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12 June 2020

Submissions
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TRUSTPOWER SUBMISSION: HEDGE MARKET ENHANCEMENTS: ENSURING MARKET MAKING ARRANGEMENTS ARE FIT-FOR-PURPOSE OVER TIME

1. Introduction

1.1.1 Trustpower Limited (**Trustpower**) thanks the Electricity Authority (**the Authority**) for the opportunity to provide a submission on its consultation paper *Hedge market enhancements (market making) – Ensuring market making arrangements are fit-for-purpose over time* (**the Paper**).[1]

1.1.2 The Paper seeks feedback on a range of proposed approaches and trade-offs in addressing two broad issues with the current market making arrangements as identified by the Authority:

a) an apparent lack of confidence among some stakeholders in market making and price formation on the Australian Securities Exchange (**ASX**) market; and

b) a clear desire from almost all stakeholders to increase the reliability of market making services.

1.1.3 It is the Authority's aim that the final approach selected will be an enduring solution for market making in the New Zealand electricity futures market.

2. Summary of Trustpower's views

2.1.1 Trustpower acknowledges the work done by the Authority to identify and explain the range of approaches and trade-offs to address the issues of confidence and reliability. However, we believe the Authority has effectively put the "cart before the horse" in presenting, and requesting feedback on, these approaches prior to it accurately defining the problem.

2.1.2 Our views are summarised at a high level in Figure 1, followed by a more detailed discussion.

[1] Consultation Paper available at https://www.ea.govt.nz/dmsdocument/26664-hme-market-making-consultation-paper

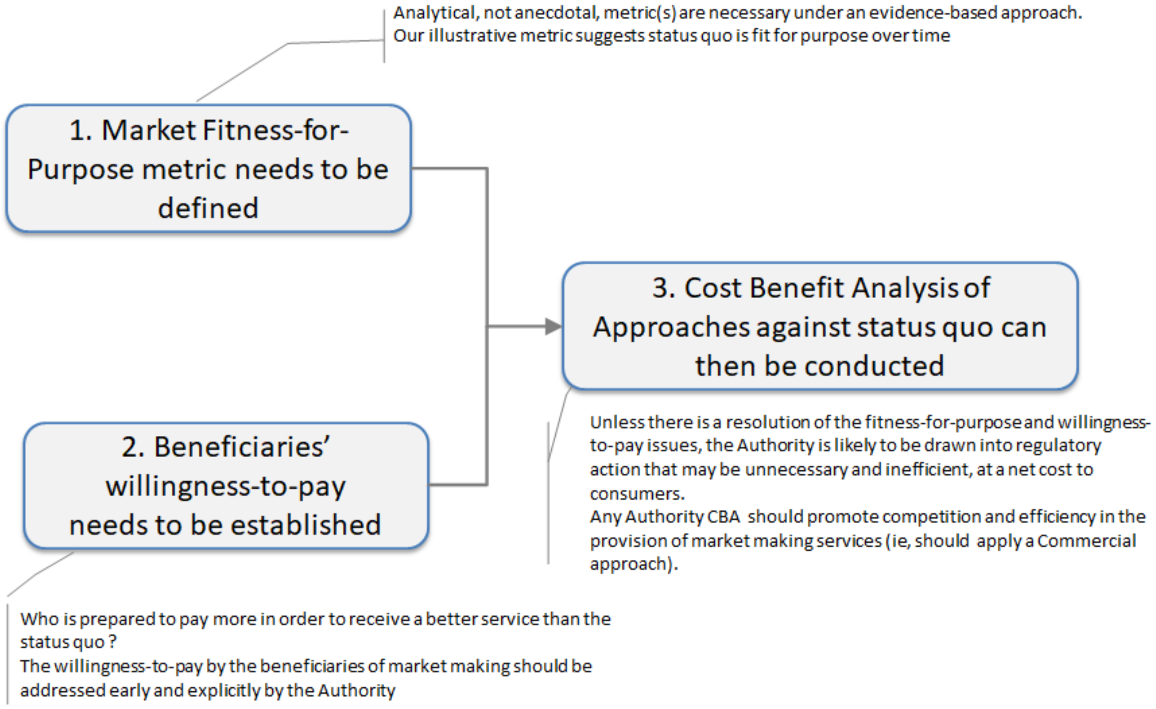

Figure 1: High Level Diagram of Trustpower Views

2.2. Fitness-for-purpose not adequately defined

2.2.1 In our view, the Paper's references to "lack of confidence" and "unreliability" in hedge market performance are largely anecdotal, rather than analytical, issues.

2.2.2 Under such an anecdotal assessment, the problem (if one exists) is too ill-defined to manage effectively. There will always be some participants who express a lack of confidence in the hedge market; the challenge is to prove or disprove its actual fitness-for-purpose over time.

