European Association of CCP Clearing Houses

EACH response - Targeted consultation on the review of the functioning of commodity derivatives markets and certain aspects relating to spot energy markets

April 2025

Introduction

The European Association of CCP Clearing Houses (EACH) represents the interests of Central Counterparties (CCPs) in Europe since 1992. CCPs are financial market infrastructures that significantly contribute to safer, more efficient and transparent global financial markets. EACH currently has 18 members from 14 different European countries. EACH is registered in the European Union Transparency Register with number 36897011311-96.

The European Commission has published a targeted consultation on the review of the functioning of commodity derivatives markets and certain aspects relating to spot energy markets. In this response, EACH addresses the following section of the consultation:

- Section 6.2: The Market Correction Mechanism and other dynamic caps

6.2. The Market Correction Mechanism and other dynamic caps

In providing your answers under this section, please specify, to the extent relevant, whether your assessment would differ depending on whether natural gas or electricity is concerned.

(67) Do you believe that MCM is a useful tool to limit the episodes of excessive – and significantly diverging from global markets – prices in the EU? Please explain.

EACH does not believe the MCM to be a useful tool to limit the episodes of excessive – and significantly diverging from global markets – prices in the EU, neither for natural gas nor for electricity. While noting the fact that the MCM has never been activated, due to the prices dropping below the activation conditions, the mechanism presents unforeseen risks that would prevent it from achieving its objective and even exacerbate the problem. For instance:

- As soon as the price cap legislation is introduced market participants will be incentivised to shift their positions OTC so they can effectively manage their exposure only to a single price. However, many futures market participants do not have access to OTC markets (or will face bilateral credit constraints) and therefore this will reduce liquidity on the exchange and in the market overall.
- Energy traded derivative markets liquidity providers who cannot or do not wish to take physical delivery of gas will exit the market due to the risk of being trapped in a position after the cap is triggered. This in turn will exacerbate price

moves and increase the prices, making it more likely that the price cap will be triggered.

Furthermore, research has demonstrated that the MCM implemented during the energy crisis did not succeed in lowering gas prices.

(68) Building on the experience of the MCM, do you think dynamic caps based on external prices (whether in the shape of the MCM or in another shape) would help avoid situations where EU energy spot or derivatives prices significantly diverge from global energy prices, and should therefore be codified in legislation? If not, please explain why, and specify, if relevant, to what extent you believe price divergences between EU prices and international prices can be warranted. If so, please explain to which products you believe such dynamic caps should apply (e.g., spot/derivative, OTC/venue-traded) and how such dynamic caps should be calibrated (e.g., reference price, frequence at which the boundaries are renewed, etc.). Please point to potential risks and opportunities.

EACH strongly believes that such dynamic caps based on external prices (whether linked to natural gas or electricity) should not be codified in legislation. Implementing an artificial price cap would not address the underlying changes in global natural gas or electricity valuations driven by evolving supply and demand dynamics.

(69) Do you believe that the MCM or other dynamic caps could have an impact on the attractiveness and/or stability of EU commodity derivatives markets? If so, please explain how.

EACH believes that a dynamic cap such as the MCM could negatively affect the attractiveness and/or stability of EU commodity derivatives markets in the following ways:

- The artificial price controls would make Europe a less attractive and reliable partner for suppliers, who may prefer markets where they can sell at competitive, market-driven prices. It could also lead to hedging outside the EU: for instance, hedging European gas on non-EU venues is possible and likely to take place at large-scale.
- It would likely harm the trust into the market and prompt the global community to shift towards other, unrestrained and therefore more representative reference prices, which are primarily located outside of the EU.

(70) What is your assessment of the impact of a triggering of the MCM on trading conditions and financial stability?

The MCM would likely have the effect of decreasing financial stability because of:

- Inability or limitations to CCPs performing their crucial risk management function of default management: In case of default of a market participant, CCPs would hedge the portfolio in the market or auction the portfolio. However, with regulated trading venues being subject to the price cap, CCPs could be unable to do so when the defaulter's position is priced higher than the cap. If the CCP's losses in this case are deep enough, CCP recovery and resolution could be triggered, with potential contagion effects not only in the derivatives market but also in the physical market.
- Negative impact on liquidity: Because of the artificially lowered price, market participants may decide to no longer access regulated trading venues and CCPs, trading over-the-counter (OTC) instead and ultimately leading to a reduction of market participants and liquidity in the markets. This could affect the CCP's risk management in case of a default, if not enough market participants participate to the default management process, thereby increasing systemic risk.
- Increase of margin requirements due to the complication of the CCP business-as-usual risk management:
    - CCPs may need to collect more margin because of the discrepancy between the capped price and the price in the bilateral OTC market, which is however not entirely representative of the "real" price. The CCP might increase margins excessively to ensure that they estimate the "real" price as conservatively as possible.
    - Moreover, the moment that the MCM is triggered (either on the first day or at some point in the future after the mechanism is already in place), prices could decrease abruptly if the market price is above the cap and generate a sudden mark-to-market correction, positive for those with short positions and negative for those with long positions. This would lead to potentially large and destabilizing margin calls.

  Increased margin requirements could amplify market stress and increase contagion risk in case of failures to meet margin calls, negatively impacting financial stability.

(71) Are you aware of any impact on margins (or other trading costs) of the mere existence of the MCM, notwithstanding the fact that the mechanism has never been triggered? If so, please provide details on such impacts, ideally providing quantitative input.

The existence of the MCM could lead to an increase in margins, depending on the risk model of the CCP. This is more likely to occur with derivative products than with the spot market:

- CCPs have the obligation to value all positions on a basis that reflects the real value of the relevant derivative. CCPs use trading venue prices to calculate the risk as regulated trading venues are the most reliable and transparent source for prices. CCPs' risk management therefore depends on predictable prices that reflect the true price of the instrument being traded.
- To be a conservative and prudent risk manager, the CCP would start managing risk according to what the CCP considers the real price is. In absence of the exchange's price reflecting the actual price, CCP valuation of positions is likely to take place in the OTC bilateral market. Once a cap is in place, liquidity will begin to shift away from the exchange to the OTC bilateral market, as market participants will not want to manage price exposures across a dislocated market.
- To reflect inefficiency in the clearing mechanism, margins will increase significantly. For example, to avoid being left with insufficient margin, the CCP could increase margins excessively to ensure that they estimate as conservatively as possible the real price.