ASX response to National Electricity Rules Amendments - Retailer Reliability Obligation

Draft Rules Consultation Paper

ASX submission

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ASX

ASX response to Section 6: Qualifying contracts and Net Contract Position

Thank you for the opportunity to comment on the ESB's Draft Rule Consultation Paper. The following sections provide ASX's responses to the issues discussed in Section 6.5.

Section 6.5.1: Triggering the Market Liquidity Obligation

ESB observations and issues raised.

- MLO trigger: The ESB is seeking feedback on the proposal that the MLO only be triggered when sufficient voluntary market-making in not already occurring in the region. Further, feedback is sought on challenges with this approach other than those identified and how to overcome the identified challenges of this approach, if it were adopted.

ASX response

ASX believes that even with sufficient market making in a region, there may still be the need for the MLO to be triggered.

ASX anticipates having its voluntary market-making scheme operational from 1 July 2019. This arrangement between ASX and market users includes some financial incentives for market makers who participate and comply with the scheme. A failure by a market maker to comply with its market making obligations leads to the incentives being forgone and these re-distributed to the remaining compliant market makers. There is no 'penalty' outside this loss of rebate and revenue share. Details of the proposed market making obligations under the ASX scheme are set out in Appendix 1.

ASX understands that the intent of the MLO is to ensure that prices are available in the market for the period in which the reliability gap is identified. ASX is seeking to align its market-making scheme with these objectives so that if an entity is making markets according to the ASX scheme, they would be compliant with the MLO. In the event of a MLO being triggered, the failure of the market maker to continue to make markets would not only mean a loss of ASX rebates and incentives, but also be in breach of the MLO requirements and subject to the associated penalties.

If the ASX market-making scheme is being complied with, triggering the MLO will have no effect on a market maker's activity – other than they would now become subject to possible penalties associated with the MLO. The combination of the loss of financial incentives from ASX and the MLO scheme penalties will reinforce compliance with the requirements.

Section 6.5.2: Obligated parties

ESB observations and issues raised.

- MLO obligated parties: The ESB is seeking feedback on the proposal that MLO obligated parties would be deemed in the Rules for the first two years of the Retailer Reliability Obligation (RRO).

ASX response

ASX agrees that the provision of a market-making scheme needs to be in place for an extended period to ensure that the forecast reliability gap is closed. Having a period less than the proposed two years would introduce a risk that contracting is only temporary and of no practical impact in closing the reliability gap.

Section 6.5.3: Market making requirements

ESB observations and issues raised.

- MLO information: The ESB is seeking feedback on the prescribed bid/offer spread and other aspects of the market making requirements.

