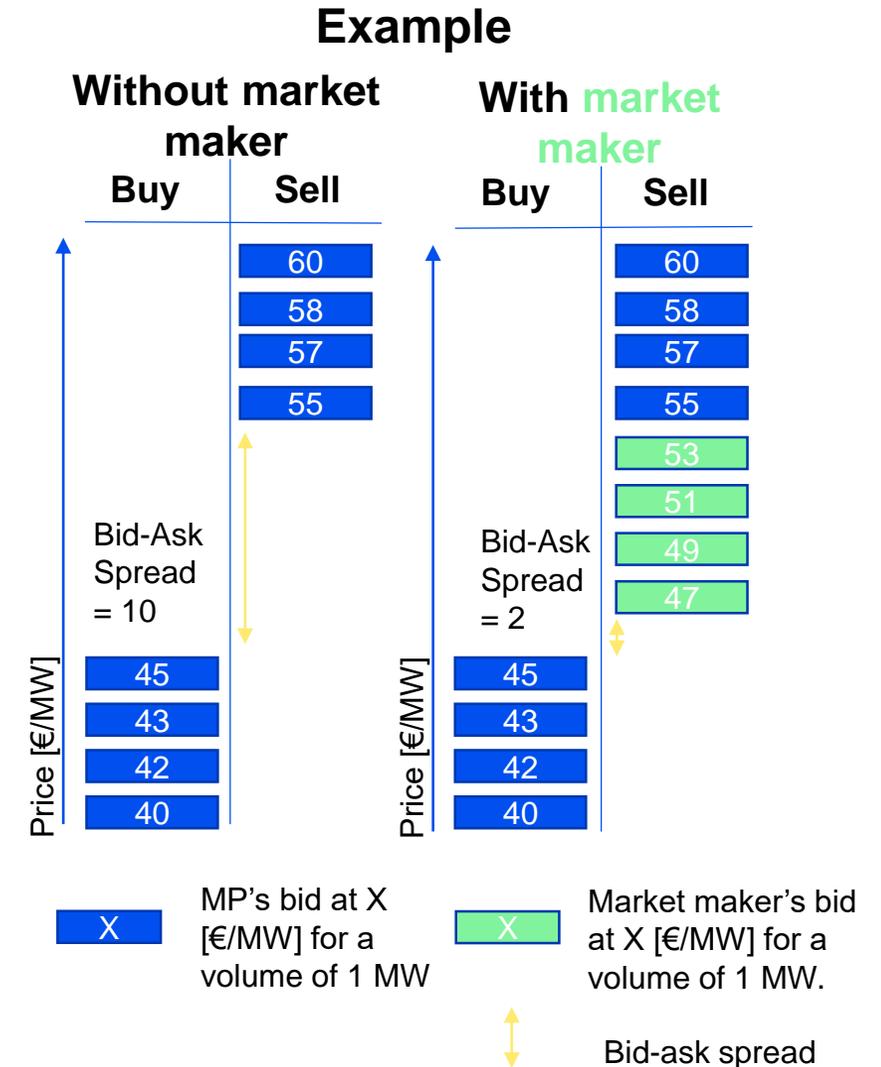
Many design elements still need to be defined (hub price definition, hub structures, hub interactions, ...).

- The hub design will need a detailed analysis
- Hub price definition and liquid FTRs are considered to be a key factor for hubs to be able to attract liquidity.

*See for example [ACER decision No 12/2022 concerning risk hedging opportunities on the bidding zone borders between Finland and Sweden](#).

4. Market making

- Following a national decision, TSOs organize the nomination for a market maker function to complement the LTTRs/EPADs
- Selected market makers are obliged to facilitate order books for forward products at PXs (Futures, EPADs) with an objective of reducing the bid-ask spread
- They will charge a fee for this service which is covered from network tariffs and defined in the tendering conditions



Preferred policy option 5: FTR obligations with full financial firmness

Remaining risks and challenges

14:55 – 15:10

**Martin Povh – Senior Expert,
Electricity Department, ACER**

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5. FTR obligations with full financial firmness

FTR obligations has several advantages over FTR options:

1. Provide a full hedge (i.e. full price lock-in) at the **lowest cost**
2. Value of FTR obligations is **easier to estimate**. Easier monitoring and benchmarking.
3. **Easier arbitrage** between two forward markets with futures
4. **Better capacity allocation**: (i) more capacity due to netting, (ii) enable capacity leftovers
5. **Concentrate liquidity** into a single product per zone – more competition in primary and secondary market (Core+IT North region today has 42 different FTRs, this can be reduced to just 13)
6. **Reduce undervaluation** due to above

The impact of FTR options in parallel to FTR obligations should be further analysed

For LTTRs to be true complementary for Futures, obligations with full financial firmness are needed.