2.2.3 We ask:

a) What indicator does the Authority propose will actually measure the fitness-for-purpose of market making arrangements, whether they be current or proposed?

b) How will participants know whether fitness-for-purpose is currently being achieved by the incumbent market making regime, and whether it is improving over time?

These questions are not addressed in the Paper.

2.2.4 We liken the Authority's approach to a simple analogy; purchasing a new car. The specifications may include a set of approaches (buy, rent, lease-to-own, etc.) and a set of trade-offs (price, colour, style, accessories, etc), but the key consideration is fitness-for-purpose: will it tow the boat?

2.2.5 We have proposed an illustrative metric for the Authority to consider, which is described in detail in Appendix B. Our illustrative metric suggests that the existing market is, arguably, fit-for-purpose and has remained so throughout the gas/hydro supply stresses of late 2018 and early 2019, as well as throughout the Covid-19 demand shock of March-May 2020.

2.2.6 Although it may be argued that this model is not representative of all participants' requirements, our point is that it enables an evidence-based monitoring of market performance over time, and avoids claims that particular short-lived instances of market instability are proof of market failure.

2.2.7 To support our view that the existing market is (arguably) fit-for-purpose, we note commentary that acknowledges that the hedging opportunities across the industry do, in fact, enable the sustained and competitive growth of a retail customer base.[2]

2.2.8 To be clear, Trustpower is not proposing the adoption of any specific metric; rather we have constructed one that we believe has merit and is effective at measuring the market's performance.

2.2.9 We accept that the industry as a whole, in conjunction with the Authority, should discuss and assess a variety of alternative metrics before a particular one (or set thereof) is adopted.

2.2.10 The adopted metrics(s) should then be applied within the Authority's Code amendment framework to analyse the current and historical performance of the market before any consequent structural changes to hedge market services, if necessary, are made.

2.3. Willingness to pay is not adequately explored

2.3.1 The second significant reservation we have with the Paper is its lack of explicit focus on the willingness of benefiting participants (beneficiaries) to pay for market making services.

2.3.2 This concern is linked to the issue of fitness-for-purpose, because any participant who is "free-riding" on the service provided by market makers will have a clear incentive to lobby for an improved service as it comes at no cost to them.

2.3.3 The Paper does not address the question: Who is prepared to pay more in order to receive a service better than that offered by the status quo?

2.3.4 Given that the current costs of market making are incurred internally by the four market makers (and not passed on to other participants), we believe the Authority will continue to face increased lobbying from "free-riders" calling for more stringent market making parameters, especially if fitness-for-purpose is not quantitatively assessed.

2.3.5 If there are an insufficient number of participants prepared to pay more in order to receive an improved market making benefit, then it may well be that the status quo arrangements are, in fact, the closest to a practical optimum.

2.3.6 The willingness-to-pay by the beneficiaries of market making (which includes all market participants), should be explicitly addressed by the Authority as a matter of priority.

2.3.7 To be clear, Trustpower (as a market participant and beneficiary) is prepared to pay its share of the costs for the current level of service offered by the existing regime, provided those costs are efficiently derived and applied even-handedly to all market participants.

2.3.8 Unless there is broad-based agreement on a solution for the fitness-for-purpose and willingness-to-pay issues, the Authority is likely to be drawn into regulatory action that will prove unnecessary and/or inefficient, at a net cost to consumers.

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[2] Refer to example from Energy News 1 Aug 2019 at https://www.energynews.co.nz/award-finalist/electricity-retailing/43831/awards-finalist-consumer-nz-energy-retailer-year-electric : "Electric Kiwi has a long-term wholesale hedging function, underpinned by sophisticated modelling of customer consumption and hedge products. It has constructed a long-term portfolio with a blend of contracts for difference, options, hedge settlement agreements and financial transmission rights which hedge its current and expected customer load and cashflows. Electric Kiwi's portfolio contains locational hedges and optionality that allows uncertainty over the success of marketing campaigns to be managed. This approach has proven – especially in the past 12 months – that an independent retailer can lead the market in customer growth, and expand during extremely volatile wholesale market conditions."

2.4. Although yet to be proved necessary, the Authority's Approaches are otherwise fairly described

2.4.1 Notwithstanding the need to define fitness-for-purpose and to determine whether participants are willing to pay for market making benefits, Trustpower generally supports the Authority's descriptions and analysis of the proposed approaches and trade-offs.

2.4.2 We support the concept of the commercial approach ahead of other voluntary or mandatory approaches.

2.4.3 The commercial approach should be preferred by the Authority as it not only makes costs visible, but also allows competition to minimise those costs. We consider that this approach is the one most closely aligned with the Authority's Code Amendment Principles.[3]

2.4.4 We are also generally supportive the recent work of the Industry Forum (**the Forum**), with respect to the development of an incentive-based market making scheme, as outlined in its submission dated 27 May 2020[4].