ASX response

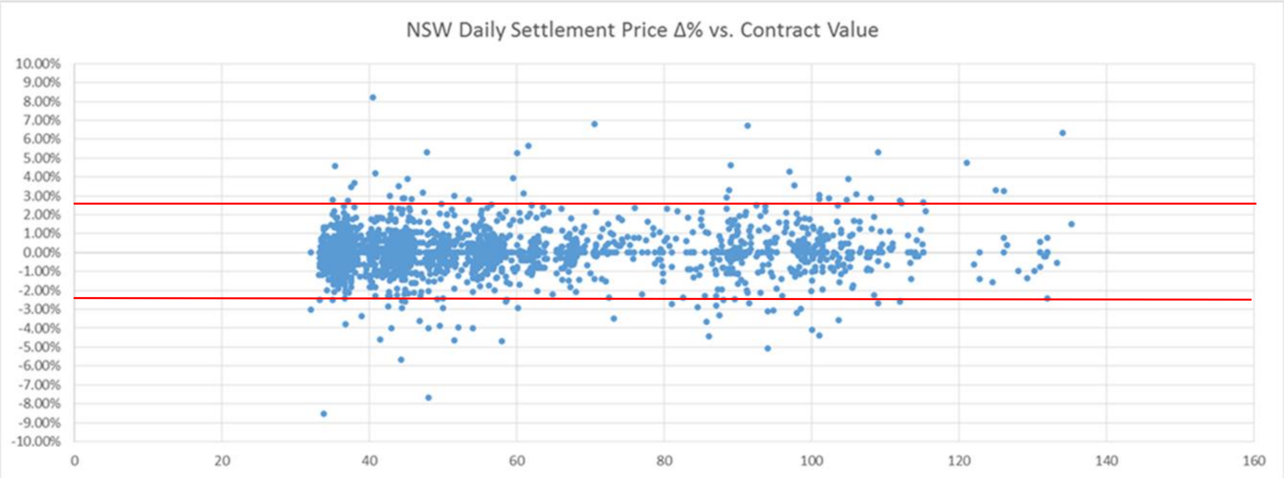
- Bid/offer spread

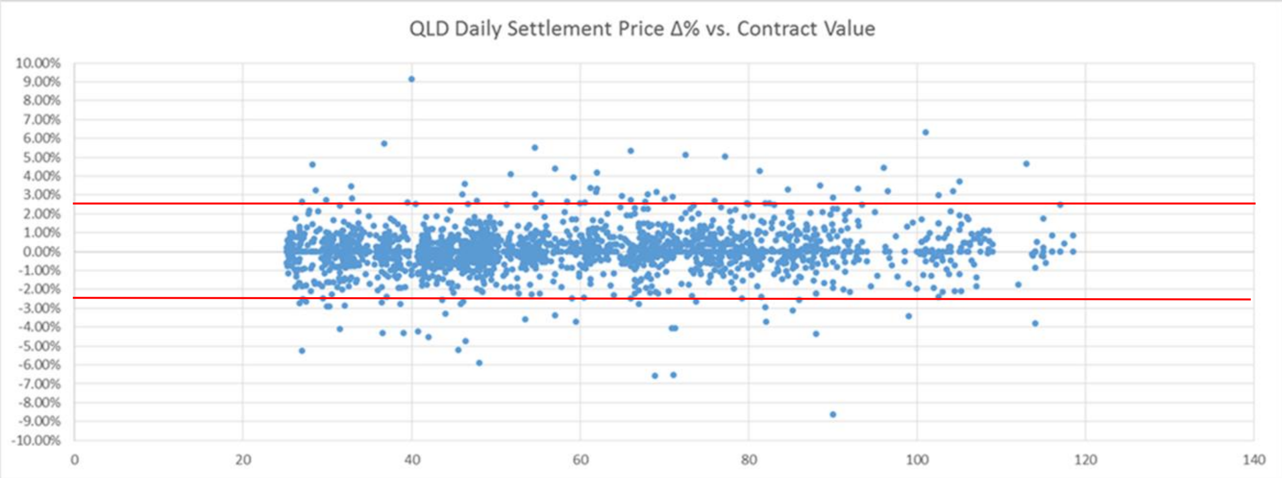
The purpose of the market maker is to bracket, or frame the market, not necessarily to be the counterparty to every trade. In fact, given price making falls away upon a market maker trading, it is helpful for trading to ideally occur inside the market maker's spread. On this basis, a 5% bid/offer spread in NSW, VIC and QLD will more appropriately bracket the market than a 3% bid/offer spread. Likewise, given the characteristics of the SA market, a 7% bid/offer spread in SA is likely to be more appropriate than a 5% spread.

Assuming market makers hold different views of the market and have different hedging requirements, a narrowing of the spread from 5% to tighter pricing will naturally occur. A 3% spread would increase the likelihood of market makers trading with each other and make it less attractive for other traders to contribute to price formation. Such trading activity will mean their market-making obligation for that trading session fall away, with the result being that they will no longer be contributing prices. It is therefore in the interest of continued price provision and price transparency that the bid/offer spread not be too narrow as the effect will simply be market makers trading amongst themselves and price provision ceasing.

ASX believes the proposed spreads set out in the Draft Rule Consultation Paper are too narrow. ASX has analysed movements in the end of day settlement price for the 3rd Quarterly Base Futures contract on a rolling basis at the current Settlement Price since January 2008. As evidenced in the graphs below, the data indicates that regardless of whether the absolute contract price is high or low, the majority of moves in the daily settlement price from one day to the next, fall within 5% of the contract value. Outliers in the data, in part, reflect activity around contract rolls. A 2.5% spread either side of this potential movement (implying a total spread of 5%) frames the market and will not reduce the likelihood of market makers simply trading amongst themselves.

ASX recommends that the bid/offer spread for NSW, QLD and VIC be set at 5% and for SA 7%.





- Number of trading sessions per month

The MLO requirement is for market makers to make prices for 35 sessions per month, except in January and December when it is only 25 sessions per month. The ASX market-making scheme has sought to align itself with the proposed MLO requirement. The table below analyses the number of trading sessions per month a market maker will not be obligated to make markets each month.

