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ECC Spot Market Margining

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1. Introduction

This document provides the documentation of ECC's spot margin model. The current values of used calculation parameters, if not set in this document, can be found in the risk parameter file¹.

The margining for derivatives is documented in a separate document that is published on the ECC website¹.

Information on margin reports that are available for members can be found here:

<https://www.ecc.de/en/member-section/smss-reporting>

1.1 Overview of Margin Types

On spot markets, the credit exposure comprises all payment obligations from concluded transactions by a trading participant that have not been settled yet. ECC uses an in-house model based on the time-series of a trading participants trading behavior to calculate the margin requirement.

ECC clears spot markets for commodities on which mainly non-financial trading participants are active. Settlement cycles between the non-financial trading participants and their Clearing Member are usually longer than between ECC and the Clearing Members. On some spot markets (power, natural gas) trading and clearing takes place 24/7 while settlement of payments from accrued exposures is restricted by the business hours of the payment systems.

ECC measures exposure on spot markets near to real time using the Current Exposure Spot Market that has to be covered with collateral. In order to avoid frequent margin calls due to collateral shortfalls and to cover exposures that might arise from trading activities outside the business hours of the payment systems. ECC has established the Initial Margin Spot Market (IMSM) as an additional margin component. This IMSM is a buffer and is designed to cover exposure from potential spot transactions in the future until the next settlement time.

Margin requirements on spot markets are adjusted on each ECC business day to adopt to changes in both market conditions and trading behavior (except for CESM which is calculated near to real time). ECC performs daily back testing for IMSM². ECC Validation performs an independent annual validation of methods, models, and model assumptions.

¹ <https://www.ecc.de/ecc-en/risk-management/margining>

² See Back Testing Procedure.

The following table gives an overview of the different margin types:

Exposure Type	Margin Type	Description
Current Exposure	Current Exposure Spot Market³ (CESM)	The net value (debit payment amount) of all concluded transactions on the spot markets during the day that have not been settled.
	Deferred Payment Margin (DEPA)	Used to cover the net debits from daily payments in the case of problems or delays within the payment settlement.
	Additional Margin Curtailment (AMCU)	The expected closeout costs of physical positions in the case a trading participant is curtailed by transmission system operators (TSO).
Potential Future Exposure	Initial Margin Spot Market (IMSM)	The IMSM is called for expected spot transactions in the future until the next payment time and serves as a buffer to reduce intraday margin calls.
	Pre-Auction Margin (PAMA)	This margin is a pre-collateralization for certain types of spot products.

1.2 Regulatory Requirements

While commodity spot products are not covered by EMIR, ECC applies the same regulatory standards to risk management for commodity spot products as for derivatives:

Regulatory Item	ECC Methodology
ESMA ⁴ Article 24 requires that for the calculation of initial margins the CCP shall at least respect the following confidence intervals: (a) For OTC derivatives, 99.5%. (b) For financial instruments other than OTC derivatives, 99 %.	For spot initial margin ECC uses 99% confidence level.
ESMA Article 25 requires that a CCP shall ensure that initial margins cover at least with the confidence interval defined the exposures resulting from historical volatility calculated based on data covering at least the latest 12 months. A CCP shall ensure that the data used for calculating historical volatility capture a full range of market conditions, including periods of stress.	ECC uses a one-year lookback period.

³ Storable commodities (e.g. EUA certificates) have current exposure only; non-storable commodities (e.g. gas and power transactions) also have potential future exposure.

⁴ Commission Delegated Regulation (EU) No 153/2013 (Regulatory technical standards), p. 41ff, Official Journal of the European Union, L 52, 23 February 2013

ESMA Article 26 requires that the liquidation period shall be at least two business days for financial instruments other than OTC derivatives.

A liquidation period is not relevant for spot products. ECC uses the period between last settlement and the expected termination of a trading participant from the markets as basis for calculating potential future exposure or delivery risk.

