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WELLINGTON

By email: submissions@ea.govt.nz

Genesis Energy Limited

Dear Tim

Submission on Hedge Market Development

Genesis Energy Limited welcomes the opportunity to provide a submission to the Electricity Authority ("the Authority") on the "Hedge Market Development: Enhancing trading of hedge products" dated 1 May 2015 ("the Paper").

Genesis Energy is disappointed the Authority has not provided any real options for market making initiatives in the ASX Futures market, such as those relating to incentives or thresholds for a mandatory regime. We suggest the Authority needs to take the initiative and work with the sector to develop some workable options to improve market making. Evolving market making obligations to a more certain and durable framework is the single most important improvement the Authority can do for the ASX Futures market.

Need to develop market making options

A well-functioning hedge market benefits all participants and consumers. The current reliance on volunteer market making has been essential to the establishment of the current ASX Futures market. However, we suggest the ASX futures market now requires a more certain and durable market making scheme for it to continue.

Increasing the number of market makers is the best way to improve the durability and usefulness of the ASX Futures market in all products. We suggest the positions of the major participants on the need for clearer market making obligations are well known, and some of these positions are incompatible with the continuation of a voluntary approach to market making. Therefore, we have

reluctantly come to the view a regulatory alternative is likely to be required if the ASX Futures market is to continue to provide value.

The Paper does not include any of the detailed exploration of regulatory options for improving market making. We are disappointed with this lack of progress, but we accept it creates an opportunity for the Authority to work closely with the sector in developing regulatory options.

Potential regulatory options

Any regulatory market making option will need to be based on clear criteria that provides certainty to new and current participants, and is durable to changes in participants and the sector across time. It will also require broad industry participation, and we welcome the opportunity to participate in the improvement process.

We suggest that the Authority needs to develop a range of regulatory options – from those relying on incentives to encourage market making to the mandatory or compulsory approach. Some of the factors we consider important when considering regulatory options are:

- Any market needs both buyers and sellers. Having people on the buy side of market making, as opposed to the current market makers who are more often sellers, would actually close the spreads and increase the liquidity more than any other action the Authority could take. It would also provide additional security and confidence for the entire market, including the market makers.
- We suggested in our last submission to the WAG that a range of criteria should be considered to assess which parties are included, such as: generation capacity, load portfolio, volume of buy and sell activities and size of the entity. The Authority will need to consult with the industry further on the framework and criteria for these obligations.
- For our part, we would prefer a regulatory approach that incentivizes market making, in order to reimburse current market makers for the costs incurred, and to try and encourage other parties to begin market making.

New Products: Caps and Peaks

Caps

Genesis Energy is disappointed that the Authority continues to pursue the introduction of caps/options into the market making scheme, despite the lack of enthusiasm from the market. We accept caps/options are a good product for the Australian market, but they are not suitable here in New Zealand due to the underlying risk that New Zealand market participants are managing. We suggest this is a result of our market being hydro-dominated, while Australia's market is dominated by thermal generation.

Our own experience suggests these products will not be well-used. Genesis Energy has offered caps for several years, and there has been very little interest from anyone in New Zealand to trade this product. The possibility of a few Australian intermediaries trading caps should not mean that the Authority pushes caps onto an unwilling New Zealand market, eschewing other more useful products in the process.

Peaks

Genesis Energy views the peak product as being of much greater use to parties who are natural buyers or sellers in the New Zealand market, in order to shape their load. The peak product is a natural extension of the baseload products already offered. Peaks could be introduced into the voluntary market making scheme at a relatively low cost to the market makers. The inclusion of market making a cap/option product would be much more expensive, due to the difference of the product and the skill set required to make markets for it.

As discussed in our responses to the Paper's specific questions, we are seeing a lot of trading of peak products in the Over-The-Counter (OTC) market. Shifting this load onto a standardised futures contract would provide more transparency, price certainty and confidence for the market.

Next steps for improving hedge markets

Genesis Energy views the priorities in hedge market development as:

- Creating more authoritative market making arrangements (i.e. increasing the number of market-makers though exploring an incentivised scheme and/or threshold criterion for a mandatory regime);
- Greater liquidity in the existing baseload futures products, via changes to market making arrangements, which may include:

- a. tighter bid-offer spreads
 - b. greater volumes
 - c. extending market making in the monthly futures product
 - d. market making a peak product
- Publication of market making metrics; and
 - The introduction of a half-hourly settled cap product (or products), and price making arrangements to support it, which may comprise regular posting of one-way prices (i.e. offer prices only).

We view market making of a peak product as a preferred option to the inclusion of caps/options.

We reiterate that although the Authority has addressed some options, there has been no indicative way forward in the market making space. The options set out in the Paper are very high level and do not propose any real way forward to encourage additional players in the market.

If you would like to discuss any of these matters further, please contact me on 04 830 0013.

