14 April 2025

Electricity Authority
Level 7, AON Centre
1 Willis Street
Wellington

To whom it may concern,

Re: Expiry of Urgent Code regarding market making under high stress conditions

Thank you for the opportunity to respond to the consultation in relation to the expiry of urgent code regarding market making under high stress conditions.

Contact is supportive of a strong liquid futures market and believes the market benefits from its existence. We note the success the success the market has had in attracting many and varied participants, many of whom now trade voluntarily between each other. In that context, we believe that a strong liquid market with well-resourced market makers is important but that the role of market making should not come at any cost. We also firmly believe the role of a market maker should be one which is aimed at providing backstop liquidity for the physical market participants in our market and as a backstop to provide hedging where trading would not have otherwise occurred.

Unforeseen changes to market making conditions

We argue that the most significant issue participants who were not in favour of the rule changes enacted in August 2024 relates to the fact they may not have seen it coming. Secondly, the application of the relief mechanism to all available contracts would likely have been even more unexpected – where more targeted relief to the affected contracts could have been more appropriate. This sudden change may have left parties exposed to risk on positions that they would have normally shifted on to market makers at a lower cost.

Contact is supportive of a solid, well thought out relief mechanism which targets only the affected contracts and gives market makers relief during times of high stress and volatility. The mechanism should be stable, unable to be manipulated and known well in advance. This type of mechanism would allow participants to plan their trading activities and prepare for relief mechanisms to be enacted, while not impacting liquidity in parts of the futures curve that were not relevant to the underlying issue.

Access to hedging for physical participants

We argue physical market participants have ample opportunity to hedge using electricity futures across the three year to four year timeframe that futures contracts relating to a particular quarter are available to trade. We believe that non-physical participants are the most likely parties wanting to trade in times of market stress and high volatility.

We believe that market makers have the responsibility to put a frame around a market and should be the liquidity of last resort. However, in New Zealand electricity futures, market makers are consistently the first line of liquidity in market making sessions – during high stress and/or high volatility they can become the first and only source of liquidity which places significantly more risk on the market maker.

As a further observation we note that whilst the rule changes were in force in August 2024, many trades were voluntarily executed inside the wider spread permitted – an indication that those willing and wanting to trade were still doing so.

Commercial market maker costs

Given the events of the last 12 months, it is likely the cost of having a commercial market maker will increase dramatically if the same terms are retained in the next iteration of the commercial market making scheme. This cost will ultimately be borne by New Zealand electricity consumers and regulated market makers.

We consider that the design of the regime should more accurately balance the benefits and costs to end consumers and market participants. While we support market making to create liquidity, this should not be done at any cost. A regime that allows some lenience in times of high stress and/or high volatility is likely to achieve a better benefit/cost trade off than one without.

Preferred option

Contact is supportive to retaining a form of market making relief during adverse market conditions. Of the options provided, Contact would have preferred a modification of the urgent code amendment, however we believe this requires substantially more thought and analysis than could be achieved in the timeframe to respond to this consultation.

Therefore, we are supportive of retaining the current urgent code amendment (Option 2) as a form of relief to the market makers. It is certainly not perfect, but it is easily measurable, and its implications are well known in advance to participants.

Future market making schemes

For the next iteration of the commercial market making scheme, Contact would like the Authority to work through a market making scheme with a relief mechanism that considers not only market stress but also market volatility. Market making may not only be costly in market stress situations, but also in periods of high volatility (i.e. periods where the absolute daily changes in settlement prices are high – such as a sudden increase in hydro inflows following a period of low inflows).

If there is anything in our response that you wish to discuss further, please feel free to contact me.

Yours sincerely,

Nigel East
Forward Markets Manager