To achieve this, the following changes to the current framework are needed:

- Remove curtailment in normal situations
- Remove curtailment in case of force majeure or emergency situation
- Remove compensation cap
- Remove exemptions to LTTR remuneration
- No reduction periods possible anymore – only full baseload
- Removal of LTA inclusion **or** maintain LTA inclusion but allow for deviation in case of operational security concerns

The statistical approach for capacity calculation (preferred policy option of improved allocation of LTTRs) should minimise the likelihood of revenue inadequacy.

The FCA Regulation should ensure full cost recovery comfort to TSOs in case of revenue inadequacy.

Consultation outcome:



Main consultation feedback:

FTR obligations would only make sense if market participants would trade between themselves such or similar contracts, and payment for the negative spread would be the consequence of risks premium. This is however not the case when TSO allocate capacity.

FTR obligations “lock” the market context and do not allow market participants to grasp opportunities in the same way that options do.

FTR obligations already exist in the FCA Regulation and no market participant seems to be interested.

FTR obligations will increase the exposure of market participants.

Evaluation:

The proposed model does exactly that: MPs trade FTRs among themselves, TSOs use cross-zonal capacity only for cross-zonal matching. Its a similar model as in market coupling.

Today futures are preferred over options. There is no reason to believe that FTRs are any different.

FTR obligations are currently not offered by TSOs – it is hard to actually conclude in the interest. In forward markets futures attract much more interest than options.

Higher exposure comes with a lower cost. Futures are much more attractive than options.

Expected benefits and risks?

1. **Pooling liquidity:** Instead of many national (illiquid) forward markets we gather all liquidity at regional hub
2. **More efficient hedge:** Hub Futures are better hedge for most zones than e.g. German Futures (better correlations)
 - this means less need for TRs to cover the basis risk
3. **Market beyond 3YA:** a hub makes the development of a market beyond 3YA a bit more likely
4. **Independent on the changes/size of zones:** Forward market liquidity is no longer a barrier to changes of bidding zones
5. **No force needed:** Power exchanges can still offer zonal Futures, MPs can still trade Z2Z TRs, yet we expect that much of the demand will switch to a hub due to Z2H TRs

1. **More continuous access:** TRs auctioned daily/weekly, secondary market at exchanges
2. **Less fragmentation:** a single product per bidding zone
3. **More liquidity:** market participants can also sell TRs, matching inside a zone or across zones, netting of cross-zonal capacity
4. **TRs support hub Futures up to 3YA:** they are needed only in case of low correlations to a hub
5. **Reduce undervaluation:** move to FTR obligations, easier valuation, regional competition, regular adjustment of offered capacity based on undervaluation

1. **Liquidity at the hub does not develop:** in this case Z2H LTTRs will be used as Z2Z
2. **Full financial firmness:** TSOs/NRAs need to accept more financial risk for network tariffs
3. **Statistical capacity calculation:** a new challenge with splitting into weekly portions
4. **Transformation of JAO:** daily auctions, secondary market
5. **Definition of hub prices:** rely on ex-ante parameters or on parameters depending on the SDAC results (e.g. traded volumes)
6. **Smaller regions:** establish its own hub, join a bigger hub or join a bigger region
7. **Nordic dilemma:** support existing EPADs (traded at PXs) or support Z2H LTTRs

Critique

1. Focusing on undervaluation problem aims to maximise TSOs congestion income

- Regulators focus only on market value for LTTRs
- Efficient market should minimise risk-free arbitrage

2. TSOs should allocate FTR options, not obligations

- There are numerous advantages of obligations
- The hub model with options would be much less efficient (fragmentation, no netting, no leftovers)

3. Competition between the borders is not desirable (flow-based allocation) due to risk of low capacities in low-spread borders

