

## Appendix A Format for submissions

Submitter

Smartwin Energy Trading Limited

### **General Comments**

The FTR market is a relatively new one, and the skills to trade in it are relatively specialised.

The market itself has undergone almost constant change since its inception 3 years ago, with the addition of new hubs, market features, auction profile changes, prudential changes etc.

As such, the capability and available attention for existing participants to evolve mature and dynamic strategies has been limited, and the ability to develop new and innovative hedging products based on FTRs even more so.

Smartwin believes that while the Authority has developed several potentially useful ideas, at this time it would be better to take a 'wait and see' approach than implement large scale changes.

However, a useful role for the Authority could be to provide more active oversight and reporting on the FTR market, which could include setting indicators of performance. For example, the options paper refers to a relatively low percentage of reconfiguration volumes, however I believe this is the first time this statistic has ever been quoted by the Authority. Providing more information about how the FTR market is developing, and what is happening within it, would appear to be a valuable role for the Authority to play at present.

The one issue that Smartwin feel particularly strongly about in this consultation is the proposal to extend direct participation in the FTR market to parties based in Australia. As a non-incumbent party that has entered the FTR market, we can attest that the barriers to entry are not high, and therefore we question the genuine desire for meaningful participation by parties who are not willing to overcome the existing barriers.

We consider that such parties are more likely to be opportunistic, and therefore unlikely to add meaningful value to the FTR market, or to NZ customers. In particular it is hard to see how an overseas company who trades FTRs can then turn these into a hedge product for NZ retailers, given that the same barriers that apparently prevent them from trading FTRs would also prevent them from completing contracts with those retailers.

Question	Comment
Q1. Do you agree that further enhancing the FTR market could support the issues identified by the Authority, and provide benefits to the wider hedge market?	Yes, further enhancements to the FTR market could deliver greater net benefits to the electricity market, and consequently to consumers
Q2. Are there other issues with the current arrangements for FTRs that we have not identified?	There are signs that for some FTR products the incumbent participants are overbidding, i.e. paying an unusually high price for some products. The potential reasons for this are many and varied, and the size and severity of

	<p>the problem is highly dependent on the reasons, however at its most basic, over-pricing of FTRs will limit their usefulness as a hedge product.</p>
<p>Q3. Are there any other ways to develop the FTR market that we have not identified? If so, please describe them.</p>	<p>A different mechanism for auctioning could provide more effective price discovery and efficient allocation. This was recommended by the LPRTG during FTR market development, however the Authority chose the 'one-shot blind auction' approach that we have at present. Obviously a change to the auctioning mechanism would be a very significant change to the FTR market and would carry with it major costs and disruptions.</p>
<p>Q4. What are your views on the relative merits or priority of these twelve potential developments? Could some of them complement or substitute for others?</p>	<p>In priority order with brief explanation (more detailed answers given to specific questions below):-</p> <ol style="list-style-type: none"> <li>1) More hubs via the allocation process Better hedge matching, unlocks and reallocates more LCE revenue</li> <li>2) Introduce peak FTRs Allows building of a hedge profile suitable for retail participants</li> <li>3) Improved transparency Addresses numerous issues including that raised in Q2 above</li> <li>4) Support education Minimal cost, fundamental role for regulator</li> <li>5) Extend horizon Minimal cost, may improve hedging</li> <li>6) Allow short selling/origination/derivatives These are all effectively equivalent. Might be a good idea although obligation volumes suggest take-up will be low Not supported</li> <li>7) All contracts each month FTR manger has enhanced the auction frequency and has the ability to enhance it further via the allocation plan if needed. Auctioning all contracts each month would add unnecessary complexity and excessively dilute available auction volumes.</li> <li>8) Quarterlies Would seem to be very complex to manage and could have bizarre pricing outcomes</li> <li>9) Preferential pay-outs Adds a lot of complexity for a rare (non-existent to date) event</li> </ol>

	<p>10) Bulletin Board Advice from other markets was that reconfiguration is more useful, and we have this already</p> <p>11) Overseas parties Existing barriers to entry are not high. Also if parties do not trade here, how can they offer hedge services to NZ retailers?</p>
Q5. Do you agree the Authority should provide policy direction on the four developments in Group 1, but that service providers can lead further assessment of the developments in Group 2?	The Authority appears to have assessed the policy landscape accurately. We urge the Authority to work very closely with service providers in developing any substantial policy changes.
Q6. What are your views on the merits of extending direct participation in the FTR market to parties based in Australia?	Smartwin opposes this proposal. The barrier to entry is not substantial, hence if parties are genuinely interested in participation, they will have no hesitation in setting up a local office. Further, if the intended purpose of market changes is to enable better hedging of locational risk, then parties buying FTRs need to be in a position to offer hedge contracts to NZ retailers and other market participants, hence allowing non-resident companies does not promote this as most NZ market participants will be unwilling to enter into hedge contracts with foreign companies.
Q7. What are your views on the merits and practicality of allowing parties other than the FTR manager to originate FTRs?	Enabling short selling via origination or derivatives has merit, particularly in the case of a market with constrained supply, or one that is overbid, both of which potentially apply to the FTR market. However, given the open-ended risk of selling FTRs, the number and depth of selling participants is likely to be low. Hence the confidence of achieving net benefits is also likely to be low, unless the costs of implementing the change are very small. Note, for clarity, we do not see that the proposal to allow non-resident entities to participate would fix this issue. This is because of the inherent complexity of FTRs, such that new entities are even less likely to take on the risk of a sold position than incumbent participants.
Q8. What are your views on the merits and practicality of developing an FTR derivative product?	See answer to Q8. Additionally, adding another set of energy derivatives to the alphabet soup that is already forming on the ASX may not be helpful at this stage.
Q9. What are your views on the merits of developing a bulletin board?	Advice sought by the LPRTG during development of FTRs informed us that the overseas markets that had bulletin boards and reconfiguration auctions saw the vast majority

	<p>of secondary trading going through the reconfiguration auctions. The perceived lack of success of reconfiguration auctions in NZ is probably more to do with market maturity than a genuine market design issue.</p> <p>Also we note that the desire for secondary trading is perhaps overstated in the options paper. In the 2 years that Smartwin has held FTR positions (visible in the register) we have not once had any request or contact from other parties wishing to buy or sell FTRs on the secondary market.</p>
<p>Q10. Of the two approaches to overcoming the inherent limitations in the supply of FTRs that have been discussed (allowing parties to originate or develop a derivative product), which do you consider preferable and why?</p>	<p>Of the two, Smartwin would be more likely to use origination, due to having existing systems in place. However, as per above comments, we think neither approach is likely to be viable in the near term.</p>
<p>Q11. Are there other approaches to overcoming the inherent limitations in the supply of FTRs that the Authority has not identified?</p>	<p>The revenue adequacy requirement (1 month in 12) could be relaxed or made more aggressive. Auction profile could be modified to release more volume up front, using reconfiguration facilities to buy it back as required.</p>
<p>Q12. What are your views on how these developments would complement each other? To what extent might they be dependent on each other?</p>	<p>We see the proposed developments as largely independent. Each is addressing a specific issue, and as such should be able to be evaluated independently. Caution should be taken if considered a 'package' of measures aimed at addressing a package of problems.</p> <p>The depth and level of origination/derivative activity is likely to be enhanced by a healthily traded market in caps.</p>