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Clearing Circular 04/2023

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ECC informs on the so-called Market Correction Mechanism

Dear Trading Participants, dear Clearing Members

with the publication of the Council Regulation (EU) 2022/2578 of 22 December 2022 (hereinafter “the Regulation”) on the so-called Market Correction Mechanism (MCM), there is a legal basis for a market intervention in the trading of gas market derivatives in the TTF derivatives taking effect as of 15 February 2023.

As announced in our press release of 20 December 2022, we provide you with a more detailed overview of EEX/ECC´s understanding of the most important provisions of the Regulation and what changes are expected for trading and clearing at EEX and ECC. This understanding has been shared with the competent authorities of EEX and ECC but remains subject to orders or objections of said authorities or guidance from relevant European authorities. In due course, you will find more information in a Q&A which will be published soon and thereafter updated regularly.

Market Correction Mechanism

The MCM is triggered by the following factors in regulated exchange natural gas market trading (referred to as a market correction event): The settlement price for derivatives trading in natural gas in the TTF Front Month contract, published by ICE Endex B.V., the Netherlands, exceeds a price of 180 EUR/MWh on three consecutive working days and is 35 EUR/MWh above the global LNG reference price calculated by ACER during that period. If this is the case, ACER shall publish on its website by 23:59 CET at the latest a notice of the occurrence of a market correction event (market correction notice).

As of the day after the publication of the market correction notice, a so-called dynamic bidding limit for TTF derivatives with certain maturities takes effect. More specifically, TTF derivatives market participants shall not submit and market operators shall not accept orders for TTF derivatives that are due to expire in the period from the expiry date of the front-month TTF derivative to the expiry date of the front-year TTF derivative with prices of 35 EUR/MWh above the reference price published by ACER on the previous day. If the reference price falls below 145 EUR/MWh, the dynamic bidding limit shall remain at the sum of 145 EUR/MWh + 35 EUR/MWh, i.e. EUR 180 EUR/MWh.

This means that the dynamic bidding limit may change in correlation to the reference price if the LNG reference price is above 145 EUR/MWh (dynamic bidding limit = LNG reference price + 35 EUR/MWh) and remains static at a price of 180 EUR/MWh if the LNG reference price is lower than 145 EUR/MWh.

Unless the EU Commission suspends the MCM or declares a regional or Union emergency, the dynamic bidding limit will be deactivated at the earliest after 20 working days if the LNG reference price is below 145 EUR/MWh for three consecutive working days. ACER will publish a corresponding deactivation notice.

Implications of the Market Correction Mechanism on Trading at EEX

PRODUCTS

The MCM applies to all TTF futures (i.e. EEX TTF Natural Gas Futures and EEX TTF EGSI Futures) that expire between the expiry date of the front month and the expiry date of the front year, including all months (from M+1 onwards), quarter and season contracts that expire during that time and the front-year contract itself. Maturities shorter than one month are not in scope of the Regulation. Such shorter maturities exist only for the financially settled TTF EGSI Futures as day, weekend and week contracts. A timetable reflecting the maturities affected by any potential market correction event will be attached as Annex to the Q&As.

Options on TTF futures are TTF derivatives, but the Regulation does not restrict option pricing. Options trading therefore remains unaffected. Nevertheless, as long as a dynamic bidding limit applies, EEX will not list new option series with a strike price above the applicable dynamic bidding limit. Please note that EEX currently does not offer any option series with strike prices above a potential bidding limit.

TRADING

With the activation of the dynamic bidding limit, trading participants may not submit and EEX will no longer accept orders for the affected contracts beyond the dynamic bidding limit. Unless an exemption under Article 12 (4) of the Regulation applies, orders above the dynamic price limit (including potential trades) will be manually cancelled by the market operations team.