1.3 Model Limitations and Restrictions

According to EMIR Article 26 inherent model limitations and restrictions shall be considered and documented:

Limitation/Restriction	Impact	Mitigation
Availability of Exposure Data	Incomplete or stale data might lead to incorrect initial margin calculations	Monitoring for stale prices; conservative corrections (safety add-on) for short time series (see 2.1)
Consideration of Changes in Trading Behavior	Sudden Changes in Trading behavior between two calculation points in time are not predictable using historic data, however they can lead to underestimating the exposure (e.g. for a weekend).	Monitoring of CESM on near to real time basis and intraday reaction if certain thresholds are exceeded (e.g. suspension of trading participants, intraday margin call).

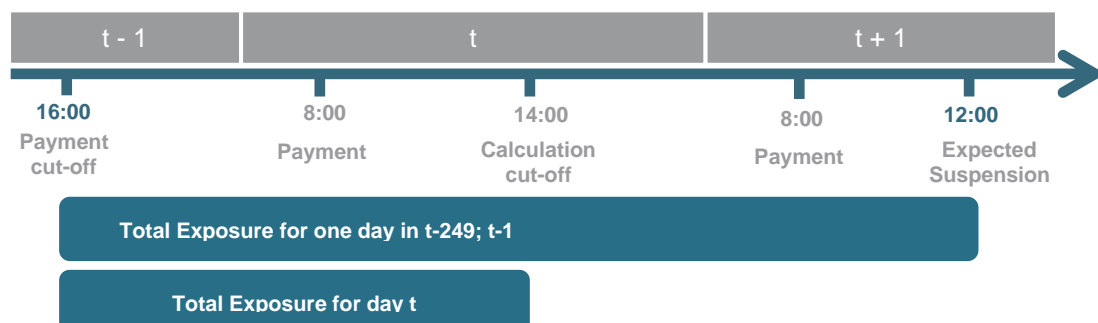
2. Calculation of the Spot Initial Margin

Spot markets for commodities such as power or natural gas are different from derivatives markets for several reasons:

- On power and natural gas spot markets transactions are concluded 24 hours a day, 7 days a week that can result in credit exposures during that time. The credit exposures from those transactions are measured on near-to-real time basis with the Current Exposure Spot Market (CESM) as described in chapter 3.1.
- A delivery versus payment (DVP) standard cannot be employed to limit counterparty exposures as delivery of power and natural gas takes place shortly after trading and those commodities are not or only very limited storable.

For these reasons ECC has introduced the concept of Initial Margin Spot Market (IMSM) which is based on an in-house developed model. The IMSM is called for expected transactions i.e. before any transactions are concluded and before any credit exposure has arisen. It serves as a buffer to reduce the number of margin calls during the day and to ensure that credit exposure (measured with the CESM) in times where settlements/margin calls are not possible (e.g. weekends), i.e. the potential exposure from expected transactions, will be covered with a high degree of confidence.

The calculation of IMSM is based on a statistic of the history of daily total exposures. The daily total exposure⁵ comprises the net payment amount of all spot transactions that have been concluded between the payment cut-off of the previous weekday⁶ and the latest point in time where a trading participant in default would be suspended from trading the next weekday. On calculation day, ECC takes the exposure from all concluded and registered trades of the previous exposure day $t - 1$ after 16:00 CET until the point in time of exposure calculation (currently 14:00 CET) to improve the forecast of the model. This “incomplete” exposure is often referred to as “t-Exposure” since it includes in particular the trades of the day ahead auction for power of calculation day t . The following graphic gives an overview of the total exposure:



⁵ In EUR, used EOD FX rates can be found at <http://www.eurexchange.com/exchange-en/market-data/clearing-data/risk-parameters/Haircut-and-adjusted-exchange-rate>

⁶ Monday to Friday including all holidays on weekdays

The IMSM model for non-storable commodities is based on the historical daily exposures of a trading participants during a look-back period of 1 year. The history of one year is modelled by using 250 exposure days which are all weekdays. Exposures from different commodities are netted.

The Spot Initial Margin is called with admission of a new trading participant and is only returned when the trading admission is terminated and all pending payments with the trading participant have been settled.

Contracts with no 24/7 trading, e.g. Emission certificates⁷, are excluded from IMSM however these products are considered in CESH calculation. For products that are storable and where the notional market value of the product can be used to offset potential losses in a default (e.g. European Emission Allowances that can be used similar to securities) only the price-change risk is considered as exposure.