2.4.5 The Forum explains why the most appropriate approach to an enduring market making solution is one that is commercial in nature:

> *"The current "threat of regulation model" where market makers are not paid by beneficiaries is unlikely to be in the interests of consumers:*
>
> *• The current market makers may not be the least cost providers.*
>
> *• Market makers bear all market making costs. Beneficiaries do not face costs and are therefore incentivized to demand more stringent requirements on market makers*
>
> *• Market makers currently have limited options to pass on cost to beneficiaries*
>
> *• The number of market makers selected may be inappropriate*
>
> *In contrast, an incentivised scheme would also be more flexible, durable, "right-sized" for the New Zealand market, and better align costs with benefits."*[5]

2.4.6 The focus for any reforms should be on ensuring the least cost, most efficient suppliers of market making services are providing the determined service levels. The Lantau Group supports our conclusion:

> *" The related question is whether the method by which the service is provided is the least cost method to do so – again reflecting the theme that if customers are to pay for this, then it should be provided at reasonable least cost. If the service provided currently is presumed or thought to be deficient in some way, then the question of whether forcing additional providers to be required to provide the service is the best way to do this is an important question. It is an important question especially if the [market making (MM)] service is itself something that involves particular expertise or financial or other capacities that are not necessarily or proportionately available amongst market participants. The fact that MM services may also be provided by non-market participants, such as trading houses or large financial players, supports this perspective. There is no inherent logic in requiring market participants to provide MM services just because they are market participants or just because some other participant is willing to do so. There are a number of factors at play – size, role, resources, exposure, expertise, systems, effectiveness and so forth. Omitting full consideration of these in the name of mandated provision does not assure an improved outcome."*[6]

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[3] Of particular relevance are the Authority's stated preferences for a clearly identified market failure before amending the Code, quantified net benefits, greater competition and market solutions. Refer to the Authority's Consultation Charter, available at https://www.ea.govt.nz/dmsdocument/14242-consultation-charter-december-2012

[4] In particular, "… the forum participants agree that the beneficiaries pay principle should be at the heart of any market making scheme. If it is not, the scheme will suffer from free-rider issues whereby beneficiaries of the scheme will forever demand increased market making services because they are not exposed to the additional costs of providing those service improvements." Refer Enduring market making: Industry-led options development (cover letter), [2020] Industry Forum, p. 1

[5] Enduring market making: Industry-led options development (submission), [2020] Industry Forum, p. 1

[6] Refer to Appendix C in this Submission: Memo to Trustpower – Market Making, [2019] The Lantau Group, pp. 1-2

2.4.7 We also agree with the Authority's own view that:

a) "using a market mechanism to determine the most efficient providers of market making services will likely reduce the overall costs of market making"[7]; and

b) "allocating costs to beneficiaries is likely to improve incentives for consumers of the service to demand an efficient level of service".[8]

2.5. Structure of Remainder of Submission

2.5.1 Our answers to the specific questions posed in the Paper are provided in Appendix A.

2.5.2 Appendix B provides further analysis and a detailed summary of our illustrative fitness-for-purpose metric to assist the Authority in measuring hedge market performance.

2.5.3 Appendix C is a memo from The Lantau Group (**TLG**) addressing key market design questions that are relevant to the Authority's consultation process, as well as supporting a voluntary, incentive-based (commercial) approach should any Code change be necessary.

For any questions relating to the material in this submission, please contact Shane Adams on 021 751 971.

Regards,

PETER CALDERWOOD
GENERAL MANAGER, STRATEGY & GROWTH

[7] Consultation Paper, [2020] Electricity Authority, para. 5.18

[8] Consultation Paper, [2020] Electricity Authority, para. 6.11

Appendix A: Responses to the Authority's questions

	Question	Response
Approaches		
1(a)	Has the Authority correctly described the approaches above? If not, please identify any changes to the approach description.	The approaches are correctly described, but any further evaluation must be subject to the prior need to determine fitness-for-purpose and identify beneficiaries' willingness-to-pay.
1(b)	Are there any other approaches the Authority should consider? If so, please provide a brief description of the approach and its merits.	No. We believe that the approaches listed in the Paper represent a wide range, with enough flexibility to cover all reasonable options for providing market making services. Again, fitness-for-purpose and willingness-to-pay must be established before approaches are evaluated.
1(c)	Do you have strong preference or strong aversion to any of the approaches outlined? Please explain your reasoning.	We have a strong preference for the commercial approach, once the fitness-for-purpose and willingness-to-pay issues have been resolved. Should changes to arrangements then prove warranted, a commercial approach would be the one most likely to deliver benefits at least cost, using the most efficient suppliers of market making services for any given service levels. A mandatory approach is our least preferred option because, in our view, it would prove: a) arbitrary in its application (to whom and how it should it be applied); b) unnecessary (unless transparency, education and commercial approaches have been fully explored and found inadequate to achieve fitness-for-purpose over time); c) economically inefficient (because it attempts to hide costs, rather than fairly distribute them, and is inferior to cheaper information-based solutions); and d) regulatorily inefficient (because it is heavy-handed, is not market-like and therefore sets a poor precedent of intervention, contrary to the Authority's Code Amendment Principles).