- More FTRs between high price zones and less between low price zones is beneficial
- High price spreads correspond to poor correlations - more FTRs needed.
- Reducing forward price spreads correspond to consumer/producer benefits (e.g. lower consumer prices in high price areas)

4. Instead of Z2H FTRs, TSOs should do only small improvements: more capacity, longer timeframes and secondary market

- Forward markets needs to be integrated (combine supply and demand from many bidding zones - explicit allocation of capacity is not efficient way to integrate markets)
- Explicit allocation promotes bilateral markets, regulators prefer supporting trade on exchanges
- FTR market is currently too fragmented (more than 80 different products in EU) for secondary market to develop. A TSOs' platform will not help.
- High risk of more state interventions (e.g. CfDs, CRMs) – even more important to “merge” the remaining supply and demand

5. The goal of forward market is not optimisation of flows

- Indeed, optimisation of flows is not the goal here
- What is important is to “merge” supply and demand across different zones with the help of cross-zonal capacities

6. Market integration is not the goal in the forward market

- Forward market can only work in hubs (not enough supply and demand in individual zones)
- In case of significant congestions, hubs are fundamentally dependent on FTRs

Q&A for Session 2

15:10 – 15:25



**Moderator: Mathieu Fransen, Team Leader,
Electricity Department, ACER**

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1. Do you agree that pooling liquidity at hubs which would be complemented by accessible transmission rights would be beneficial?
2. What are the main risks of the preferred policy options? (open text – two words maximum)
3. What are the main opportunities of the preferred policy options? (open text – two words maximum)

Stakeholder views

15:25 – 15:50

Jim Vilsson, ENTSO-E
Christian Baer, Europex
Hélène Robaye, Eurelectric,
Jérôme Le Page, EFET,
Michaël Van Bossuyt, IFIEC

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ENTSO-E's first views on ACER's policy paper on forward markets

13/03/2023



ENTSO-E's first views on ACER's policy paper on forward markets

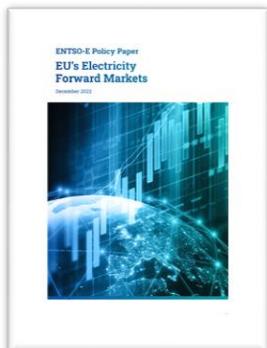
Based on ENTSO-E's Policy Paper - [Link](#)

Topic	Agreement	Disagreement	
1	Problems of forward markets	<ul style="list-style-type: none"> In most EU countries most forward commercial markets are lacking liquidity; 	<ul style="list-style-type: none"> Some points require further detailed assessment (i.e. maturities, harmonisation); LTTTs are only a part of forward markets and they cannot solve every issue - Other aspects to be also tackled: i.e. adopting CRMs in most markets - PPAs and CfDs also to be assessed; None of the proposed commercial baseload hedging products would work for RES/industrial consumer (variable production);
2	Valuation of LTTTs	<ul style="list-style-type: none"> ENTSO-E finds similar results of LTTTs: valuation continuously below the materialised price difference Consequence financial loss for end consumers (in most countries, gap compensated via network tariffs); 	
3	Improved allocation (longer products, more auctions)	<ul style="list-style-type: none"> Market Participants keep requesting products with a longer time horizon and more frequent auctions; 	<ul style="list-style-type: none"> Huge uncertainty and higher financial burden on end consumers - risk shift from MPs to TSOs; Additional need of redispatching in real time and higher costs due to more frequent curtailment; Additional auctions cannot lead to more total capacity. Reduced offered capacity in each auction → negative impact on liquidity;
4	Statistical Capacity Calculation process	<ul style="list-style-type: none"> There are no coordinated planning processes on the regional level that allow the state of the grid to be modelled more than 1 year ahead of real time; Performing sophisticated capacity calculations based on forecasted scenarios cannot be expected; 	<ul style="list-style-type: none"> Potential higher risk and financial burden on end consumers; LTFBA efforts for a short period of time; No consideration of outages planning; Weak link with reality - lose of LTA inclusion: financial risk; Statistical should use real time capacity values and no long-term values - DA capacity values to be used; No prediction (only looking backwards);

ENTSO-E's first views on ACER's policy paper on forward markets

Based on ENTSO-E's Policy Paper - [Link](#)

