Virtual trading hubs in continental Europe bear more risks than benefits - Energy Traders Europe, Eurelectric, Europex

Virtual trading hubs would deter rather than enhance the liquidity of electricity forward markets in Central and Eastern Europe - shows new quantitative study.

IXELLES, BRUSSELS, BELGIUM, November 12, 2024 / EINPresswire.com/ -- The EU electricity market reform has mandated the European Commission to assess the impact of virtual trading hubs on the liquidity of electricity forward markets. A new study conducted by Compass Lexecon on behalf of Energy Traders Europe, Eurelectric and Europex reveals that these hubs are likely to deter, rather than enhance, the liquidity of forward markets in Central and Southern Europe. Based on the quantitative analysis, the three associations call on policymakers to consolidate existing forward markets and prioritise proxy hedging via existing instruments over virtual trading hubs to increase forward market volumes, keep transaction costs stable and ultimately spare consumers greater energy costs.

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> *Cillian O'Donoghue - Policy Director at Eurelectric*

Liquid electricity forward markets are key for market participants to plan production and manage risks related to short-term power prices. Today, participants mainly hedge on their local market or on more liquid neighboring markets, such as those in Germany or Hungary. This practice, called proxy hedging, involves the use of instruments that provide insurance against price movements between these markets. The main instruments in this regard are Long-Term Transmission Rights (LTTRs) and price spread trading.

To improve hedging on forward markets, the European Commission is now considering the introduction of virtual trading hubs in continental Europe. Such hubs would provide market participants in a certain area with a synthetic price based on the aggregation of their different zonal prices. These hubs, however, bear more risks than benefits compared to existing hedging practices and are found to perform worse than existing physical hubs – shows the Compass Lexecon quantitative analysis.

"One key lesson of the energy crisis is that in addition to more long-term contracting, we also need more liquid forward markets to improve visibility for electricity market participants and to protect consumers. The Commission proposal for virtual hubs, however, will not achieve such an objective. A better way to increase liquidity in forward markets, instead, is facilitating trading on physical hubs, longer long-term transmission rights, no market interventions and more reasonable collateral rules." - said Cillian O'Donoghue – Policy Director at Eurelectric.

The study demonstrates that for Central and Southern European countries, transitioning to regional virtual hubs would introduce higher costs and risks. It would increase complexity in the market and potentially deteriorate hedging opportunities by splitting liquidity between physical and virtual hubs. Lowered liquidity would, in turn, translate into higher transaction costs and ultimately increase prices for consumers. Hedging on physical hubs, on the contrary, is a safer option given the less volatile price differences between local zones and the existing German and Hungarian hubs.

"We are happy to see forward electricity markets build up their liquidity again after the 2021/2022 drop. But they are still recovering, in a geopolitical situation that is possibly even worse than 3 years ago. In this context, planning a drastic change requires a strong justification of the benefits of that change – and what this study shows us is that the benefits of virtual hubs are far from certain. So, to provide stability and predictability, we'd rather see incremental improvements to forward markets and transmission rights." – stated Jérôme Le Page – Electricity Committee Chair at Energy Traders Europe.

Another reason why virtual hubs would bear more risks than benefits is the need to issue so-called zone-to-hub LTTRs, a measure to hedge market participants in relation to the allocation of transmission capacity between the hub and the zone. Yet, the contracts made on the hub are not related to a specific zone.

"The introduction of zone-to-hub LTTRs supporting proxy-hedging with a virtual hub that the market did not ask for will impose a higher financial risk for transmission system operators. TSOs should instead support existing market-based hedging instruments rather than artificially imposed regional virtual trading hubs." – said Michele Stretti – Senior Policy Adviser at Europex.

Other options to improve current forward markets in Continental Europe could be enhancing LTTRs volumes, maturities and frequencies and establishing a secondary market for LTTRs.

The associations call on the European Commission to test the feasibility of virtual trading hubs for continental Europe with a comprehensive impact assessment and to identify alternative means to improve market participants' ability to hedge price risks in the internal electricity market.

Note to Editors:

Energy Traders Europe is the voice of Europe's energy traders. We promote competition, transparency and open access in the European energy sector. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy.

Eurelectric represents the interests of the European electricity industry. We seek to contribute to the competitiveness of our industry, provide effective representation in public affairs and promote the role of electricity in the advancement of society.

Europex is a not-for-profit association of European energy exchanges with 35 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

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