Year	Month	Business Days	Holidays	Half Days	Trading Days	Total Sessions	Req. Sessions	Leniency
2019	July	23	0	0	23	46	35	11
2019	August	22	0	0	22	44	35	9
2019	September	21	0	0	21	42	35	7
2019	October	23	0	0	23	46	35	11
2019	November	21	0	0	21	42	35	7
2019	December	22	2	2	20	38	25	13
2020	January	23	2	0	21	42	25	17
2020	February	20	0	0	20	40	35	5
2020	March	22	0	0	22	44	35	9
2020	April	22	2	0	20	40	35	5
2020	May	21	0	0	21	42	35	7
2020	June	22	1	0	21	42	35	7
2020	July	23	0	0	23	46	35	11
2020	August	21	0	0	21	42	35	7
2020	September	22	0	0	22	44	35	9
2020	October	22	0	0	22	44	35	9
2020	November	21	0	0	21	42	35	7
2020	December	23	2	2	21	40	25	15
2021	January	21	2	0	19	38	25	13
2021	February	20	0	0	20	40	35	5
2021	March	23	0	0	23	46	35	11
2021	April	22	2	0	20	40	35	5
2021	May	21	0	0	21	42	35	7
2021	June	22	1	0	21	42	35	7

A Business Day is defined in Section 7 of the ASX Operating Rules as meaning any day other than a Saturday, Sunday, New Year's Day, Good Friday, Easter Monday, Christmas Day, Boxing Day and any other day ASX notifies participants is not a Business Day.

In practice, this means that market makers are given extra flexibility in December and January reflecting the holiday season. The low level of flex in February reflects the shorter month, whilst in April it reflects the larger number of public holidays that generally falls in that month. ASX believes that such flexibility is appropriate and workable for market makers. Possible consideration should be given to reducing the number of trading sessions in February and April to 30.

Section 6.5.4: MLO trading arrangements

ESB observations and issues raised.

- MLO information: The ESB is seeking feedback on the criteria to approve a trading facility.

ASX response

ASX notes that a trading facility for electricity derivatives will need to have an Australian market licence and a clearing facility for these products will need a clearing and settlement facility licence. ASX recommends that the ESB include these requirements in the criteria.

Aside from that point, ASX agrees with the broad thrust of the criteria to approve a trading facility.

Section 6.5.5: MLO reporting and compliance

ESB observations and issues raised.

- MLO information: The ESB is seeking feedback on the information obligations imposed on MLO obligated parties.

ASX response

ASX notes that the proposed rules require obligated parties to provide data to the AER on bidding behaviour and trading in respect of MLO products for the duration of the MLO period.

As well, ASX recommends that the rules include the ability for an obligated party to delegate this task of demonstrating compliance to an approved trading facility, if that service is available. ASX has market maker monitoring systems to monitor market behaviour that could be used to collect the required regulatory data and may minimise the operational overhead and compliance costs for participants. ASX would need to explore further the practical aspects of providing such a service and level of demand from participants. This could also obviate the need for the AER to receive large price files from multiple participants, build and manage complex data monitoring systems.

Other issues for consideration by the ESB

Listing of sufficient Quarter contracts to cover the MLO period.

The current ASX contract specifications state that the settlement months listed for ASX Electricity Base Futures are:

“March/June/September/December, such that sufficient Calendar Quarters are always available for market participants to trade the next four Calendar Years and three Financial Years or three Calendar Years and the four Financial Years.”

Given the timing of when an MLO can be triggered, a contract for that quarter may not have yet been listed. In this instance, ASX would consider listing the contract to enable compliance by obligated parties to meet MLO.

Appendix 1 – Summary of the proposed ASX market making obligations in the NEM

Contracts – Base Load Futures for Quarter 2 to Quarter 8 (e.g. no requirement to make markets in the spot quarter).

Sessions – Two trading sessions per day, these being 11:00-11:30 am and 3:30 to 4:00 pm each Business Day. During any session, the market makers is required to place bids and offers, subject to the Daily Limit, for a minimum of 25 minutes.

Size of Bids and Offers – 5 lots per session (NSW Qld Vic) 2 lots per session (SA). Note that the contract size for ASX Australian Electricity futures contracts is 1 MWh.

No reload/refresh requirement – once the size is traded, there is no further requirement to post bids and offers for that session.

Requirement to place bids and offers – 35 sessions per month except January and December where the requirement is for 25 sessions per month. This approach allows market makers to opt out from making markets in periods of low activity, market volatility, shortage of staff, etc.…

Daily Limit after which no further price making is required for that session – as per session sizes of Bids and Offers above.

Maximum Allowable bid/offer spread

Base Quarter Futures

No requirement for spreads that are less than $1

5% in NSW, Qld and Vic

7.0% in SA

Quarterly Caps

No requirement for spreads that are less than a $1

10% in all regions.