Yours sincerely



Rebekah Plachecki

Regulatory Affairs Advisor

Appendix A: Responses to Consultation Questions

QUESTION	COMMENT
Q1: Do you consider more authoritative market making arrangements to be necessary?	See cover letter – Need to develop market making options.
Q2: What are your views on the need for improved transparency around market making performance?	Genesis Energy welcomes improvements in transparency around market making performance. However, we do not consider it appropriate to identify publicly the market makers, given it is a voluntary scheme. It would be appropriate to provide the full details of the performance, including the identities, to the market makers themselves for self-policing. We consider some type of aggregate information on the performance of the group as a whole, suitable for public release, is more appropriate.
Q3: What market making metrics would be of most value to participants?	At a high level, the percentage of time each party adheres to the volumes and spreads of the market making agreement would seem the most useful. Also, releasing the average refresh time for each contract would be useful. We would envisage this information being available daily, as well as summarised monthly. It should cover all of the aspects of market making (volumes, spreads etc) as agreed upon in the market making agreement.
Q4: Do you agree the Authority should investigate improvements to the market making arrangements for the baseload futures products?	Yes. Genesis Energy is in full agreement that the Authority should investigate improvements to the market making arrangements for baseload futures products.

QUESTION	COMMENT
<p>Q5: Specifically, do you agree that it should investigate tighter bid-offer spreads, greater volumes, and an extension of the monthly futures product by three to nine months?</p>	<p>The reduction of spreads reduces the profit that a market maker can make to offset the costs of providing the service to the market. Genesis Energy would not be in favour of reducing the spreads without a corresponding reduction of the costs. For example, increasing the number of market makers would reduce the costs per market maker as we are less likely to get unwanted positions, and it would be less costly to get out of these positions. If the number of market makers was increased, either voluntarily or otherwise, then Genesis Energy would be happy to consider a reduction in the spread.</p> <p>Genesis Energy would be happy to market make with 4MW per contract, followed by a 2MW reload. We would be happy to provide these volumes on both the monthly and quarterly contracts.</p> <p>Our view is that any extension of the monthly contracts should line up with the quarterly products. At this stage we would be willing to make markets for the monthly products in the front two quarters, which would mean 4 to 6 monthly contracts are on offer depending where we are in the front quarter. We would be happy to market make for up to 9 months, or the front 3 quarters, if required.</p>
<p>Q6: Do you agree that introducing a cap product would support the Authority's statutory objective?</p>	<p>There are many other actions the Authority could take that would do more to support their objectives and that would be less onerous on the current market makers. We would prefer to increase the number of market makers and improve the current products before focussing on adding a new product, like caps.</p>
<p>Q7: What price making arrangements do you consider to be appropriate and/or necessary to support cap products?</p>	<p>Genesis Energy would like to note that we already write OTC cap products to interested parties, and are happy to offer caps when asked. We currently have several caps on our books and are happy to continue to offer caps on a voluntary basis. However, we would be strongly opposed to making markets in caps.</p>

QUESTION	COMMENT
<p>Q8: Do you agree that the Authority should not further investigate market making arrangements for the peak futures product?</p>	<p>Genesis Energy is of the view that the Authority should investigate market making in peak products.</p> <p>Over the last 6 months we have seen a huge increase in OTC deals between parties for peak products. The majority of OTC deals that Genesis Energy has been involved in, both as a buyer and seller, over that time have been peak deals. Introducing a peak product into the market making would shift a large proportion of this OTC volume onto the exchange traded product, giving a more transparent forward price and increasing the ease of dealing for smaller parties. There are also instances where Genesis Energy and other retailers are faced with the choice of hedging via a baseload product, or not hedging. In many of these cases the option is not to hedge where we would hedge if a peak product were available.</p> <p>While we agree that market making a peak product would shift some volume from the baseload contracts to the peak contracts, there would also be volume that is either not traded at all or is traded OTC currently that would shift to the ASX.</p> <p>In addition to the benefits for a retailer noted in the paper, the Authority also needs to be mindful of the benefits to the generator of a peak product. Generators with flexible plant can get a better price selling via a peak product. Those generators with less flexible plant can cover their exposure with a peak and not have to start their plant. Selling a cap does not help generators deal with these issues. All market participants, whether generators or retailers, have a profiled demand shape and the ability to use an exchange traded product to help them shape that load would be a huge benefit to the market.</p> <p>Genesis Energy notes that for the 2015 calendar year, approximately 60% of the CFD's in the hedge disclosure system are for peak contracts. By contrast, there is very little interest or activity in the OTC cap market.</p> <p>We trust the Authority will revisit their position on this issue.</p> <p>Finally, the Authority should note that the name 'peak' for this type of product is misleading and confusing to those in the industry. We suggest that renaming it as a 'Business-Day Day' (BDD) product would be clearer and easier to understand. The name 'peak' usually refers to a morning or evening peak, not the 7am-10pm product that is currently referred to as a 'peak' product.</p>

QUESTION	COMMENT
Q9: Do you agree that liquidity in the option product is best supported by improving liquidity in baseload futures products?	Yes.
Q10: Are there other products or price making arrangements that the Authority should investigate further?	Genesis Energy has also been supportive of a day-ahead and week-ahead market, for both baseload and peak products, and would view a more standardised product for the day-ahead or week-ahead market favourably.
Q11: What is your view on these approaches, and the extent to which they could be employed by the Authority, either alone, or as part of a mixed strategy?	See cover letter – Need to develop market making options.