AEMC

INFORMATION

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Market making arrangements in the NEM

Stakeholder submissions invited on draft determination

The AEMC has proposed not to make a draft rule to introduce additional market making schemes in the national electricity market, in a draft determination released today.

A number of initiatives are already under way that should increase contract market liquidity, in particular the ASX's voluntary market making scheme, commencing 1 July 2019, and the market liquidity obligation (MLO) which is part of the Retailer Reliability Obligation (RRO), also commencing on 1 July 2019. The Commission's analysis found that additional market making arrangements beyond these initiatives are not justified at present.

At the same time, the Commission has proposed a range of initiatives to improve transparency in the electricity contract market. This would improve price discovery for those seeking to buy and sell hedge contracts, and also make it easier for regulators to assess market performance including liquidity.

The Draft determination

The Commission's analysis found that additional market making arrangements beyond the ASX and MLO initiatives are not likely to be efficient. On this basis, a rule to require additional market making services would not, or would not likely, contribute to the National Electricity Objective.

Key findings in the draft determination include:

- Liquidity across the NEM is generally healthy, although liquidity in South Australia is much lower than in other regions.
- The structural characteristics of the South Australian market contribute to lower liquidity. The characteristics include limited firm generating capacity, a heavy reliance on gas for firming capacity, high penetration of renewables, low levels of demand, limited interconnection and high levels of vertical and horizontal integration which can reduce the broader availability of contracts.
- The ASX and RRO/MLO schemes are expected to improve liquidity compared to the levels currently observable in the market. These improvements should be most notable in South Australia. In particular the market making services specify requirements on market makers that are expected to improve the availability of prices, narrow the bid-ask spreads, and reduce the number of days without trades. Trading volumes are also expected to increase.
- The Commission engaged a consultant, NERA, to undertake an in depth analysis of the costs and benefits of the different types of market making arrangements put forward. The results of that analysis were released along with the draft determination. The analysis concluded that if the ASX scheme delivers to its design, then there would be no additional benefit from additional market making schemes. There would however be additional costs.

The draft determination also sets out specific monitoring and reporting that the Commission considers should be undertaken by the AER. This includes monitoring whether participants comply with requirements of the ASX scheme and the RRO/MLO if triggered, to see if these new market making arrangements provide the benefits to contract market liquidity that are intended. This function would be enabled by proposed law changes to expand the AER's market monitoring function to include the contract market.

Furthermore, in the process of addressing liquidity, it became apparent there are material information gaps in the contract market. These gaps undermine price discovery for participants, and also regulators' ability to assess market conduct and performance. The draft determination notes specific improvements are needed in relation to the reporting of OTC trades through the AFMA survey of market participants, particularly in relation to price, coverage and timeliness. The Commission will work with the AER, industry and AFMA on these improvements, and also with the AER on any additional powers the AER needs to fulfil its enhanced contract market monitoring role.

Background

Market making arrangements aim to increase opportunities for market participants to trade in electricity hedge contracts and to have greater visibility of wholesale contract prices. They can be voluntary or compulsory.

The service is typically made available in less liquid markets so that retailers and other market participants always have an opportunity to buy and sell electricity futures contracts. This helps to increase market liquidity and support competition and confidence in the market as a whole.

There has been significant work undertaken in relation to market making, both by policymakers and by the ASX:

A market liquidity obligation (MLO) forms part of the Retailer Reliability Obligation which is scheduled to commence on 1 July 2019. South Australia has additional specific arrangements that allow the MLO to be triggered in that state potentially earlier and more regularly than in other jurisdictions.

The ACCC recommended that the AEMC introduce a market making obligation in South Australia to boost market liquidity as part of the Retail Electricity Pricing Inquiry published in July 2018.

The ESB released a consultation paper on the need for a market liquidity obligation in South Australia in September 2018. It has deferred further work on this assessment until after this rule change process is complete.

In November 2018 the Commonwealth government put forward the Prohibiting Energy Market Misconduct Bill which included (i) a prohibition on generators from withholding electricity contracts with the aim of substantially lessening competition in the market, and (ii) a power for the Treasurer to direct participants to market make. While the Bill was withdrawn prior to the federal election, the government has subsequently indicated it will re-introduce the Bill.

The ASX will commence a market making scheme in South Australia, Victoria, New South Wales and Queensland on 1 July 2019.

Internationally, market making arrangements for electricity markets have been introduced in recent years in New Zealand, Singapore and the United Kingdom, and considered but not introduced in Ireland.

The rule change request

ENGIE submitted a rule change proposal in October 2018 proposing a tender for voluntary market making services in all states in the NEM, to be run by the Australian Energy Regulator. The proposal was put forward as an alternative to a compulsory market making obligation. The request asked that consideration be given to complementing the ASX market making scheme under development and called on the AEMC to examine in more detail questions about the level of contract market activity across the NEM and in South Australia in particular.

Submissions

The draft determination is available on the AEMC website. Stakeholders are invited to make written submissions by **8 August 2019**.

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