Request for Information: Current SEM and Future I-SEM Hedging Strategies

SEM-16-062

19 October 2016

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1. Purpose of this Request for Information

The purpose of this Request for Information (RFI) from the Regulatory Authorities (the Utility Regulator and the Commission for Energy Regulation) is to gather information from relevant licensees related to their current and forward hedging strategies in SEM and I-SEM, with the view of informing the current decision making process following publication of the consultation paper — Measures to Promote Liquidity in the I-SEM Forward market issued on 17 June 2016.

The CER and UR are requesting this information from above de minimis licenced generators and suppliers in the SEM as provided for under licence condition 12 (Provision of Information to the Commission) of generator and supplier licences in Ireland and Conditions 10 and 11 (Provision of Information to the Authority) of generation and supplier licences respectively in Northern Ireland. All information provided will be treated as confidential though we may include aggregate data in our published decision paper.

Please send all responses to Gonzalo Saenz (gsaenz@cer.ie) and Joe Craig (joe.craig@uregni.gov.uk) by 7 November 2016.

2. Background

In June 2016, the SEM Committee published a consultation paper on Measures to Promote Liquidity in the I-SEM Forward Market (SEM-16-030). The proposed measures focused on enhancing volumes offered for trading and price availability. A link to the consultation paper can be found here:

https://www.semcommittee.com/news-centre/publication-i-sem-consultation-measures-promote-liquidity-forward-market

Industry have provided a number of responses that raise additional questions that are considered necessary to address as part of our decision making process. Therefore, as part of developing our thinking on measures to promote forward market liquidity in the I-SEM the RAs are issuing this request for information to market participants on the details of their forward hedging strategies and their views on their efficacy. We are also

seeking industry views about future hedging needs and how this might change under I-SEM. The purpose of the questionnaire is to further inform the RAs deliberations and respondents should include any further information or views they consider may be relevant and useful for the RAs' consideration.

In addition to questions on hedging activities a section on the Market Making and FCSO intervention, which was set out in the Consultation Paper, is also included. The RAs are seeking industry views on the estimated costs of this intervention but are also interested more generally of views on the efficacy of this potential intervention. Respondents to the questionnaire are therefore encouraged to submit all information they consider relevant to this intervention that they consider should be taken into account by the RAs. It should be noted that no SEM Committee decision has yet been taken on this intervention.

Risk Management is an integral element of the efficient and effective operation of the SEM. To date, forward risk management by market participants has taken the form of 2-way Contracts for Differences (CfDs) which have enabled generators and suppliers to manage and hedge the wholesale spot price -SMP.

To our knowledge, there are currently three types of CfD referenced to the SEM wholesale spot price being offered publicly in the SEM:

- Directed Contracts (DCs) whose volume, price and eligibility is set by the RAs as part of the SEM market power mitigation strategy.

- CfDs associated with the thermal generating plants covered under the Public Service Obligation (PSO) levy in Ireland, offered via auction over the "Tullettt Prebon" platform; and,

- Non-Directed Contracts (NDCs), where market participants can offer CfDs which suppliers are free to bid for. The RAs have no role in setting the price or volume of these forward contracts although we do promote their provision. The extent and frequency of NDC trading has increased considerably in recent years with Tullettt Prebon hosting regular "Over the Counter" (OTC) windows on its

Brokered Market. This allows for greater interaction between generators and suppliers with respect to NDC prices and quantities, assisting in price discovery.

- Other forward contracts are also traded bilaterally but not on the Tullett Prebon platform.

In addition to the power hedges described above, market participants also engage in so-called proxy hedges, which seek to manage risk through correlation between the GB electricity and gas price and the SEM wholesale spot price. Cross border transmission rights are a further means of forward risk management which can be combined with the GB spot or contract electricity price. The questionnaire seeks the views of market participants on their current and projected use of these various instruments.

Market Maker and Forward Contract Sell Obligation.

