CONSULTATION RESPONSE

EFET
European Federation of Energy Traders

EFET response to the Consultation of ACM regarding long-term hedging opportunities (FCA Regulation)

Brussels, 3 October 2023 - The European Federation of Energy Traders (EFET) supports the ACM effort to better understand the long-term hedging practices of market participants and sound their needs in terms of hedging opportunities to be offered by TSOs in the future. We provide below a high-level view on improving liquidity and hedging opportunities in the forward market, and we have invited our members to provide detailed responses to the consultation.

Key messages

1. A wide range of hedging instruments enables market participants to mitigate risks in the electricity market, within zones and across borders.

2. More transmission rights, with longer maturities, should be allocated by the TSOs to support market liquidity and offer longer-term cross-zonal hedging opportunities.

3. Full financial firmness of the transmission rights should be preserved.

Comments

Current use of hedging instruments

Forward trading is currently the main tool for hedging risks in the electricity market – including short-term price volatility. Market participants have diverse hedging needs, necessitating a wide array of hedging instruments to effectively mitigate risks.

The monthly, quarterly, and yearly standard contracts, traded through exchanges or brokers, allow market participants to address most of their hedging needs for specific periods, based on market liquidity. For more specific hedging needs, bespoke bilateral contracts are employed, typically extending beyond market liquidity periods.

Proprietary forward trading is also important to forward markets, notably as a purveyor of liquidity. The presence of market participants performing this type of trading is a sign of good health of the local forward market and will tend to attract even more liquidity.

Market participants utilise various marketplaces to manage credit and cash-flow risks.

The need for more, multi-year forward transmission rights

Cross-zonal risk mitigation assumes critical importance within integrated markets. TSOs therefore need to maximise the volume of capacity they offer in the forward timeframe, as required by European legislation since 2009. As more elaborate long-term capacity calculation methodologies develop in Europe, it is key that this does not come to the detriment of capacity availability. In particular, we harbour concerns as to the development of flow-based capacity calculation and allocation in the forward timeframe in the Core region. Preliminary studies suggest that forward capacity will be significantly reduced – or inexistent – at borders with low market spreads. We request that the implementation of this project is put on hold until concerns about capacity availability, among others, are resolved[1].

EFET also advocates in favour of forward transmission rights extending beyond one year-ahead (up to 5 years-ahead). This would broaden cross-zonal hedging opportunities and enhance market liquidity during the tenure of the allocated transmission rights.

The importance of financial firmness of forward transmission rights

Forward transmission rights should remain fully financially firm. This allows market participants to hedge residual cross-zonal risk completely, at least for the part of their cross-border trading activity where they managed to secure forward transmission rights.

Amending the financial firmness of transmission rights in case of day-ahead market decoupling, as recently proposed by the TSOs in the review of the EU HAR, would lack a legal basis in the FCA Regulation. It also bears risks of underperformance of the system:

- A reduction in the firmness of transmission rights will translate into less ideal hedging opportunities for market participants. A lower risk coverage will translate into directly higher costs to hedge a specific risk on the market, costs which will ultimately be passed on to consumers.
- A reduction in the firmness of transmission rights will also be accounted for by market participants when they bid in long-term auctions, in particular for events such as day-ahead decoupling that market participants are unable to forecast or mitigate. This will reduce the overall value that market participants place in transmission rights, and what they would be willing to pay for them. This could significantly affect the revenues that TSOs capture from the sale of transmission rights.

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[1] See our response to the ACER consultation on the matter, dated 26 September 2023: https://efet.org//files/documents/230926%20Electricity%20Committee%20CR%20ACER%20harmonised%20allocation%20rules.pdf