29 March 2022

Submissions
Electricity Authority

By email: WholesaleConsultation@ea.govt.nz

Hedge Market Enhancements: Commercial market-making scheme

Meridian welcomes the opportunity to comment on the Electricity Authority's consultation paper *Hedge Market Enhancements: Commercial market-making scheme.* We are also grateful for the proactive engagement from Authority staff to discuss these proposed changes.

Responses to the Authority's specific consultation questions are included as Appendix A of this submission.

In short, Meridian broadly supports the proposed change to reduce the volume of market-making by regulated market makers, commensurate with the increase in market-making by a new commercial provider(s). Traded volumes and open interest have steadily grown under the existing settings, indicating that current market-making volumes are more than adequate to support a healthy market.[1] Furthermore, during the Authority's levy consultation, there was no indication from any respondents that an increase in total volume was preferred.

[1] If anything, a reduction in market making volumes might be considered given the extraordinarily high traded volumes seen in 2022 to date. In a future with commercial market makers where consumers carry the costs of the service via the levy, the costs and benefits of "over-procuring" market making services may need to be more carefully considered.

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Meridian broadly agrees that the new commercial market maker(s) should provide the same service as existing providers, including the same volume requirement and spreads.

Meridian is also broadly comfortable with the proposed change to the days in which market-makers are exempted from providing their service. We see the merit in seeking to spread the use of exemption days over a rolling 20 market-making windows to avoid the clustering of exempt days that currently occurs at the end of each month.

However, Meridian is concerned about the proposed change to introduce a refresh obligation that does not exist in the current regulated market-making scheme. As proposed, the refresh obligation would require market makers to split their volume obligation in two parts, with the second part contingent on whether the first part is traded. Existing market makers may require significant spend on processes and systems to facilitate this change, when it is not clear what the benefit is to consumers.

The proposal would also require market-makers to continue to meet all service level obligations for at least 25 minutes out of the 30-minute market-making window. Time spent preparing two sets of buy and sell trades for a refresh obligation will make it more difficult to meet this requirement. The proposal would effectively double the amount of activity that market makers must undertake within five minutes.

The proposal could reduce the volume of contracts available to trade, as volumes available at any point in time would be halved. This could increase the transaction costs for parties wishing to trade into positions through the ASX.

The proposal appears to be designed to suit potential commercial providers that might be used to operating that way in other jurisdictions, while it would be at the expense of existing mandatory market makers who are used to the established processes in respect of the New Zealand electricity futures market.

Given the proposal would not improve volumes available to transact but would halve bids and offers available at any one time, it is hard to see how consumers would benefit from a refresh obligation. The idea that "inadvertent trades" at the start of the market-making window somehow reduce available volume does not make sense to Meridian. Anyone entering bids or offers intends to transact. Non-market-making participants can post bids and offers to transact at the start of any market making window in the same way as market-makers. Anyone familiar with the ASX will know that the start of a window is when most volume is available to trade. Sometimes transactions will be between market makers – that is always going to be the case on an anonymised exchange with multiple market-makers. A refresh obligation will not alter these dynamics.

It is also not entirely accurate for the Authority to state that it intends to retain the current 12MW total volume of market making obligation. While only half the volume will be available at any one time, the Authority's worked example of the refresh obligation on page 45 of the consultation paper also makes it clear that in some circumstances over the course of a market making window market makers may be unable to avoid exceeding their volume requirements and will be forced to trade more than 2.4MW or 24 lots. This may further increase the already very high costs of market making.

As an alternative proposal, Meridian recommends that the Authority *enable* a voluntary refresh for market makers that wish to provide half of their volume at the start of the window. However, market makers should not be *required* to provide half of their volume at the start of the window. It seems counter intuitive for the Authority to require less volume to be offered to the market at any point in time. A voluntary refresh would enable many of the benefits identified by the Authority, for example it would reduce costs for any market-makers that wish to offer less initially and could help to spread contracts on offer across each market making window (although it is not clear to Meridian what the benefits of this might be). A voluntary refresh would also avoid the imposition of additional costs on existing market makers and enable them to experiment with and perhaps adopt a refresh approach over time rather than hitting a hard date where a change in systems and processes is suddenly required to manage a doubling in the number of times bids and offers will need to be formulated within the 5 minutes allowed in any market making window. A voluntary refresh would therefore realise many of the same benefits while mitigating the costs.

