Public

Issue 90

Could Elexon (under BSCco) administrate a tendered Market Maker (tMM)?

13 July 2020

Peter Frampton, Andrew Grace

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Introduction and Objectives

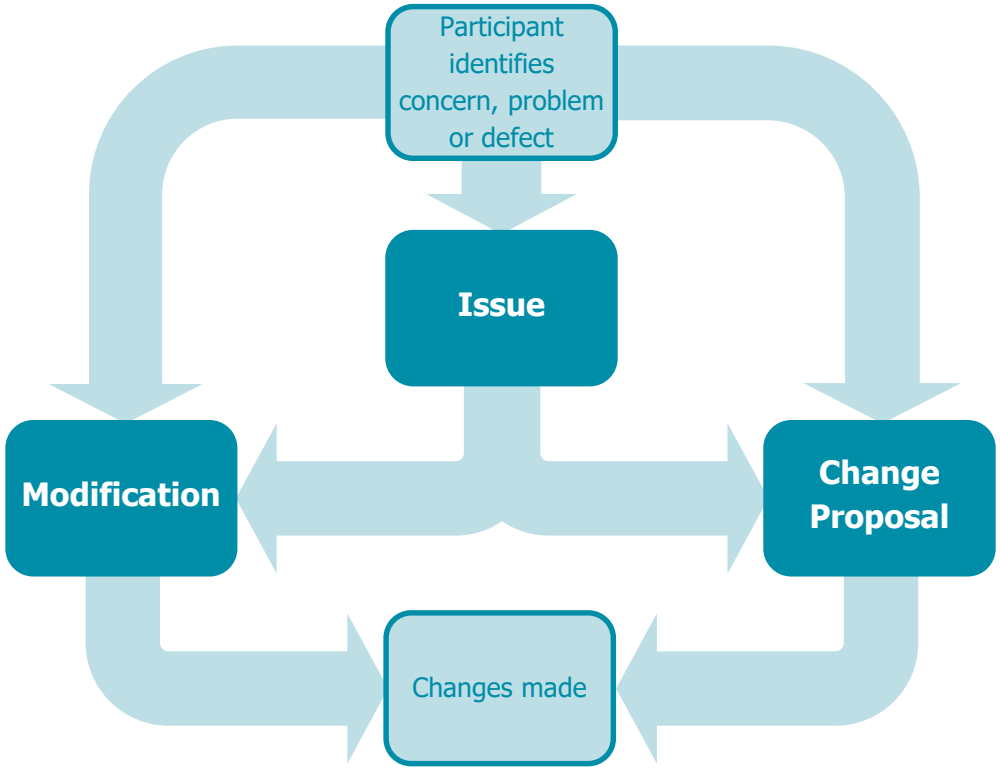
Agenda Item	Lead
1. Introduction and Objectives	Lawrence Jones (Chair)
2. BSC Issue Process	Andrew Grace (Lead Analyst)
3. Background of Issue 90	Andrew Grace
4. Issue 90 Scope	Peter Frampton (Design Authority)
5. Group Discussion	Workgroup
6. Solution Design Choices	Peter Frampton
7. Next Steps	Andrew Grace
8. AOB	Lawrence Jones

Objectives for this meeting:

- Confirm if Elexon (under BSCco) are the right party to administrate a tendered Market Maker
- If ELEXON is not the right party to run a tender for an MM, and then administer it, who may be best placed to undertake this role if required.
- Define service market participants would require from a tMM

BSC Change Process

		Will my solution amend the BSC?	
		Yes	**No**
Do I have a clear solution?	**Yes**	Modification	CP
	No	Issue	Issue



BSC Issue Process

- Raised if participant wants to discuss an issue or concern;
- Issue Group convened to discuss the Issue;
- More of an informal, ad-hoc approach;
- Group will consider any ways forward;
  - e.g. solution (any BSC Party can take forward the outcomes of an Issue e.g. BSC Modifications), extra guidance, no change
- We will prepare a final Issue report for the BSC Panel.

Issue 90 Background

- Ofgem published a decision to review market liquidity
- Suspension of Market Maker Obligation (MMO) – 18 November 2019
  - Originally 6 obligated parties
  - 2 remaining at point of suspension
- 2019 NERA report:
  - Low liquidity is not necessarily indicative of a market failure that needs to be addressed with a policy tool such as the MMO
  - Increase in bid-offer spreads (the most common measure of liquidity) after the MMO suspension and the higher liquidity in other European markets as indicative of potential market failure that could be addressed
- COVID-19 further reduced liquidity
  - Unclear if underlying trend or if liquidity will recover when the market returns to more normal operations.