Topic	Agreement	Disagreement
5 Switch to FTR obligations	<ul style="list-style-type: none"> In line with Policy Option Approach 2 of EE's policy paper; 	<ul style="list-style-type: none"> ENTSO-E's Policy Option Approach 1 (FTR Options) or Policy Option 2 (Purely financial forward markets) still to be assessed;
6 Zone-to-Hub <i>(Approach still under assessment)</i>		<ul style="list-style-type: none"> Uncertainty around capacity calculation: <ul style="list-style-type: none"> Which would be the underlying capacity? Impact on current LTA inclusion (remuneration adequacy)? Uncertainty around financial regulation: <ul style="list-style-type: none"> Will the approach fall under MiFID? Additional burden: reporting obligations, impact on collaterals, etc. Would the model be an 'add-on' or a 'substitute' framework? → Are new "future hub forward markets" supposed to coexist with current liquid forward markets, like the German?
7. Full financial firmness		<ul style="list-style-type: none"> Serious financial impact to end-consumers;



[ENTSO-E's Policy Paper](#)

TSOs will further evaluate possible ways to improve the forward markets in line with ENTSO-E's policy paper
 TSOs remain open to further assist in a proper impact assessment and upcoming discussions

Europex assessment:

**Final ACER policy
paper on the further
development of the
EU electricity
forward market**



Monday, 13 March 2023

Europex

1. General remarks on the final policy paper



- **ACER's recognition of the importance of long-term forward hedging** in the the electricity market design.
- **The intention to further improve key features of wholesale electricity forward markets**, i.e. efficiency, liquidity and transparency.



- **Missing a more comprehensive analytical approach of forward markets** and the related risk management, incl. financial markets and their regulatory framework – MiFID II / MiFIR, EMIR – as well as a consideration of the ongoing EMD review.
- **Lack of impact assessment.** Not providing sufficient evidence of identified assumptions and shortcomings.
- **Limited consideration of stakeholder feedback** following last summer's public consultation.
- **Overcomplexity of ACER's preferred policy options** (e.g., regional virtual hubs, forward market coupling with CfDs, market making with TSO support, FTR obligations with full financial firmness, long-term flow based allocation) **with limited proven added value and potentially significantly disruptive effects with unknown consequences.**
- The **FCA Guideline only covers one specific aspect** in a significantly more complex market environment.

2. Underlying problem definition unclear, assumptions misleading

- The purpose of the forward market is to **re-allocate risks** and consequently organise future cash-flows, **not** to (unnecessarily) optimise physical flows long-term.
- **Inadequate generalisation of problems** in the forward market. The liquidity status largely differs among different bidding zones.
- In the absence of a well-functioning and liquid secondary market for LTTRs, market participants make use of **locational spread products** offered by exchanges. These products can be traded continuously at relevant maturities.
- **Forward market liquidity is not a barrier to the reconfiguration of BZs** but a criterion to consider when assessing BZ reconfiguration.
- Prior to advocating for specific proposals, ACER should conduct an **in-depth impact assessment** on the current status of the forward market, including:
 - **The development of transparent and clear criteria** to assess liquidity in hedging products in the different bidding zones.
 - **An assessment of existing hedging opportunities** (e.g., location spread futures).
 - **Building on the experiences and knowledge of relevant stakeholders** and directly involve them in the process.

3. Focused assessment of the suggested Zone-to-Hub option

Negative short-term impact:

The Zone-to-Hub model **risks fragmentation** of the forward market and consequently a fragmentation of liquidity.

Negative long-term impact:

The Zone-to-Hub model **risks a structural liquidity decrease**.

Forward trading volumes in the Nordics (proxy hedging at a hub but not a zone-to-hub model as such) have experienced a continuous downtrend over the last years – independent of the current crisis – resulting in a current overall market volume which is less than half the size compared to five years ago.

Zone-to-Hub policy **does not solve** the underlying problem:

1. Transmission rights between the hub and a smaller zone will remain illiquid → shifting the problem without solving it, at the expense of turning market structures upside-down with significant adaption costs but no added value.
2. Lack of an underlying hub spot market.
3. No reason why market participants should prefer a hub over a liquid neighbouring market.