	Question	Response
Key trade-offs		
2(a)	Has the Authority correctly described the trade-offs above? If not, please identify any changes to the trade-offs.	The trade-offs are presented as if they are criteria for assessing the Authority’s approaches. Trustpower does not consider the five trade-offs to be suitable criteria for this purpose. The proper criteria would be related to fitness-for-purpose. As the Authority has not proposed any fitness-for-purpose metric, there is a lack of suitable criteria for assessing the proposed approaches. For example, if a fitness for purpose metric was established for “reliability” (in whatever form), then suitable criteria might include: a) How does each approach promote reliability improvements at lowest cost to beneficiaries? b) How flexible is each approach in adjusting to new definitions of fitness-for-purpose? As it stands, the Authority has proposed trade-offs that do have some value, but these are more akin to superficial features of a market making structure rather than a robust guide to its efficacy. Nevertheless, within these limitations, the Authority’s trade-offs may have some relevance once the fitness-for-purpose and willingness-to-pay issues are resolved.
2(b)	Are there any other trade-offs the Authority should consider? If so, please provide a brief description of the trade-off and its importance.	Within the above limitations, we suggest that additional trade-offs might be: a) What is the ability to respond to changes in the wider market, including (for example) changing the bid-offer spread obligation, or the number and specification of hedge products? These changes should be driven by an evolving fitness-for-purpose definition and/or standard. b) Does the approach minimise costs to all participants, to ensure these are no greater than the industry benefits? We expect that the costs of market making will increase if the market making obligations become too onerous. Costs will necessarily include any penalties market makers may face for non-compliance.

	Question	Response
2(c)	What trade-offs are most valuable to you, and which are least valuable to you, and why?	It is our view that the most important trade-offs are to involve markets and to allocate costs. Together, these are most likely to lead to the most efficient provision of market making services, with the lowest risk of over-specification and of prolonged lobbying. The least valuable trade-offs are likely to be the number and diversity of market makers. These factors are less relevant in the sense that a market-based approach with costs properly allocated will achieve better results than a prescribed market making membership with poor cost allocation.
3(a)	Has the Authority correctly assessed each approach against the key trade-offs? If not, why not?	Please refer to our answer at 2(a) above. The trade-offs are not suitable criteria without an agreed fitness-for-purpose outcome. However, we do note that a commercial approach scores best on our preferred key trade-offs (refer 2(c) above).
3(b)	If you have identified any changes to the approaches or key trade-offs in questions one and two, please provide your assessment of those approaches and/or trade-offs.	Please refer to our answer at 2(a). As the Authority has not proposed any fitness-for-purpose metric, there is a lack of suitable criteria for assessing the approaches.

Appendix B: The need for consensus on hedge market fitness-for-purpose metrics

Introduction

B1. The Authority's Consultation Paper is sub-titled "Ensuring market making arrangements are fit-for-purpose over time".[9] Trustpower agrees that this is a worthy aim.

B2. In support of this aim, we have previously submitted in some detail on the importance of an agreed definition of fitness-for-purpose[10]. We proposed a number of fitness-for-purpose metrics for consideration, including a simulation of a "prudent retailer" seeking to build a hedge book on the futures market.

B3. It remains evident that the Authority still has some distance to go in settling on a suitable definition of fitness-for-purpose.

B4. This Appendix makes some general points about the EA's approach, and also some specific points regarding our illustrative fitness-for-purpose metric.

B5. To be clear, Trustpower is not proposing the adoption of any specific metric, rather we have constructed one that we believe has merit and is effective at measuring the market's performance.

B6. We accept that the industry as a whole, in conjunction with the Authority, should discuss and assess a variety of alternative metrics before a particular one (or set thereof) is adopted.

B7. The adopted metrics(s) should then be applied within the current framework to analyse the current and historical performance of the market <u>before</u> any consequent structural changes to hedge market services are made.

Authority's Approach to Fitness for Purpose

B8. The Authority's problem definition is as follows:

a) "an apparent lack of confidence among some stakeholders in market making and price formation on the ASX market"; and
b) "a clear desire from almost all stakeholders we engaged with to increase the reliability of market making services".

B9. It appears that the first problem is a symptom of the second, i.e., if market making services were more reliable (especially in periods of market stress) then confidence in the market would presumably be restored. Therefore, to check whether the problems actually exist, it is fundamentally important to define what is meant by reliability.