2.1 Initial Margin Spot Market

The calculation of the IMSM is based on the historical daily exposures of the past year. The exposure $E_{i,g}(t)$ for an account i and a product group g on day t is defined as

$$E_{i,g}(t) = \sum_{s \in S} P_{i,g}(s) Q_{i,g}(s)$$

$P_{i,g}(s)$ is the price paid by trading participant i for the trade of product g at date time s and $Q_{i,g}(s)$ is the corresponding quantity bought ($Q > 0$) or sold ($Q < 0$). The exposure is calculated for every exposure day t and the index set S contains trade timestamps⁸. An example for the exposure aggregation can be found in section 2.4.

The exposure is further adjusted by a specific margin parameter $MP_{g,(Buy; Sell)}$, which is given for each product g and depends on whether $E_{i,g}(t)$ signals a net buy or sell.

$$E_i(t) = \sum_{g=1}^n E_{i,g}(t) MP_{g,(Buy; Sell)}$$

For standard products and markets the margin parameters MP_g^{sell} and MP_g^{buy} are set to 1 to determine the net payment amount. A list of adjusted margin parameters for affected market areas can be found in the ECC Risk Parameters file.

⁷ Currently including all EUA, EUAA and CER contracts.

⁸ Here, for convenience the timestamp is assumed to be a unique identifier of a trading participants trade, although in ECC's settlement instructions there is a unique primary key for each trade, because, e.g., all trades belonging to an auction are settled simultaneously.

Based on the historical exposures the spot margin $M_i(t + 1)$ called at ECC business day $t + 1$ for trading participant i is constructed to be the actual margin available at day $t + 1$. Thus, a trading participant's margin requirement⁹ is given by

$$M_i(t + 1) = \max\{\mu_{E_i,t} + \alpha \cdot \sigma_{E_i,t} ; \beta \cdot \max_{t \in T'} \{E_i(t)\}\} + M_{\min}$$

Generally, the equation of spot margin consists of three main components:

1. M_{\min} ensures that there is all the time a minimum margin, e.g. when there are no historical data for a new client, the historical and the short-term moving component would not result in a margin. Moreover, M_{\min} is generally an additional buffer to the margin. The latest parameterization of M_{\min} can be found in the ECC Risk Parameters file.
2. A short-term component allowing the IMSM model to react to drastic changes of the trading participants trading behavior or market price movements. The short term component $\beta \cdot \max_{t \in T'} \{E_i(t)\}$ uses a look-back period of 30 exposure days with $T' = [t - 29; t]$. The latest parameterization of β can be found in the ECC Risk Parameters file.
3. A statistical component using the mean and the empirical weighted standard deviation using the exposures of the past year with the time period $T = [t - 249; t]$. For the calculation of the mean and standard deviation, only exposures greater than 0 are considered. Other exposures are replaced by a missing value and are ignored. We denote the number of data points with exposure greater than 0 by m .

The mean is calculated as follows

$$\mu_{E_i,t} = \frac{\sum_{k=0}^m E_i(k)}{m}$$

The standard deviation is calculated using an exponential weighting with weight factor $\lambda=0.99$ to provide a faster adaption to recent changes in trading behavior but also ensure a stable margin calculation.

$$\sigma_{E_i,t} = \sqrt{\frac{\sum_{k=0}^m (E_{i,k} - \mu_{E_i,t})^2 \lambda^{k+1}}{\sum_{k=0}^m \lambda^{k+1}}} \cdot \varepsilon_m$$

⁹ The Initial Margin Spot Market is rounded up to the next full ten thousand euros (EUR 10,000).

To reduce the statistical error for short time series a safety add-on ε_m is calculated and applied to the standard deviation depending on the number of exposures greater than 0. An overview of the corresponding safety add-ons can be found in the ECC Risk Parameters file.

2.2 Special Holiday Adjustment

The Holiday Adjustment is introduced to cover risk from exposure periods having a longer duration as a common weekend e.g. on Easter and Christmas holidays following a weekend where the exposure period can increase up to five days.