In addition to information on hedging strategies we are also interested in garnering evidence as to the potential impacts and benefits on the market of the two main measures found in the consultation paper on Measures to Promote Liquidity in the I-SEM Forward Market (SEM-16-030), the Market Marker Obligation and the Forward Contract Sell Obligation (FCSO). The RAs therefore seek the views of respondents on the potential benefits to the market of a market maker and FCSO and any limitations or drawbacks of placing these obligations on a number of market participants in I-SEM. In particular we are seeking industry's own estimates of costs from potentially affected licencees. Annex 3 sets out our cost information request relating to the MMO, while Annex 4 does the same for the FCSO.

For the Annexes below, where historic volumes and percentages are required these should cover the years 2013, 2014, 2015 and year-to-date.

Annex 1. Questions for Suppliers

1.1	**What is the typical length of your retail price commitment with your customers?** **(Please provide historic data)**	Average (days) Minimum (days) Maximum (days)	
1.2	**What percentage (if any) of your customers pay a pass-through of the wholesale market spot price? What percentage of your load would consist of pass-through?** **(Please provide historic data)**		
2.1	**What volume and percentage of your load do you seek to contract forward?** **Hedging includes:** • **Internal hedges** • **SEM CfDs** • **Interconnector trades** • **Proxy hedges** **(Please provide historic data)**	Hedged MWh/year	
		Unhedged 1. Customers on fixed tariff contracts 2. Customers on variable pass-through tariffs MWh/year	
2.2	**How far in advance do you seek to have those volumes hedged forward?**	0-3 months 3-6 months 6-12 months	

		1-2 years 2+ years	
3.1	**What type of products do you use to hedge market price risk? Please state volumes and percentage of load of each product.** **(Please provide historic data)**	Internal Hedge MWh/year	
		DCs MWh/year	
		PSO MWh/year	
		NDC (through Tullett Prebon) MWh/year	
		Forward contracts (outside Tullett Prebon) MWh/year	
		Proxy Hedges Gas MWh/year	
		Proxy Hedges GB contract + transmission right (type of product) MWh/year	

		Other MWh/year	
3.2	**Why do you use the different types of products? Please state a brief explanation for each including what you consider to be the benefits and drawbacks of each.**	Vertical Integration	
		DCs	
		PSO	
		NDC (through Tullett Prebon)	
		Forward contracts (outside Tullett Prebon)	
		Proxy Hedges Gas	
		Proxy Hedges GB contract + transmission right type of product)	
		Other	
3.3	**What type of SEM forward contract products do you purchase and intend on purchasing in the future?** **(Please provide historic data)**	**MWhs** **1. Baseload** **2. Mid Merit** **3. Mid Merit 2**	

		4. Peak	
4.1	**Has your hedging strategy mix changed over time? If so, please explain how it has developed and why.**		
4.2	**To what extent your hedging strategy is constrained by lack of hedging options or other constraints. Briefly explain the main obstacles you have met when seeking to execute your hedging strategy.**		
4.3	**What would your hedging strategy be absent constraints?**		
4.4	**If you are considering expanding your current market share in the future, what role do you consider forward hedges will have in achieving this?**		
4.5	**In what way do you think your hedging needs and strategy will change in I-SEM? Please state what products you would wish to see in the I-SEM – i.e. type of hedging products, clip sizes, frequency of offerings, etc.**		
4.6	**What volume, if any, will Financial Transmission Rights provide to your annual hedging in I-SEM?**	MWh/year	
4.7	**Do you think FTRs will provide an efficient hedging product in I-SEM?**		
5	**Do you use the Tullett Prebon platform for SEM or other trading (e.g. bilaterals) or other platforms, etc? State percentage of annual**	Tullett Prebon	
		Other	

	forward trading for each.	Bilateral CfDs	
6.1	**Please list the market participants with which you currently have master agreements and the products to which they relate. Briefly describe the main terms of each particular master agreement (credit requirements, form and quantity of collateral, clip sizes, etc)**		
6.2	**Please state the main benefits and drawbacks of these agreements and how they might be improved.**		
6.3	**Would you be prepared to financially contribute to the establishment of a central counterpart and clearing facility in I-SEM?**		