[9] https://www.ea.govt.nz/dmsdocument/26664-hme-market-making-consultation-paper

[10] Refer submission at https://www.ea.govt.nz/dmsdocument/26508-trustpower-hedge-market-enhancements-submission, in particular Appendix B

B10. The Authority notes that it has recently implemented some reporting on market maker performance and released a beta version of an idealised hedging calculator. These are welcome initiatives, and Trustpower has made supporting suggestions in our earlier submission under the headings of transparency and education.[11] However, the Authority's reporting metrics have not been applied or analysed when attempting to define the problem in the current Paper.

B11. Instead, the Authority has proposed a set of "approaches" and a set of "trade-offs", and invited comment on the relevance of these. We have responded in Appendix A of this submission.

B12. In our view, however, the key question is being missed: What actual metric of fitness-for-purpose are we assessing these approaches against? Whatever metric (or metrics) used, they should be:

a) understood and broadly agreed by all active participants;

b) analytically derived so they can be easily monitored over time; and

c) preferably a suitable proxy for consumer benefit in any final cost/benefit analysis.

B13. Another key question is: Who is prepared to pay? One of the Authority's trade-offs is the ability to allocate costs. Trustpower considers this question should be addressed with priority, alongside achieving an accurate definition of fitness-for-purpose.

B14. The willingness-to-pay by the beneficiaries of market making (which includes all market participants), should be explicitly addressed by the Authority as a matter of priority. To be clear, Trustpower (as a market participant and beneficiary) is prepared to pay its share of the costs for the current level of service offered by the existing regime, provided those costs are efficiently derived and applied even-handedly to all market participants.

Update of Trustpower Illustrative Fitness-For-Purpose Metric

B15. Our preferred illustrative fitness-for-purpose metric (along with others) was described in our submission of December 2019.[12] To recap, we envisage this test of the futures market having direct relevance to a small-to-medium-sized independent retailer. The test is based on a hypothetical hedge purchase programme with the following features:

a) It simulates a "prudent retailer" seeking to build a hedge book on the futures market;

b) the retailer starts to trade one year ahead of the start of the hedge requirement, in order to avoid short term volatility. For example, if load starts 1 January 2019, the retailer starts to buy futures on trading days from 1 January 2018;

c) The retailer sets a target to buy a set baseload quantity of futures in megawatts (**MW**) over a 2-year hedged period, e.g., 10 MW (supplying approx. 10,000 customers) over January 2019 - December 2020.[13]

d) The retailer sets a buy size in MW, i.e., how much to buy in each trade (e.g. 2.5 MW), and buys in quarters only (i.e., eight quarters for the two years).

[11] Ibid

[12] Ibid

[13] Our example in Dec 2019 used 3 years, but we have revised this back to 2 years due to 3 years sometimes exceeding the duration of the ASX curve. For example, with trading starting April 2018, hedging for 3 years from April 2019 would require Q1/22 product which would not be available until October 2018.

e) The retailer sets a Spread Trigger on the day, e.g. 4%.

f) The retailer then buys once only for any given quarter on any given day, and only if the spread is less than the Spread Trigger threshold (thus ensuring they avoid days with a wider spread).

B16. The simulation builds up quarterly trades on suitable days (based on purchasing the lowest priced offer), until full hedging of the target volume in MW has been purchased across all quarters in the hedged period.

B17. The simulation is not intended to be necessarily representative of actual hedging outcomes. For example, a prudent hedger would also seek over-the-counter deals, power purchase agreements with generators, and other diverse risk mitigators rather than using the futures market exclusively. The key principle, however, is that a fit-for-purpose futures market should deliver a satisfactory and measurable outcome under this test (and, by implication, would be fit-for-purpose in a range of similar scenarios).

B18. The simulation does not account for structural issues involved with exchange traded futures, in particular the costs of initial and variation margin, and lack of prudential offset. These costs are unrelated to market making performance and hence are outside the scope of the current consultation.

B19. Main metrics to note from the simulation outcomes include:

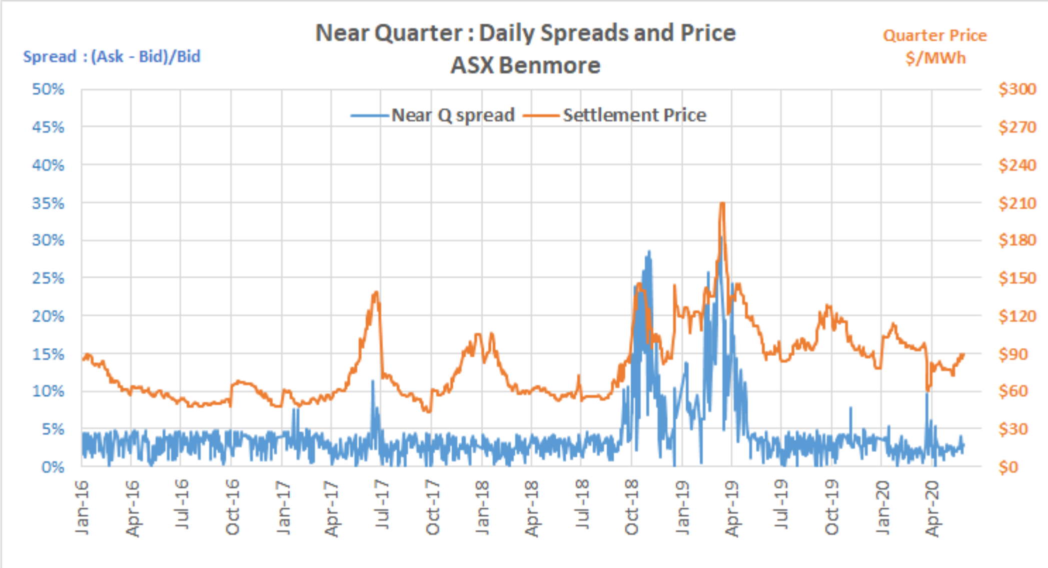
a) How long does it take to complete the full hedging requirement?

