



Setting Up an Electricity Trading Desk

Electricity markets are really volatile, offering both challenges and opportunities. To survive in this exciting and competitive environment an effective trading and risk management strategy is essential. The key to successful trading activities will be having access to real-time information about a wide range of factors including power prices, prices of other key commodities like gas, coal and oil, understanding speculative activity, global, regional and local events and demand and supply dynamics.

One thing is for sure setting up a trading desk will be a daunting and time consuming job. It is not just a plug and play thing but you need to carefully plan, manage and execute the roll out of your trading organization and manage it like any other large and complex project.

Key issues that at least need to be addressed before you can start trading are:

- Figuring out what the legal and financial obligations are for dealing with the relevant TSO(s).
- The post trade activities have to be ready within your company. Thus you need a risk management team, an accounting system, bank arrangements, a trading and risk management system either in Excel form or an off the shelf product like Open Link, Allegro, Sungard etc. and a function to oversee the whole chain of activities after the trade is done.
- Addressing everything before you will be able to execute your first trades. You need access to information sources like Thomson Reuters, Argus, Platt's, analytics and a model to estimate your potential future gains and losses.
- Taking care of the most important issue; your counterparties. This could either be a central market entity (like Nordpool, EPEX Spot etc) or OTC partners. Alternatively, you can seek the help of brokers for this. The main risk you will face with your counterparties will be the credit risk; do they have a good credit standing and are you willing to trade with them, and if yes under what conditions.
- In order to trade with counterparties in the wholesale power market you have to sign and agree a so-called Master agreement with each potential counterparty. The Master agreement is the legal document which sets out the terms of the agreement with regard to financially settling the contract and physically delivering the power. Without a signed Master agreement other parties will most likely not be willing to trade with you. In continental Europe for physical trading the so-called EFET (European Federation of Energy Traders) Master agreement and for financial contracts the ISDA agreements are used. To negotiate these master agreements you need a strong legal and credit team.
- Hiring good traders who will meet your function requirements and fit into in your trading team and risk management culture and who know how to make money.



Case Study

By means of this case study we will explain how we did successfully support an electricity company preparing itself to become active in a newly deregulated market.

Business Challenges

The company is the second largest generator in its country and delivers power in both the wholesale as well in the retail market from large industrial companies to private households. The company did have the ambitious goal to reach 30 -40 % of the electricity wholesale market in their country within 5 years from starting operations. Their urgent need was to establish an electricity trading desk capable of providing all the decision support tools the company needed to trade in the wholesale market. In other words the Trade framework should allow the optimization of supply processes for different markets (cross border trading), integrating generation, commercialization and trading activities and so providing a complete overview of the electricity business.

We were asked to design, test and start up the trading desk and to embed it in the company's corporate governance framework, that needed to be implemented at the same time.

Our Approach

The first move was to bring in our experts to understand the company's business challenges and translate that into a detailed project specifications. We did this by having a one day workshop with the Board of Directors and the Management Board to discuss the company's strategy and business case and how to bring that in line with becoming active in the deregulated electricity market. Integrated in this approach was creating awareness among the Board members what was expected from them and understanding the challenges ahead of them. The transition from an engineer based organization to a trading and marketing one would only be successful if it was openly supported and communicated by the Board and set as a high priority project within the organization.

After the goals were clearly set and defined, we did organize a one day session with the senior management and the key people active in the day –to- day work to review how the company currently was organized in terms of trading, portfolio management and whether a risk management framework was in place. We also discussed all the risks that the company did face in its operation and being active in the energy markets, prioritized them and discussed potential ways to mitigate those risks.

The results of both these workshops were used as the basis for preparing a report in which we described the best practices in the global power industry in dealing with trading and risk management and linking this to the current situation of the company



and make recommendations how to fill the gaps together with an action plan of how to tackle these issues step by step.

After the acceptance of the outcomes of the report by the Board we closely worked together with the designated key people from the company with developing protocols procedures for both the Risk Management as well as these for the Trade department. Structuring a flexible and reliable IT environment to better support its integrated wholesale and retail trading divisions, master agreements, contract data providers, selection and procurement process of ETRM software, structured risk, and created limits and mandates for the traders. Besides we did help them to apply for exchange membership, get a contract with a General Clearing Member, supported their legal and credit people with negotiation the master agreements with the different counterparties they wanted to trade within the OTC markets.

An important part of our support was also the on the job training of the front, middle and back office people. This education was part of a global change management process to help the company to manage the operational changes as a result of having to adapt to the new market design. Successfully adapting to these changes was streamlined by taking a structured approach. We formed a readiness plan by carefully assessing the situation and the organization's capabilities across people, processes and technology, to identify readiness gaps, and then manage the change process by identifying and working towards key success factors.

The result

At the end of the project the company did have an already well performing Trading desk and middle and back office staffed with well trained people. Well defined protocols and procedures for both the trading as well for the risk management thereof and a good corporate governance structure. Due to the structured approach to the change management, the transition was well received and accepted by the people within the organization and therefore was a smooth one.

We fulfilled the clients project's requirements reaching the project goals on time and within budget, and meeting the quality levels required.

Contact

If you have any question or like to discuss how our services are beneficial to you and your company please do not hesitate to contact me:

Kasper Walet
Managing Director
Maycroft

Tel: +31 653818191
Email: walet@maycroft.com
Internet: www.maycroft.com