Annex 2. Questions for Generators

1.1	**What percentage and volume of your generation do you seek to hedge forward?** **(Please provide historic data)**	Hedged MWh/year	
		Unhedged MWh/year	
1.2	**How far in advance of delivery do you seek to have those volumes hedged forward?**	0-3 months 3-6 months 6-12 months 1-2 years 2+ years	
2.1	**What type of products do you use to hedge price risk? Please state volume and percentage of generation.** **(Please provide historic data)**	Vertical Integration MWh/year	
		DCs (ESB Power Gen only) MWh/year	
		PSO (If applicable) MWh/year	
		NDC (through Tullett Prebon) MWh/year	
		Forward contracts (outside Tullett Prebon) MWh/year	

		Proxy Hedges Gas Other fuel MWh/year	
		Proxy Hedges GB contract + transmission right (type of product) MWh/year	
		Other MWh/year	
2.2	**Why do you use the different types of products? Please state a brief explanation for each including what you consider to be the benefits and drawbacks of each.**	Vertical Integration	
		DCs	
		PSO	
		NDC (through Tullett Prebon)	
		Forward contracts (outside Tullett Prebon)	
		Proxy Hedging Gas	

		Other fuel	
		Proxy Hedges GB contract + transmission right (type of product) MWh/year	
		Proxy Hedging Other	
		Other	
2.3	**Has your hedging strategy mix changed over time? If so, please explain how it has developed and why.**		
2.4	**To what extent your hedging strategy is constrained by lack of hedging options or other constraints. Briefly explain the main obstacles you have met when seeking to execute your hedging strategy.**		
2.5	**Please list the market participants with which you currently have master agreements and the products to which they relate. Briefly describe the main terms of each particular master agreement (credit requirements, form and quantity of collateral, clip sizes, etc)**		
2.6	**Please state the main benefits and drawbacks of these agreements and how they might be improved.**		
2.7	**Do you use the Tullett Prebon platform for SEM or other trading (e.g. bilaterals) or other platforms, etc? State percentage of annual forward trading for**	Tullett Prebon	
		Other	

	each.	Bilateral CfDs	
3.1	**Do you believe that you will be hedging with Financial Transmission Rights in I-SEM? If so what will be your objective and do you think FTRs will provide an efficient hedging product in I-SEM?**		
3.2	**In what way do you think your hedging needs and strategy will change in I-SEM?**		

Annex 4. Forward Contracting Selling Obligation

This annex is applicable only for those who may fall within the scope of the FCSO as per the Consultation Paper (SEM-16-030), i.e. generators with dispatchable generation above the de minimis threshold of 267 GWh per year.

1	**Estimated Total set-up cost for FCSO trading** **Please categorise costs e.g, legal, IT, staff costs etc.**		
2	**Estimated time required to set up the FCSO**		
3	**Estimated Annual Ongoing Costs of FCSO**	Staff costs	
		Transaction fees	
		Costs from managing credit exposures	

* It is recognised by the RAs that completion of the costing template requires estimates that are based on assumptions e.g. the scale of the FCSO and level of trading, cost of credit etc. The assumptions set out in the consultation paper should be used to calculate these estimates. If any of the assumptions contained therein are modified, please explicitly state so in order for these to be taken into account when reviewing the information received.

Annex 4. Market Making Obligation

This annex is applicable only for those who may fall within the scope of a market making obligation as per the Consultation Paper (SEM-16-030) (i.e. ESB, SSE, BGE and Energia).

1	**Estimated Total set-up cost for MMO trading** **Please categorise costs e.g, legal, IT, staff costs etc.**		
2	**Estimated time required to set up the MMO**		
3	**Estimated Annual Ongoing Costs of Market Making**	Staff costs	
		Transaction fees	
		Costs from managing credit exposures	

* It is recognised by the RAs that completion of the costing template requires estimates that are based on assumptions e.g. the scale of the market making obligation and level of trading, cost of credit etc. The assumptions set out in the consultation paper should be used to calculate these estimates. If any of the assumptions contained therein are modified, please explicitly state so in order for these to be taken into account when reviewing the information received.

* It is recognised that certain potential market participants who may be elected for a market making obligation will already be companies within a group that already contains a market making function. In this situation it is the cost of the additional I-SEM obligation only which is being sought. Where it may be the intention to source the market making function from a dedicated service provider this should be stated.