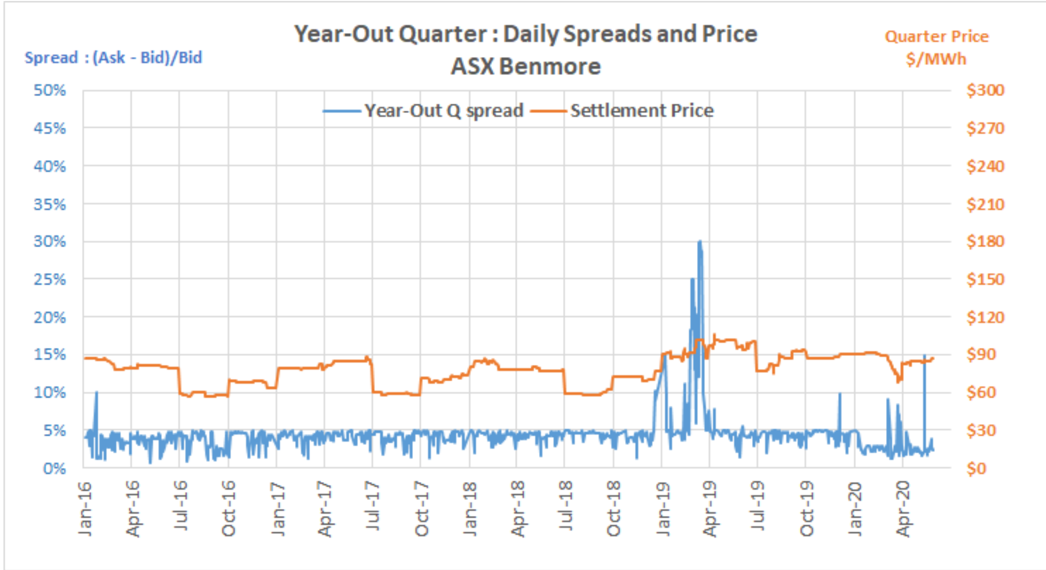
b) What was average price paid across all hedges purchased?

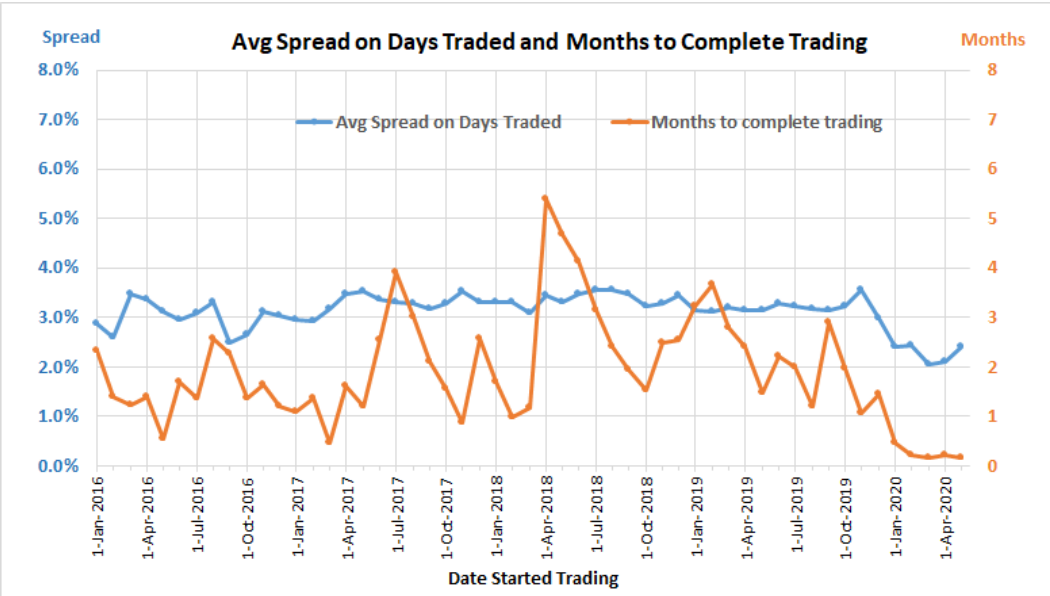
c) What was the average spread experienced on days when a trade occurred?

d) How have the above factors changed over time (as an overall metric of market health)?