To cover this risk, ECC increases IMSM on special days where the IMSM needs to cover a longer period due to extra non-ECC business days. Hereby, the single exposure value on the calculation day t ("t-Exposure") will be replaced by the following conservative estimation of possible exposures on dates prior the holiday period:

$$E_i(t) = \eta \cdot \mu_{E_i, \hat{t}} + \max_{t \in \hat{T}'} \{E_i(t)\},$$

where η is 2 for a five-day exposure period or 1 for a four-day exposure period respectively. Here $\mu_{E_i, \hat{t}}$ designates the mean of all exposures for single exposure days (Tuesday, Wednesday, Thursday) of the last calendar year $\hat{T} = [\hat{t}-250; \hat{t}-1]$. The maximum is taken over the period of 29 exposure days $\hat{T}' = [t-29; t-1]$. This estimator extends the common exposure for this very short period using the mean as the unweighted standard estimation of long-term historical member data and the maximum to cover short term trading behavior.

A list of the special days and the corresponding factor η can be found in the ECC Risk Parameters file.

2.3 Consideration of delivery risk in the exposure generation

For markets where ECC faces a delivery risk, i.e. where ECC's physical nomination can be cancelled by the network operator, the delivery risk is included in the exposure generation of the corresponding product groups by taking a relative portion¹⁰ of the financial exposure.

Example:

For the UK market, sellers are facing a curtailment risk by the TSO. In order to cover the potential payments of imbalances, 30% of the financial exposure is considered.

$$\text{Exposure}_{\text{old}} = -\text{GBP } 1,000 \quad \text{Exposure}_{\text{new}} = -\text{GBP } 1,000 \cdot -0.3 = \text{GBP } 300$$

¹⁰ Can be found in the ECC Risk Parameter File.

2.4 Example for exposure aggregation

ECC's exposures towards the trading participant contain all trades between the last booking cut of the previous exposure day at 16:00 CET and the next exposure day at 12:00 noon CET. They are the basis of ECC's Spot Margin. The following example shows how they are derived over one week:

- - - ECC 4pm Booking Cut		- - - Latest possibility for suspension 11:45 am	
Day	Time	Trade Value ¹¹ (k€)	Exposure
Mo	22:00	-56.00	0.00
Tue	12:00		
	12:00	233.00	
	16:00	98.00	
	21:00	-110.00	
Wed	12:00		63.00
	13:00	29.00	
	16:00	108.00	
	20:00	36.00	
Thu	12:00		226.00
	13:00	112.00	
	16:00	34.00	
	19:00	44.00	
Fri	12:00		783.00
	13:00	190.00	
	16:00	122.00	
	22:00	346.00	
Sat	12:00	55.00	
	14:00	-3.00	
	21:00	-31.00	
Sun	13:00	4.00	
	15:00	86.00	
	21:00	-30.00	
Mo	12:00		737.00
	13:00	192.00	
	16:00	28.00	
	21:00	90.00	
Tue	12:00		

¹¹ The trade value is the traded quantity times the price.

In order to better illustrate the IMSM algorithm and how the exposures are processed by the daily margin calculation ECC provides an IMSM calculator as an excel version. The current version can be downloaded on the ECC website <http://www.ecc.de/ecc-en/risk-management/margining>.

2.5 Computation of Spot Initial Margin during change of Clearing Member

Considering the ECC booking cut at 16:00 CET on ECC business days and the time of the transfer on the "Transfer Day" (TD) at 12:00 am CET, it must be taken into consideration that the NCM has the possibility to trade in the time between booking cut and time of effective Clearing Member (CM) change while creating additional exposure at the old CM. This exposure is settled the day after the TD and remains as exposure for the old CM until this point in time.

To reduce the possible remaining exposures during that period, the change of the CM is effectively possible only on days not following a weekend or holiday period of relevant currencies. To cover possible exposure of the remaining period at the old CM, the Spot Initial Margin (IMSM) is split between the old and the new CM at the day before the TD. The old CM keeps 20% of IMSM requirement and ECC pledges 80% of IMSM requirement from the new CM until the remaining exposure is settled. The Current Exposure Spot Market (CESM) relevant for transactions between 16:00 pm CET and 12:00 am CET at the TD will be considered for the old CM in that time.