Issue 90 Scope

- Is Elexon the appropriate body to tender for a commercial MM?
  - If not who should tender if Ofgem were to go down the tMM route again?
- What would the tender look like?
  - Live auction, sealed bid, paid as cleared or bid?
- What products should be included?
- Would a tMM involve financial regulation?
  - If it does, do the associated costs and risks make the solution inefficient?
  - Is there a version of a solution that would limit exposure to financial regulation?
- How quickly could a solution be implemented?
  - Could it be implemented in stages?
- How much would it cost to implement?
- Who will pay for it and how?

Scope

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Issue 90 Scope - continued

- Will there be any parties that disproportionality win or lose?
  - Customers, small/large Generators, Suppliers, renewables, Interconnectors?
- Are there other market interactions not considered?
  - Balancing services, TERRE?
- Are there other regulatory or code areas that would interfere with implementation?
- Should the tMM be reviewed to check it is still necessary and if so at what interval and by whom.

Issue 90 – Not in scope

- Should the GB electricity industry procure a commercial MM service?
  - This decision should be informed by Ofgem findings. A BSCCo procured tMM delivered by Modification would need to satisfy Ofgem's Modification approval criteria.
  - Industry may progress a Modification absent any final decision from Ofgem, noting that it will eventually be subject to this approval process.
  - If approved, the provisions introduced by Modification P390 may provide an alternative mechanism by which BSCCo could establish a tMM, again subject to Ofgem approval.

Group Discussion

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Who should run the tMM Tender?

Is Elexon the appropriate body to tender for a commercial MM?

If not who should tender if Ofgem were to go down the tMM route again?

- A tMM requires an organisation to run the tender (procurement) and oversee the performance of the tMM (assurance).
- This organisation would also be responsible for making payments to the tMM and collecting costs from industry via the agreed tMM funding mechanism.
- ELEXON has experience in procuring and assuring services on behalf of the electricity industry, notably in respect of settlement systems.
- ELEXON funding mechanisms can also be adapted to ensure appropriate cost recovery of the service.
- Other Code Administrators may also have access to the expertise and funding mechanisms necessary to procure a tMM on behalf of the electricity industry.

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Who should run the tMM Tender?

Is Elexon the appropriate body to tender for a commercial MM?

If not who should tender if Ofgem were to go down the tMM route again?

- Marketplaces may also be able to procure a tMM on behalf of their customers. While this case may be platform specific, the bids and offers will need to be placed on a marketplace regardless of who procures the tMM.

Who should run the tMM Tender?

Is Elexon the appropriate body to tender for a commercial MM?

If not who should tender if Ofgem were to go down the tMM route again?

- A Modification to enable a tMM is likely to meet BSC Objective (c);
  - Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity
- In as much as it promotes competition in the sale and purchase of electricity by ensuring all market participants have access to a sufficient range of products, both for purchase and price discovery.
- In addition, it may meet BSC Objective (b);
  - The efficient, economic and co-ordinated operation of the National Electricity Transmission System
- As it would enable better hedging options for market participants, reducing imbalance exposure and the cost of balancing the system

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Tender structure

What would the tender look like?

Live auction, sealed bid, paid as cleared or bid?

- The NERA report covers live and sealed bid auctions for procuring the MM, and monthly or per-unit costs for ongoing compensation.
- These options were considered on the basis of an Ofgem procurement with Ofgem specified criteria
- Industry defined requirements may mean that the procurement method can be simplified to achieve similar outcomes
- It is unclear at the moment how much interest there would be in running a tender process, or how complex the requirements would be. It may be too early to determine which method is better.

tMM offered products

What products should be included?

- Ofgem's MMO included baseload and peakload for month+1, m+2, quarter+1, season+1, s+2, s+3 and baseload only for s+4
- The Proposer believes these products do not adequately cover the needs of Parties who would benefit from a tMM.
- In particular, the Proposer believes more granular products closer to real time would also benefit from being covered by the tMM, in particular EFA Blocks throughout prompt market and up to season ahead.
- Increased range and granularity of products will also increase the cost of providing the tMM service. The service provider would need to monitor a greater range of markets, and be exposed to more overall risk.

Implementation time

How quickly could a solution be implemented?

Could it be implemented in stages?

- An ELEXON procurement process would likely take 6-9 months, depending on requirements.
- This timescale does not take into account time for the winning bidder to implement the solution. This may be a factor in the procurement process.
- The tender requirements could be structured in such a way as to require regular re-procurement, with the terms adjusting based on lessons learned from the previous tender period.

Implementation cost

How much would it cost to implement?

- The cost of implementing the solution is likely to depend on the requirements.
- Licensees provided information on costs for complying with the Market Making obligation, for Ofgem's review in 2017
  - Fixed costs were reported as £500,000 annually per licensee
  - Variable costs were between £200,000 and £700,000 per licensee in 'normal' years, and £3m to £8m per licensee due to high volatility in 2016
- Fixed costs are unlikely to scale significantly across a tMM procurements, however the MMs operating would still be exposed to volatility on the same volume covered by the MMO obligated parties.
  - The NERA report offers a low cost case of £6.7m per year and a high cost case of £53.5m per year, including set-up costs per MM

Implementation cost

How much would it cost to implement?