B20. We have updated our simulation at Benmore (previously submitted in December 2019), and the results are shown in Figure B1, plotted against the short and medium-term market spreads for context.







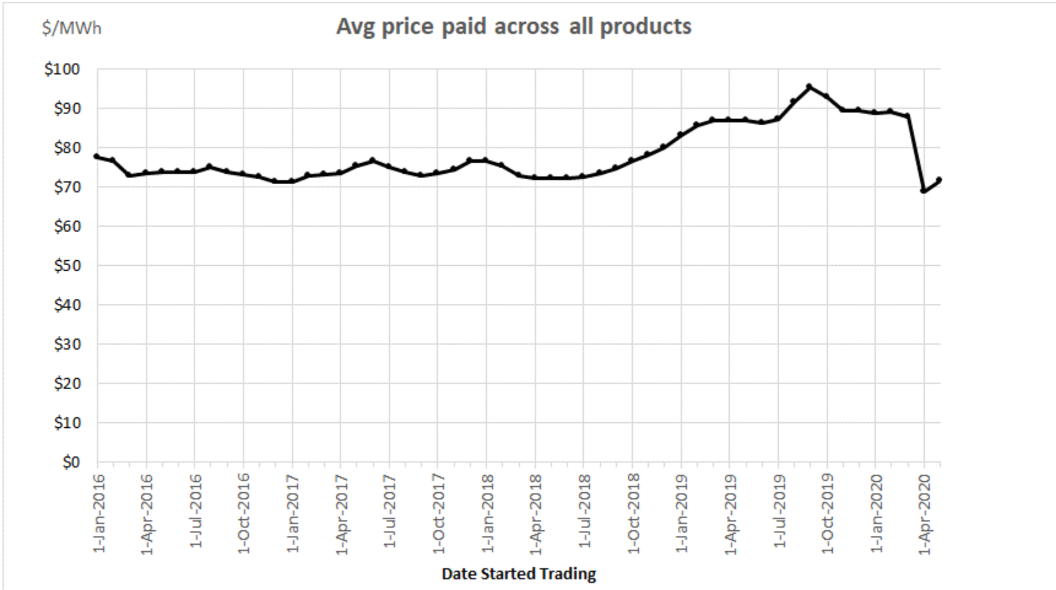


Figure B1: Observed spreads and prudent retailer metric results for trading start dates from 1 January 2016

B21. The periods of wide spreads during October 2018 and March 2019 are clearly evident in the top 2 charts of Figure B1, especially for the near quarter. Spreads for the year-out quarter were well contained through October 2018 but did have a brief widening in March 2019.

B22. Since voluntary market making spreads were narrowed to a nominal 3% in January 2020, spreads appear to have reduced accordingly, although with occasional excursions.

B23. The key metric in our view, however, is the fitness-for-purpose simulation results in the lower two charts. These particular results apply to a buyer seeking:

- 10 MW of futures cover at Benmore across two years, starting to trade one year prior to the covered period;
- trades triggered whenever the spread is less than 4%; and
- trades executed in quarterly products in 2.5 MW blocks, once per trading day.

B24. The average spread on days traded (i.e., the effective spread when trades are triggered) was consistently below 3.5% from January 2017 and dropped to between 2.0% and 2.5% from Jan 2020. The time it took to achieve the hedging program averaged around two months, although it reached over five months for trading starting April 2018.[14] From January 2020, however, the hedging program could be achieved in very short order, in well under one month. This suggests that recent tightening of market making obligations are having a significant effect.

B25. The overall results produced by this pragmatic metric are meaningful in showing that the periods of widening spreads in October 2018 and March 2019 did not have any significant adverse effect on the ability of a hypothetical "prudent retailer" to build a medium term hedge book. Like dollar-cost averaging with investments, the strategy of setting a threshold and buying when conditions are favourable, would have allowed for steady and consistent results to be achieved throughout the period 2017 – 2020, with notable improvements since January 2020. The metric also showed very favourable and stable results throughout the Covid-19 related demand shock of March-May 2020.

B26. We believe these simulation results put the futures market performance into a useful context. The futures market, under its current structure, can remain resilient during periods of stress in this "prudent retailer" metric. In practice, better results would be likely because our simulation uses bid/offer prices at market close, whereas narrower spreads may be available within the daily trading window.

B27. A version of our illustrative "prudent retailer" test (or some agreed industry alternative) could be run weekly or monthly and be used to monitor ongoing market making performance (at an aggregate level). This would help the Authority determine whether market making arrangements are fit-for-purpose and whether they are remaining so over time.