Market Participants views on ACER policy paper on forward market

ACER workshop on further development of EU forward electricity market, 13th March 2023

The paper is based on a wrong understanding of the forward market



- While not perfect, **forward markets do function well**. They allow to hedge part of the exposure to short term market price volatility. They played their role during the crisis to indicate scarcity hence the need for efficient dispatch including demand participation. In less liquid BZ, MPs are used to proxy hedging (even in the absence of LTTR, or without a neighbouring border with a liquid BZ!).



- In ACER paper, we welcome:
 - the wider analysis on forward markets liquidity
 - the need to have better access to the transmission grid in the forward market via higher volumes of LTTRs
 - the recognition that cross-border hedging opportunities beyond one year ahead can be improved



- However, we strongly disagree with ACER diagnosis:
 1. The perception that LTTRs are related to the low(er) liquidity in some BZ (LTTRs are related to the ability of Market Participants to hedge against market price spread volatility).
 2. The statement that “forward market are not integrated”. Proxy hedging currently performed by MPs shows the integration of forward markets. Neither market coupling in forward, nor flow determination are needed.
 3. The conclusion of an undervaluation of FTR options and the proposed “remedy” to introduce a competition between borders for FTR allocation.

Proposed remedies are not desired by market participants, over complexifying the forward markets (and related costs), without any proven benefit

ACER proposal

Long-Term Flow-Based Allocation



Virtual Hubs



FTR obligation



EFET/Eurelectric view

- Demonstration of benefits highly contestable: based on TSO surplus!
- Leads to low/zero capacity volumes at some borders
- Is complex and impossible to implement in practice (collateral issue)
- Dangerous to allocate LTRs based on forward spreads

- Very low positive feedback in consultation (12% agree vs 45% disagree/strongly disagree)
- Based on theoretical concept that have not been assessed !
- Increase complexity of forward market / segregation of BZ (out of region)
- Shift liquidity issue to Hub-to-Zone risk
- Deteriorate further hedging possibilities (at a cost for consumer)
- Unlikelihood of TSOs allocating FTRs without underlying physical capacity

- Very low positive feedback in consultation
- Justified by wrong perception of FTR option valuation
- Goal to increase TSO surplus => maximization of TSO surplus has never been an objective of the market / bidding would be different
- Locking spreads in fwd is meaningless ! Spreads are constantly moving => we urge TSOs to ensure issuance of optional products

ACER proposes a revolution, market participants want evolution that addresses the problem

Our recommendations

1.

Remove regulatory disincentives

Such as:

- Regulatory intervention that increase uncertainty e.g. Iberian price control, cap on inframarginal rents
- Specific regulatory frameworks e.g. support schemes linked to spot prices

2.

Widen collateral options

- by diversifying the types of eligible non-cash collateral
- recent EC proposal for EMIR review (Art. 46.1) is promising when it comes to easing collateral requirements

3.

Ensure FTR options are issued by TSOs in greater volumes and for longer maturities

Ensure simplicity and transparency, notably assess carefully the impact of product design changes (such as virtual trading hubs)

4.

Facilitate secondary trading of transmission rights

e.g. having power exchanges easing the exchange of LTTRs between market participants at a price agreed between them (commercial transaction)

5.

Stimulate voluntary "market making"

These services should be contracted by a market-based process, with voluntary participation

ACER workshop on further developments of the EU forward market

13/03/2023

IFIEC Europe wants to stress that **forward markets** are **essential** for many **industrial consumers** to allow them to **hedge positions!**

Forward markets are already delivering value today and must now be improved

- **As much capacity as possible must be given by TSOs to the market to increase liquidity and allow for efficient hedging**
 - IFIEC Europe insists that sufficient capacity of interconnectors is given to the forward markets
 - If needed, mandatory minima should be imposed! (*Cf. minimum 70% minRAM for DA*)
 - *Grid users pay for 100% of the capacity (whether given to the market or not)!*
- **Longer-term forward markets provide value for hedging, better alignment with hedging needs**
 - *Important not to dilute liquidity over too many products/timeframes, need for an efficient allocation mechanism*
- **Congestion income from TSOs should be used in the first place to invest in cross-border capacity**
 - *Evolve towards system integration and not just market coupling*
- **IFIEC Europe is a priori not in favour of Long-Term Flow-based allocation**
 - Long-term is not related to actual flows in the short term, other solutions could lead to more cross-border capacity in the forward timeframe (e.g. statistical approach)
 - Flow-Based → risk for low/zero capacity!
- **Virtual Hubs are not a magic bullet → Need to work on other solutions**