- The NERA report also estimates the cost of administering the tMM at £500,000 per year.
  - This will vary depending on the complexity of the tender, the monitoring requirements, and how frequently the tender will be re-run.
- NERA's net benefit table, based on an MMO rather than tMM;

Table 7.1: Our Estimated Net Benefits of the MMO (Units in £m)

	High liquidity counter-factual bid-ask spreads		Historical bid-ask spreads		Low liquidity counter-factual bid-ask spreads	
	(Lower)	(Upper)	(Lower)	(Upper)	(Lower)	(Upper)
Benefit	14.5	18.8	29.5	38.2	76.7	99.3
Cost	51.5	4.7	51.5	4.7	51.5	4.7
Net Benefits	**-37.0**	**14.1**	**-22.0**	**33.5**	**25.2**	**94.6**

Source: NERA Analysis

Cost distribution

Who will pay for it and how?

- However the tMM is procured, it will be possible to develop a funding mechanism associated with it.
  - For example, ELEXON could collect and pay costs as part of it's normal mechanism, with costs spread per normal funding share.
  - Alternatively, a bespoke mechanism could be set up and calculated, levying an additional cost on certain sections of the market.
- If a tMM were established, it should be on the basis that it is a universal good, for the correct functioning of markets, accruing (Primary or Secondary) benefits to all. Therefore, it may be reasonable to assume that all energy market participants should contribute towards its operation.
  - Primary benefits accrue to parties trading with the market maker. While costs could be levied in respect of these users, that would place additional costs on the transactions of Parties who are already struggling to access the products they need.

Distributional impacts

Will there be any parties that disproportionality win or lose?

Customers, small/large Generators, Suppliers, renewables, Interconnectors?

- With decreased integration of generation with supply assets in the GB electricity market, there may be a greater range of participants who benefit from the MMO.
- While traditionally the benefits were seen to accrue with smaller parties who can access a greater range of products for hedging there may also be benefits for product access for larger trading parties.

Other market interactions

Are there other market interactions not considered?

Balancing services, TERRE?

- As the tMM covers wholesale market products, it shouldn't impact on delivery of or competition for balancing services including TERRE.
- One objective of the tMM is to improve access to hedging products. In theory, this should lead to improved balancing across participants and reduced balancing costs.

Other regulation/codes

Are there other regulatory or code areas that would interfere with implementation?

- We have not currently identified any impacts on other regulatory or code areas.
- Any tMM may come with additional licence obligations, if specified by Ofgem.
  - For example, it could become mandatory for certain licensees to bid for tender, or Ofgem may reserve the right to compel tender bids in certain scenarios.
- Industry may determine to implement a tMM without any explicit direction from Ofgem, if it is felt to be a beneficial feature of the market overall. In this case there are unlikely to be any regulatory or code impacts outside of those necessary to establish and run the tMM process.

TMM review

Should the tMM be reviewed to check it is still necessary and if so at what interval and by whom.

- The value of the tMM will be sensitive to a range of market conditions. It would therefore make sense to include a regular review.
- If the tMM is implemented by way of Ofgem policy (regardless of how it is delivered) it would make sense for Ofgem to be responsible for review.
- If the tMM is implemented by the will of the industry, then a review could be built in when the tender is re-run.

Financial regulation

Would a tMM involve financial regulation?

If it does, do the associated costs and risks make the solution inefficient?

Is there a version of a solution that would limit exposure to financial regulation?

- It is not clear at this stage that any financial regulation would apply to a tMM.
- The tMM would need to ensure that posted Bids/Offers comply with market manipulation rules, and are posted at a price representative of the product being traded.
  - The tMM is naturally incentivised to do this, as they would be operating on both sides of the market and therefore stand to lose money if trading at false prices.

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Additional design features

- The NERA report also comments on potential additional design features of a tMM. This includes;
  - How many market makers are procured
  - The maximum spread on products
  - Fast market and other suspension rules
  - Trading windows
  - Market making volumes

Additional resource

- NERA report for Ofgem on Options for liquidity policy
  - https://www.ofgem.gov.uk/publications-and-updates/update-liquidity-policy-review-publication-nera-economic-consulting-options-assessment-report
  - Appendix B of NERA's report contains case studies of international tMMs
- Ofgem 2017 consultation on secure and promote policy
  - https://www.ofgem.gov.uk/system/files/docs/2017/12/december_2017_consultation_final.pdf

Next Steps & AOB

- Consider any actions
- Confirm if another Issue Group is required
- Confirm recommendations to update BSC (if any required)
- Notes sent to participants
- Issue report presented to Panel
  - 13 August if no further Issue Groups required
- AOB