Liquidity of the MIBEL derivatives market– summary of the main conclusions from the meetings held with MIBEL stakeholders

In 2018, the MIBEL Technical Committee (MIBEL TC) held regular meetings with key stakeholders concerning the functioning of MIBEL, in order to obtain their views, concerns and proposals for improvement.

One of the topics that the MIBEL Board of Regulators considered relevant was the **liquidity of the MIBEL derivatives market**. To discuss this topic, the MIBEL TC invited a group of heterogeneous stakeholders – consumer associations, supplier associations, energy traders associations, market operators, central counterparties and brokers – to attend its meetings in order to assess and analyse the current state of market liquidity, its restrictions, the degree of competition, its challenges and next steps.

This document summarises the key aspects highlighted by such entities with regard to the liquidity of the MIBEL derivatives market.

Current state and competition in the MIBEL derivatives market

- Several trading venues coexist in the MIBEL derivatives market, resulting in liquidity fragmentation;
- Stakeholders/members seek liquid trading venues – at the expense of less liquid trading venues – that allow them to open and/or close derivatives positions, where appropriate, with a lower consumption of Value at Risk (VaR) of their portfolios;
- Given the fluctuation of spot market prices, resulting from the dynamics of the different variables used for their formation, stakeholders would have sufficient reasons to hedge prices through the derivatives market. However, many of the stakeholders that trade on the MIBEL spot market do not trade in the derivatives market;
- Prices offered by vertically integrated groups are, sometimes, more attractive than derivatives market prices, hence, some stakeholders decide not to negotiate in this market;
- The withdrawal of some financial institutions from the trading of commodity derivatives had an impact on the liquidity of the derivatives market.

Challenges and constraints of the MIBEL derivatives market

- The CESUR auctions provided liquidity to the MIBEL derivatives market. The cancellation of the results of the auction held in December 2013[1] triggered a change in the types of participants in this market (reduction in the number of participants for purposes other than risk hedging); a decrease in trading volumes; and introduced the perception of regulatory risk, primarily by foreign participants, thus reducing the liquidity of the derivatives market;
- Financial regulation, in particular, the entry into force of MiFID II on 3 January 2018, has raised some uncertainty in relation to its impact on non-financial counterparties that trade on the commodity derivatives market and this has contributed to active economic

[1] https://www.cnmc.es/sites/default/files/1542614_8.pdf

stakeholders adopting more conservative investment decisions, bearing in mind these requirements;

- The increase in participants' costs, as bank guarantees which are not fully backed by collateral are not accepted by a Central Counterparty (CCP)[2];
- The various changes introduced in the spot market regulation generate instability and a lack of predictability, affecting risk hedging via derivatives and introducing regulatory risk in the prices (thus regulatory changes in the spot market cannot be hedged through the existing portfolio derivatives contracts);
- Despite the creation of a single electricity market in Spain and Portugal, there are structural differences between both markets which affect the Iberian participants, as well as foreign participants that could bring liquidity to the derivatives market; and
- Low degree of sophistication of some Iberian stakeholders/members and lack of financial literacy with regard to risk hedging via the derivatives market.

Proposals to increase the liquidity of the MIBEL derivatives market

- To introduce new technologies and solutions (e.g.: Blockchain);
- To have closer contact with electricity sector players and more information on the functioning of the derivatives market: information on the different types of contracts for hedging; the fundamentals of risk analysis; and the advantages and disadvantages of clearing contracts with a Central Counterparty (CCP);
- To hold mandatory auctions and list new contracts better suitable to the market needs (e.g. reviewing peak load contracts and listing contracts with longer delivery periods);
- To seek solutions that can provide liquidity to the market, attracting the participation of funds and other financial institutions, or liquidity "aggregators";
- To extend the activity of market makers for a larger number of derivatives contracts to attract greater levels of liquidity to the derivatives market; and
- To strengthen regulatory stability.

The MIBEL TC took the aforementioned considerations into account in the comparative study of MIBEL prices (spot and forward) with other European Markets and their relationship with the internal energy market, both in the conclusions section and in the section with the measures that could improve its functioning and development (confidential section).

[2] Pursuant to Section 2 (1)(h) of Annex I of Commission Delegated Regulation 153/2013, of 19 December 2012, with regard to regulatory technical standards (RTS), although bank guarantees are accepted by CCPs, they must be fully backed by collateral.