Exemptions under Article 12 (4) include for example buying and selling TTF derivatives to offset or reduce TTF derivatives contracts concluded before 1 February 2023. As EEX and ECC cannot check the date of conclusion of a TTF position, we will rely on the correctness of the information provided by the trading participants. In order to make use of an exemption, trading participants must enter the relevant information in the respective text field upon order entry. If an order above the dynamic bidding limit does not contain corresponding information, it will be treated as a normal order entry and EEX will delete this order and corresponding trades. The requirements for an exception must be met on both sides of a trade. Further instructions will follow in this regard.

The handling described above also applies to so-called implicit orders generated by the system from spread orders. Therefore, trades concluded via an implicit order above the dynamic price limit in a TTF future will be cancelled as well.

DAILY SETTLEMENT PRICES

The EEX settlement price determination procedure will continue to apply without changes, as settlement prices are not subject to the prohibition of Article 4 (5) of the Regulation. The settlement price procedure has always considered not only trading activity on the regulated market, but also fair values provided by market participants and data from sources outside EEX. This means that settlement prices will continue to reflect the proper fair market value, irrespective of whether a dynamic bidding limit applies. Please find EEX' Settlement Pricing Procedure here.

CLEARING

The availability of daily settlement prices reflecting fair market value is the basis for key risk management processes for ECC, Clearing Members and Trading Participants. EEX continues to provide fair market values even if a dynamic bidding limit applies. In addition, default management auctions of ECC do not fall under the MCM. The registration of the auction results on EEX' regulated market is explicitly permitted by Article 12 (4) (c) of the Regulation.

Hence, no material changes to the approved and established clearing processes are required:

Both the calculation of initial margins and the regular variation margin process will remain unchanged without cap interference. If participants accumulate very large positions or the market volume is significantly reduced, resulting in an increased concentration risk, the concentration risk margin increases. This is in line with the existing and established procedure to calculate concentration risk margins.

The general procedure for intraday exposure management will not change either. Intraday margin calls are calculated during the day based on price signals from transactions. Depending on the number of transactions, ECC might additionally use price signals from other sources (e.g. OTFs or OTC) to complement those price signals.

Nevertheless, as the Regulation might impact market behavior, ECC will continue to assess the adequacy of its risk management systems. ECC will intensify its monitoring of inter alia volumes, prices and liquidity to detect any potential developments at an early stage and implement changes if required according to its established change management procedures.

OTF

The EEX Organised Trading Facility (EEX OTF) is not covered by the Regulation and remains unaffected by any potential market correction event as the Regulation exclusively limits the MCM to regulated markets (Article 4(5) and definition of "TTF Derivative" in Article 2(1) of the Regulation). To recall, an OTF is a MiFID II regulated trading venue that is not a regulated market. The EEX OTF had been established in 2016, when it was still called a non-MTF. With the entry into force of MiFiD II, EEX was granted an OTF license.

At the EEX OTF, TTF Natural Gas Futures are listed which are contractually identical to the EEX Regulated Market TTF Futures. The EEX OTF offers order and trade based intraday and settlement price information and continues to be a transparent and supervised trading venue with secure and safe clearing at ECC. Article 9 of the Regulation provides for the extension of the MCM to derivatives linked to other VTPs by means of a Commission Implementing Act. In the future, the full set of EEX Regulated Market Natural Gas products will be provided on EEX OTF.

The EEX OTF allows market participants and clearing members to manage existing regulated market positions unrestricted from the MCM. In the future, Clearing Members and Non-Clearing Members can request, for risk reduction purposes, a compression (netting by novation) with regards to futures transactions in natural gas futures concluded on two different markets (e.g. EEX Regulated Market and EEX OTF). By this compression - each subject to ECC´ confirmation - Clearing Members and Market participants will be enabled to not only economically but also legally offset regulated market futures positions in Natural Gas derivatives.

All trading participants that are admitted for trading in EEX Natural Gas Futures at EEX Regulated Market and that have provided access to the relevant balancing agreement(s) will be set-up by EEX on the EEX OTF accordingly.

Further information will follow in due course.

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