

23.3.2016

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FCA study - public consultation

Fingrid's comments to NordREG's report on measures to support the functioning of the Nordic financial electricity market

Fingrid would like to thank NordREG for the opportunity to comment the consultation report on TSO intervention alternatives to financial electricity markets. The consultation report presented an interesting analysis of different measures with a strong emphasis on a market participant viewpoint. Fingrid would like to express the following views on the report from a TSO perspective.

Fingrid understands the basic premise of the report about insufficient hedging opportunities and that the relevance of the premise was not studied yet. However, the first and extremely important step in the forward markets assessment process is to analyze whether hedging opportunities are insufficient, and if there is a true need for intervention in the financial market. The careful assessment should be done before considering different intervention alternatives as the assessment should identify the core problem - bidding zone by bidding zone. This means that when the diagnosis is done, the treatment can be designed to address the disease instead of relieving the symptoms.

Fingrid have received controversial signals from Finnish electricity market participants about the state of the financial electricity market. In 2015, Fingrid launched a consultation about the state of the Nordic financial electricity market and about market participants' preferred hedging products. Fingrid received 17 replies from producers, consumers, traders and service providers that act in financial electricity market. Most of these market participants were satisfied with the current hedging opportunities and told that there have not been any problems for hedging and EPAD contracts can usually be made via broker. In contrast, some participants replied that market could function better and that the liquidity should be improved, possibly by a TSO intervention, but also by market participants themselves by trading more actively.

Most of the responses highlighted the strength of the current hedging model based on a liquid and creditable system price reference and an EPAD to cover the remaining price risk. All respondents preferred EPADs to FTRs since FTRs do not have connection to the Nordic system price, and for that reason many respondents were concerned that introduction of FTRs would split the liquidity of EPAD market. Diminishing liquidity of the current financial market could further erode the role of system price highly appreciated by Nordic market participants. Yet, some respondents mentioned that FTRs could also increase hedging possibilities and increase the liquidity in the financial markets. In addition to measures related to EPAD and FTR products, many participants mentioned also other measures to improve the markets in general, like larger bidding zones (more volume per zone), increasing transmission capacity between bidding zones (smaller price differences and risks) and enhancing transparency of the market.

Fingrid agrees that well-functioning EPAD market would be better for the Nordic market than introducing a completely new hedging product that does not fit to the Nordic market design. However, the alternatives presented in NordREG's consultation report are not as straightforward as stated. The report did not consider consequences of the measures thoroughly, and the costs and risks to TSOs were probably underestimated. TSOs do not have relevant expertise in financial markets. Shifting the risk from a market participant to a TSO means socializing the market risk to the TSO's customers and finally to the end consumers.

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According to references^{1,2}, the liquidity of the EPAD market is mostly on OTC market (OTC volume is up to 85 %). It should be investigated why market participants prefer to trade via broker. If the barrier is on the market platform, it should be a task of Nasdaq OMX Commodities to make the market place more attractive by improving the conditions. The barrier might also be in the insufficient transparency as the actual trading price is not visible in the listed price (Spodniak et al. 2015). If market participants prefer to trade via broker instead of Nasdaq OMX Commodities, TSO intervention in Nasdaq OMX Commodities will not improve the hedging possibilities straightforwardly. In addition, providing a market place for financial products is competitive business and TSOs should not support Nasdaq OMX Commodities because the support would be competitive advantage. If implemented, EPAD auctions should be held on the Single Allocation Platform because it would be a non-discriminant option in relation to various competing auction platforms.

Further, the report assumed that congestion income could be directed to finance the EPAD market support, but financing the EPAD market support in this way is not as straightforward as the report stated. Regulation 714/2009 states that congestion income can only be used to maintain and increase cross-border capacity and to guarantee the actual available transmission capacity. We do not agree with the report that FCA guideline explicitly permits congestion income to be used to EPAD market support, as EPADs are not directly related to cross-border transmission capacity and EPADs are considered as an exemption in the FCA guideline. Therefore the EPAD support would probably be financed via grid tariffs. Proportionate tariff design and cost reflectiveness would be difficult as not all EPAD market participants are TSO's customers. National regulatory authorities might not have adequate powers on financial market, which makes these alternatives even more problematic to implement.

Legally auctioning of FTRs would be more straightforward although these products would not fit to the Nordic market design. The roles, procedures and financing are clearly stated in the FCA guideline and Harmonised Allocation Rules, and therefore FTRs seem to be more feasible from TSO's viewpoint. However, if NRAs request TSOs to support the EPAD market, the legal matters have to be clear - before that, Fingrid cannot take any actions.

Several TSOs' financial cross-border risk mitigation alternatives were presented in chapter 3.5.2 of the report, for example, investments in the grid (more interconnection capacity to reduce price differences) and provision of transparency of which produces predictability. All these measures would reduce risk for the whole market and would fit better to TSOs' role defined by regulations and TSOs' task elaborated in network codes.

Fingrid will continue working for well-functioning wholesale market by improving and maintaining transmission infrastructure and ensuring adequate cross-border capacity.

We would be happy to continue discussion related to this report. For this, you can contact Heidi Uimonen (heidi.uimonen@fingrid.fi).

Best regards



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¹ Anne-Marit Rudby, Nasdaq Commodities, 2015, How to improve hedging, Fingrid's electricity market day 2015. <http://www.slideshare.net/Fingrid/electricity-market-day-2015-annemarit-rudby-nasdaq-commodities-how-to-improve-hedging-47494523?related=1>

² Spodniak, Petr; Collan, Michael; Viljainen, Satu, 2015, Examining the Markets for Nordic Electricity Price Area Differentials (EPAD) - Focus on Finland. <http://www.scribd.com/doc/267178725/Examining-the-Markets-for-Nordic-Electricity-Price-Area-Differentials-EPAD-Focus-on-Finland>

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