If, despite this submission, the Authority decides to implement a refresh obligation rather than an option then Meridian suggests that the Authority consider:

- Allowing market makers 10 minutes in the 30 minute market making window to formulate bids and offers given the doubling in the number of times market makers must go through this process.
- Providing certainty of implementation timeframes as far in advance as possible and allowing sufficient lead time for development of systems and processes prior to the change taking effect.

Please contact me if you have any queries regarding this submission.

Nāku noa, nā

Sam Fleming
Manager Regulatory and Government Relations

Appendix A: Responses to consultation questions

	Question	Response
1.	Do you have any feedback on the Authority's proposal to align regulated market-making obligations with commercial market-making obligations?	Yes. Meridian broadly supports this aspect of the proposal.
2.	Do you agree that the total volume should remain at 12MW per contract, if not why?	Yes. Meridian broadly supports this aspect of the proposal.
3.	Do you agree that the spread between bid and offer prices should remain at a maximum of 3% if not why?	Yes. Meridian broadly supports this aspect of the proposal.
4.	Do you agree that changing to a rolling 20 trading days exemption scheme will benefit the New Zealand electricity futures market if not why?	Yes. Meridian broadly supports this aspect of the proposal.
5.	Do you propose an alternative solution to maintaining market-making services through a calendar month?	No.
6.	Do you agree that introducing a refresh obligation will benefit the New Zealand electricity futures market if not why?	Meridian does *not* support this aspect of the proposal. As discussed in the cover letter of this submission, the refresh obligation would increase market making costs and reduce by half the volumes available to trade at any point in time. Meridian instead proposes that the Authority enable a voluntary refresh.
7.	Do you have any feedback on the Authority's cost-benefit analysis set out in Appendix A?	Meridian does *not* agree with the cost benefit analysis in respect of the proposed refresh obligation. The Authority identifies that a qualitative benefit of the refresh obligation would be a reduction in "inadvertent trades". Anyone entering bids or offers intends to transact. Non-market-making participants can post bids

		and offers to transact at the start of any market making window in the same way as market-makers. Sometimes transactions will be between market makers – that is always going to be the case on an anonymised exchange with multiple market-makers. A refresh obligation will not alter these dynamics and Meridian does not consider this to be a real benefit. The Authority states that the refresh proposal would reduce financial risk for market makers. Meridian disagrees and considers the opposite to be true. Financial risk will increase, we do not expect to transact less as a result of a refresh. We will need to back out of the same (or potentially more) unwanted positions and do not expect a refresh obligation to assist with that. The Authority states that "reducing … inadvertent trades will increase liquidity". No trades are inadvertent and requiring market makers to only offer half their volume will decrease available volumes at any point in time. We expect this potential halving of the market-making volume obligation to be behind the lower price indication from some potential commercial providers of market making. While volumes available to trade might reduce, we do not expect liquidity (i.e. the change in price with each transaction) to be affected by the proposed refresh obligation. The only real benefit would be to levy payers if in fact the commercial provider is willing to provide a service with a refresh at a reduced price. However, this benefit would equally be realised if the Authority enabled a voluntary refresh. Meridian agrees with the costs identified by the Authority but considers there to be additional costs to market participants and consumers because the volume available to trade at any point in time would be halved. These costs would be significantly mitigated (if not avoided) by enabling a voluntary refresh.
8	Do you have any feedback on the Regulatory statement in Appendix B?	Meridian disagrees the benefits of the proposed refresh obligation outweigh the costs and therefore that aspect of the proposal does not comply with section 32(1) of the Act. The alternative of a voluntary refresh addresses the Authority's objectives and achieves the same benefits with reduced costs.

9.	Do you have any feedback on the Code amendment set out in Appendix C?	Not at this stage. Meridian's preference is for the Code amendment to reflect the voluntary refresh option discussed in this submission rather than a refresh obligation.