23 January 2023
ESMA70-446-778

Annex II – points for clarification

1 Introduction

1 ESMA has identified some provisions considered to be unclear in the Council Regulation (EU) 2022/2578 of 22 December 2022 establishing a market correction mechanism to protect Union citizens and the economy against excessively high prices (the Regulation).

2 ESMA is of the view that further clarity on the application of the MCM would be of benefit to ensure a common understanding and convergent implementation of the Regulation when the MCM is activated and sets out below the areas where such clarifications would be most helpful. ESMA stands ready to provide technical assistance to the Commission to that end.

2 Identified ambiguities or uncertainties regarding the operation the MCM

2.1 Supervision and enforcement of the Regulation

3 The Regulation is clear in its Article 4(5) that in case of an activation of the MCM, market operators and other market participants are obliged to adhere to the dynamic bidding limit.

4 ESMA notes that EU legislation governing financial markets normally includes a designation of the relevant competent authority(ies) responsible for supervising compliance with the requirements mandated in legislation as well as a determination of the supervisory powers and applicable sanctions in case of breaches of the requirements.

5 Although ESMA could not find any express provision to that effect in the Regulation, ESMA understands that the direct applicability of the obligations to market participants subject to the concerned sectoral legislation, would mean that the relevant competent authorities designated by the applicable sectoral legislation are responsible for supervision and enforcement of those obligations. This being said, in ESMA's view, ideally supervisory responsibilities should be clarified in the Regulation.

2.2 Exemptions for contracts prior to 1 February 2023

6 The Regulation introduces an exemption under Article 12(4)(b) for buying and selling of TTF derivatives in order to offset or reduce TTF derivatives contracts concluded before 1 February 2023. In ESMA's understanding, the intention of this exemption is to ensure that any dynamic bidding limits following an activation of the MCM do not apply in such cases,

aiming to allow parties holding open positions to offset or reduce positions in an orderly manner.

7 ESMA has some questions as to how this exemption would operate in practice. It would appear that any market participant trying to close such a “protected position” from before 1 February 2023 can only do that by “finding” another market participant holding an opposing “protected position” equally wanting to offset or reduce the position.

8 For market participants to submit orders and conclude trades outside the dynamic bidding limit it would be essential to have legal certainty that the positions are indeed “protected” and can be offset based on prices outside of the dynamic bidding limit.

9 In addition, it would appear that for orders to offset “protected positions” trading venues would need to establish a separate order book or to technically limit the counterparties that can interact with certain orders in the ordinary order book (implementing such changes would likely take a significant amount of time). A pre-arranged trading facility already offered by commodity derivatives trading venues could be an alternative but raises the same legal certainty issue as the one mentioned above.

10 While this may allow counterparties to close or offset positions without any price limitations, it would however reduce and artificially split available liquidity and would add to the complexity of trading arrangements for all market participants concerned.

11 ESMA has tried to paraphrase its initial understanding of the intentions behind Article 12 (4)(b) of the Regulation and the potential challenges for applying it in practice without going into an excessive level of detail. Initial feedback from market participants indicates that there are also questions in the market about the correct application of this exemption.

12 ESMA would therefore consider it useful if some guidance in respect of this provision could be provided in order to ensure a convergent application in full compliance with the Regulation.

2.3 Application to default management process

13 The Regulation introduces an exemption under Article 12(4)(c) that the CCP register “OTC transactions in a regulated market” to liquidate the defaulters’ portfolio that are not subject to the MCM.

14 The exact implementation of these rules is unclear. It appears that the CCP can organise an auction process outside of the central orderbook but how would trades concluded with auction counterparties be treated during and after the default management process is unclear both from a legal and operational perspective. The possibilities for auction

participants to reduce their exposures relating purchased portfolio after the completion of the default management process is crucial for a successful auction. As outlined in the preliminary data report, legal and operational uncertainty could discourage participation to the auction.

15 ESMA would welcome further clarification that the trades obtained in an auction procedure as part of the default management process by clearing participants are exempt from the MCM, including after the end of the default procedure.

2.4 Scope of the MCM – application to “block-trading facilities”

16 Regulated Markets can offer “block-trade facilities” for TTF products. Block trades are typically pre-negotiated transactions in large sizes initiated and agreed outside the venue and then reported to the venue, notably for post-trade and clearing purposes, under the rules of the trading venue. As such they fall outside the order book of the Regulated Market. The Regulation applies to orders submitted to the Regulated Market.

17 ESMA would welcome further clarification as to whether such block trades formalised on a Regulated Market outside the order book are within the scope of the MCM.

2.5 Scope of the MCM – meaning of front-year TTF derivative

18 The dynamic bidding limit under Article 4(5) of the Regulation applies to 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. Stakeholders reported difficulties in determining the contract maturities in scope of the MCM.

19 According to the definitions under Article 2(4) and 2(5) of the Regulation, the front-month contract is the contract whose expiration date is the nearest among the derivatives with a one-month maturity, and the front-year contract is the contract whose expiration date is the nearest among the derivatives with a twelve-month maturity. Although the definition refers to “twelve-month maturity” rather than to a maturity of one calendar year, ESMA notes that in accordance with market practice, only yearly contracts based on a full calendar year are available on trading venues and would meet the definition of having a “twelve-month maturity”.

20 Consequently, as of 13 January 2023, the front-month contract is the Feb23 contract (which expires on 30 January 2023) and the front-year contract is the Cal24 contract (which expires on 27 December 2023[1]).

21 As a result, as of 13 January 2023, any contract with an expiry date between 30 January 2023 and 27 December 2023 is in the scope of the MCM, irrespective of it being a monthly, quarterly, season or yearly contract. Throughout 2023, the front-year contract remains the Cal24 contract, while the front-month contract changes every month. Consequently, each month, there would be one less monthly contract caught by the MCM.

22 Should this understanding be incorrect, ESMA would welcome further clarification.

2.6 Application to options

23 The dynamic bidding limit under Article 4(5) of the Regulation applies to all 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 and not just futures.

24 With regard to options, and besides the complications with valuing such instruments in case of an activation of the MCM, also here some further clarification would be useful on how the bidding limit should be applied as the option prices are quoted in premium (e.g. depending on the strike / maturity, etc.) and not in nominal gas price, as is the reference price.

2.7 Conditions of activation and deactivation

25 According to the Regulation, the MCM activation threshold is linked to the level of the front-month TTF derivative settlement price on ICE Endex and its spread with the reference price under Article 4(1) (i.e. when the Settlement Price is > EUR 180 for three working days and Settlement Price > 35 EUR + Reference Price during the same period), while the MCM deactivation threshold is linked to the level of the reference price alone under Article 5(1) (i.e. if, within 20 working days from the occurrence of the MCM or afterwards, reference price is lower than EUR 145 for three consecutive working days).

26 By definition, the front-month TTF settlement price would be higher than EUR 180 / MWh at the time of the potential activation of the MCM as it is one of the activation conditions. The MCM would introduce a TTF derivative order cap (Article 4(5)), set to a maximum

[1] The expiry date on the Cal24 contract was found to be different on the two venues, 27 December 2023 for EEX and 28 December 2023 for ICE Endex

spread of EUR 35 from the reference price. At the same time, the evolution of the settlement price will depend on the process and algorithm used by ICE Endex B.V.

27 ESMA therefore notes that, in theory, there could be a situation where the activation and the deactivation conditions are true at the same time, e.g. where the settlement price (based on TTF contracts not subject to the MCM and/or traded OTC) remains higher than EUR 180 / MWh and at the same time the reference price is lower than EUR 145 / MWh.