

Markets of Choice are the Secret to Liquidity

According to Peter Terium, CEO, RWE Supply and Trading, we need the co-existence of power exchanges and OTC markets and better EU-wide regulation to realise the vision of a single EU wholesale energy market.

Wholesale market success

Power wholesale trading in Europe is a success story. This would not have happened without the OTC markets. Recently, it has become fashionable to blame OTC as an opaque area or a “grey” market and argue that only exchanges can promote market integrity, liquidity and trust.

I am very much in favour of strengthening and consolidating the energy exchanges in Europe. For example, I support the co-operation between EEX and Powernext. But “either...or” seems to me a one-dimensional approach to increasing trust in wholesale power markets in Europe.

I am convinced that we need both markets since they complement each other. In the history of market development, OTC trading traditionally precedes the creation of exchanges and supplements continuously their range of products and services. Market participants use OTC as a flexible means of securing their supplies.

The variety of products available is proof of the innovative power of OTC trading. Exchanges deal with different demands and offer standardised products in a liquid market as well as a reliable clearing mechanism. Both markets are professional and offer a sufficient level of transparency.

Even in developed and liquid markets, the co-existence of exchanges and OTC is a sensible platform.

Without the co-existence of exchanges and OTC trading, we would not have the liquidity nor the correlation between power prices necessary to avoid unstable market price distortions.

In short, without OTC trading there would, for example, be no opportunity for flexible power trading. This would be detrimental, especially for smaller market participants. The operation of a single “new entrant” power plant could not be secured on short notice. Furthermore, market participants who do not have assets of their own could withdraw from trading and this would reduce liquidity. To trade exclusively on the exchange would simply be too expensive for small traders or those who only trade sporadically. Only the combination of exchange and OTC trading makes it possible to have complimentary products and the 24/7 availability of trading and procurement.

Threat of rising prices

There is a strong political movement against free wholesale markets and choice due to rising power prices. But to try and protect certain customers from higher power prices by creating national ►



fiefdoms and regulatory barriers is going in the wrong direction. Artificially creating and maintaining market barriers to close off markets and calling out “national champions” will open up a Pandora’s Box.

Neglecting reliable price signals will lead to lower investment in new power generation and volatile power prices on the forward curve. Fundamentals like the growing demand from countries like China and India and the international climate protection policy are drivers of power prices that cannot be switched off.

As wholesale traders and market experts we have to tell stakeholders and counterparties in industry and politics the plain truth: globalised markets for energy and carbon will reward those who can efficiently react to the forces of supply and demand. That includes optimising and hedging our own supply and demand for energy and its derivatives by using the manifold possibilities offered by power trading across borders.

Harmonising trading rules

To strengthen wholesale markets, the EU Commission has to harmonise trading rules and structures. This should include both intelligent “market design” and “better regulation.” As long as regulation ensures the same rules of the game for everyone, the markets will continue to attract liquidity and ensure that there is an optimal balance between supply and demand at fair prices.

One of the major challenges facing the EU power market is to establish transparent and market based capacity allocation mechanisms at the borders in order to ensure the most efficient use of transmission assets for the ultimate benefit of the European electricity consumers. The crucial instrument in this respect is the establishment of European-wide transparent, auction-based capacity allocations. Functioning spot exchanges and complementary market instruments such as futures contracts

which can then be settled against physical or financial indices, are key components in a suitable European market platform.

One should not underestimate the lack of current opportunities to enter into any long-term trading of transport capacities. The physics of power transport involved in this equation are important. Thanks to intensive power trading many projects have been initiated to improve the infrastructure of the grids and improve the physical flow of power. Ever since power has had to cover larger distances and move beyond national borders, the physical bottlenecks have increased.

The transfer of information between supra-regional network operators must be standardised and be made available on a European-wide basis. Market coupling is of the greatest importance because, as I see it, the existing capacities are not being put to their best possible use. Too often the discussion concentrates on the interconnectors between countries. However the actual bottleneck is often not the interconnector, but the grid that lies beyond it.

In a nutshell, only with a strong commitment to the co-existence of power exchanges and the OTC markets and a European-wide agenda of “better regulation” we will be able to achieve our vision of a European internal wholesale market for energy.

We have achieved high levels of liquidity, but we cannot be complacent. Traders have to continue doing their part. My vision is something along the lines of a “Schengen Agreement” for energy trading: free cross-border travel, reduction of existing barriers, a European passport that entitles every trader to be active anywhere in Europe and enjoy the same conditions wherever they are. ■