3. Calculation of Current Exposure

ECC's intraday exposure (also referred to as current exposure) is reflected in the "Current Exposure Spot Market" (CESM).

3.1 Current Exposure Spot Market

For all spot products, the CESM is the net payment amount of all concluded but not yet paid transactions. The net payment amount per product will be multiplied with a multiplier to also reflect

- an increased risk for market areas where ECC faces a delivery risk (e.g. by trading on a non-virtual balancing point or by a local limit implementation of the TSO) or currency risk.
- the risk from storable products (like EUA or CER) where the CESM is the price change risk and not the full payment amount.

The CESM is calculated in the following way: Firstly, all outstanding payment amounts $PA_{i,g}$ for account i and product group g are determined with $P_{i,g}$ as the price and $Q_{i,g}$ quantity for Product g (e.g. POWER 50HZ, NATGAS TTF) traded in margin account i :

$$PA_{i,g} = \sum_{s \in S} P_{i,g}(s) \cdot Q_{i,g}(s)$$

The amounts $PA_{i,g}$ are then multiplied by the respective MP_g^{sell} as multiplier in case there is an outstanding payment and by MP_g^{buy} as multiplier in case there is an outstanding payout. Thus, the CESM for account i results in:

$$\sum_{g=1}^n \begin{cases} PA_{i,g} \cdot MP_g^{sell} & \text{if } PA_{i,g} > 0 \\ PA_{i,g} \cdot MP_g^{buy} & \text{if } PA_{i,g} < 0 \end{cases}$$

For standard products and markets the multipliers MP_g^{sell} and MP_g^{buy} are set to 1. A list of multipliers by market area can be found in the ECC Risk Parameters file.

The CESM is floored at 0, so no credit will be granted to other margin classes. This margin is uploaded intraday into the EUREX Clearing system and is updated every 10 minutes. It is reported in EUREX's reports so Clearing Members can detect accumulating exposure on the spot market intraday.

The margin will be reduced as soon as the corresponding payments for the next business day have been instructed in the payment system at the end of the business day (currently 18:00 CET). If financial settlement is deferred (e.g. due to non-TARGET2 holidays in the corresponding market), the CESM additionally includes these deferred payments.

4. Other Margins related to Spot Markets

4.1 Pre-Auction Margin

The Pre-Auction Margin¹² (PAMA) reflects the financial limit set by the Clearing Member per auction and NCM. The margin is used only for auction markets (*AM*) having a longer repetition cycle and trading systems that provide a financial pre trade limit. The collateralization of the pre trade limit is used to prevent unexpected margin calls for Clearing members caused by the auction.

$$Limit_{NCM/AM} = PAMA_{NCM}$$

PAMA is released to the Clearing Members after the financial settlement of payments related to the auction at the next business day.

4.2 Deferred Payment Margin

The Deferred Payment Margin (DEPA) is used for cases where the financial settlement with Clearing Members is not possible during the common ECC payment cycle. This could be the case if it is technically impossible to generate payments for daily cash settlement or if a delay in provision of transactions results e.g. as part of the *Nordic Fallback*.

The margin is calculated after 18:00 CET and becomes effective at the next business day. It reflects the open net payment amount (debits only) from all spot market that should usually be settled the next business day. The DEPA is only called if the amount is not covered by the Initial Margin Spot Market (IMSM) e.g. at Thursday (effective on Friday) for settlement on Monday or Friday (effective on Monday) for settlement on Tuesday.

4.3 Additional Margin Curtailment

The Additional Margin Curtailment (AMCU) is used for the handling of imbalance or deviations in case that the TSO suspends trading participants balancing group agreements. This makes it impossible for ECC to nominate transactions already concluded by the trading participant to the TSO. The expected costs for position close out depending on prices achieved for position closing via market, or the price for balancing energy will be covered within this margin.

¹² The Pre-Auction Margin is currently used for Guarantees of Origin auctions at EEX only.