B28. We have previously emphasised[15] that there are also a number of underutilised data sources that could serve to better inform participants of the general state of health of the wider hedge market, rather than focussing strictly on the performance of the ASX.

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[14] The reason for this, on inspection, was that the product Q3-20 had wider spreads than other products (between 4 and 5%) for an extended period in winter 2018 and therefore purchase of the full 10 MW was not completed until 11 Sep 2018. All other products had been completed by mid-June 2018 (i.e., after 2.5 months)

[15] Refer submission at https://www.ea.govt.nz/dmsdocument/26508-trustpower-hedge-market-enhancements-submission, in particular Appendix B

Appendix C: The Lantau Group memo to Trustpower regarding market making

THE LANTAU GROUP

Memo

To:	Trustpower
From:	Mike Thomas
Date:	19 June 2019
Subject:	**Market Making**

At our discussions in early May, the Electricity Authority indicated that in their view the current voluntary Market Making (MM) arrangements are not sustainable and so it sought options for an enduring change to the current MM arrangements. Accordingly, I wanted to set out a couple of thoughts that might usefully inform approaches or considerations of approaches related to the MM debate.

One issue raised concerned the option of allowing a party to outsource their MM obligation. But the more important question is who can reasonably be expected to pay for the MM service in general. A MM service only has value to the extent that it has value to customers. It is a protection against market illiquidity and supports, at least in theory, more robust price discovery. All parties who participate in the market are free to trade as they are able, but the specific service of MM involves an additional cost to the service provider that should be recovered. To say it has value to new entrants or any existing player is really only to say that it enhances a business case to provide an end service to customers. So the key question is are we willing to charge the cost of the service on to customers.

The related question is whether the method by which the service is provided is the least cost method to do so – again reflecting the theme that if customers are to pay for this, then it should be provided at reasonable least cost.

If the service provided currently is presumed or thought to be deficient in some way, then the question of whether forcing additional providers to be required to provide the service is the best way to do this is an important question. It is an important question especially if the MM service is itself something that involves particular expertise or financial or other capacities that are not necessarily or proportionately available amongst market participants. The fact that MM services may also be provided by non-market participants, such as trading houses or large financial players, supports this perspective. There is no inherent logic in requiring market participants to provide MM services *just because* they are market participants or *just because* some other participant is willing to do so. There are a number of factors at play – size, role, resources, exposure, expertise, systems, effectiveness and so forth. Omitting full consideration of these in the name of mandated provision does not assure an improved outcome.

No doubt some concerns arise related to the potential cost of providing MM services via mechanisms that make the full costs of MM more transparent. Few things cause greater concern than realising that a buried or non-transparent cost or obligation actually is material. And that implementing what is essentially a market liquidity reliability standard to support an even higher degree of liquidity or protection comes at a non-linear increment to costs. Making such service a tendered service would do a lot to make clearer the underlying cost and performance relationship. One can then ask the question of what are consumers willing to pay for a market that supports a given level of trading liquidity and thus exposes participants to a level of trading risk during infrequent but intense market situations. And perhaps a better version of that question is whether it is really better to treat this as an insurance product and pay a potentially material amount all the time, or is it better to take more risk of retailers going out of business or deciding not to enter with offers that cannot withstand the risks to which they would be exposed?

The twin questions of what is a reasonable cost for MM and who should pay for it remain. The robust approach is to make it a service that is paid for and whose costs are recovered from customers on a non-bypassable basis. If there are concerns with this approach they are most likely to be of two types:

- First, the charge might turn out higher than expected and thus not be considered acceptable, even if the charge is competitively determined and linked to a seemingly accepted MM performance obligation. The solution to this problem is partly education, partly time, and partly fine-tuning the obligation.

- Second, the market is not sufficiently competitive, which could increase the cost of MM provision for any given performance obligation. The solution to this problem does not involve expanding the MM obligation to ever smaller parties with even less ability to consequentially impact MM provision, but rather recognising the problem is structural and must either be accepted or addressed directly.

A third issue also exists in that all the MM in the world will not overcome the basic problems of math. An entrant deciding to accept a level of exposure to the spot market is under no obligation to demonstrate to its customers that it can actually deliver on the contracts it has with them. Managing risk exposure is part of being a sustainable participant in the market. Yet, even in other sectors such as insurance and lending, rating agencies help to mitigate information gap risks and push market participants towards minimum standards; is something similar required here? Another is to ensure the market is as reasonably competitive as it can be and provide some reasonable amount of MM but far less than the assurance that might be preferred by a few so as to save the many undue additional costs. And then focus on providing the additional information that might allow smarter alignment of costs and risks.

Expanding the MM provisions and making them mandatory does not address either of these types of problems, and so really has no real hope of providing a lasting improvement to address concerns arising to date.