Closing

15:50 – 16:00

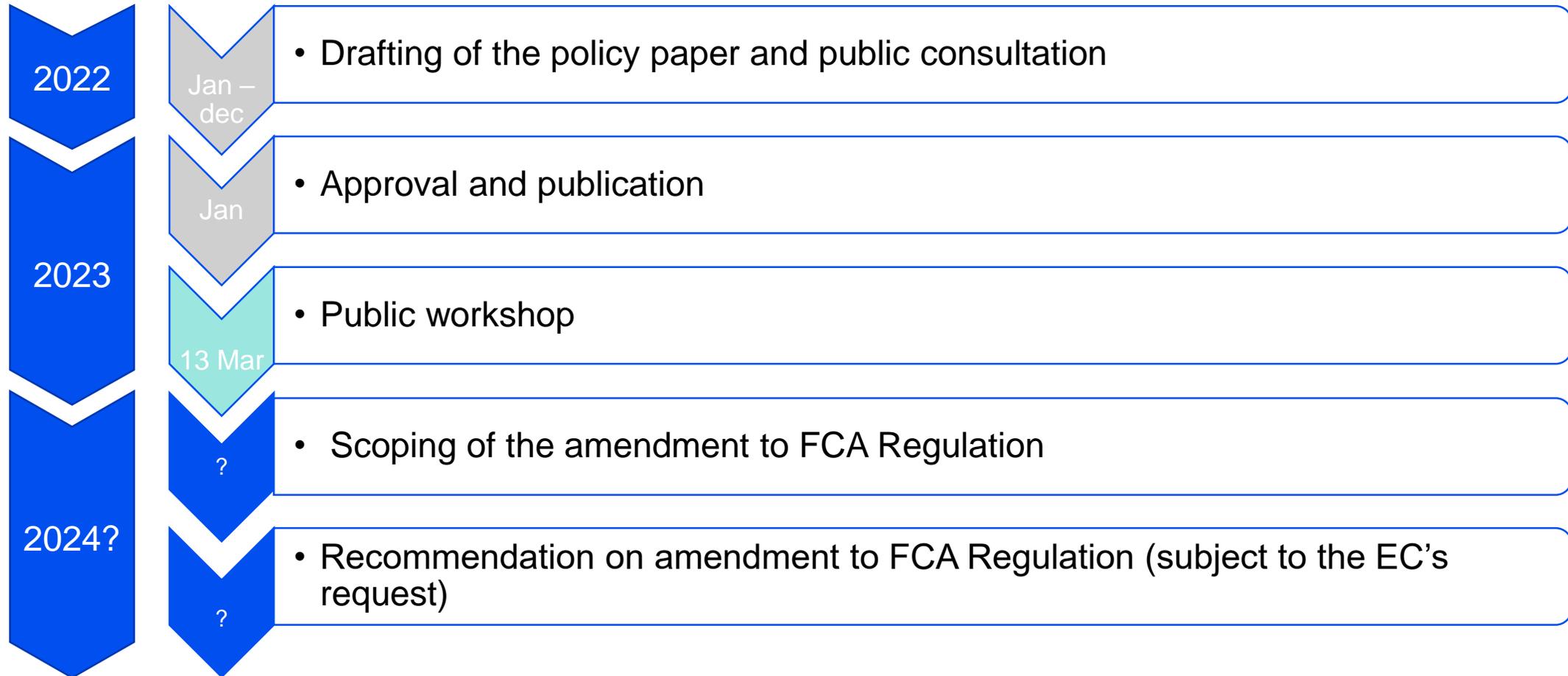
Anne Radermecker, European Commission
Christian Zinglensen, Director, ACER

Ask question via Slido in MS Teams, by scanning the QR code or using the direct link:

<https://app.sli.do/event/bpV5AC18PEdzTABsMDFPvd>



Process



Thank you



European Union Agency for the Cooperation
of Energy Regulators

✉ info@acer.europa.eu
🖱 acer.europa.eu

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