Facing the energy crisis in the EU: work streams related to the financial system

On 14 September 2022, President **von der Leyen** announced a first package of emergency energy measures aimed at providing an EU-wide response to the difficulties that high energy prices are causing for consumers, as well as for energy firms participating in wholesale energy markets. The Commission continues its work and may adopt further measures in the coming days and weeks, including on financial markets. This text details the measures the Commission is working on regarding the financial system.

1. Addressing liquidity stress

Current situation

A derivative is a financial contract linked to the future value or status of the underlying asset to which it refers, for example the development of interest rates, a currency value, or the possible bankruptcy of a debtor. The use of derivatives is essential for energy companies when planning their operations, giving them greater certainty about supply and pricing in future periods. They allow companies to hedge their risks e.g. the wholesale price they have to pay for their supplies or the output price at which they can expect to sell gas or electricity, using futures[1] or spot[2] contracts.

Most of the trading in energy derivatives is conducted on regulated (futures) markets and is cleared centrally via central clearing counterparties (CCPs)[3]. The use of derivatives involves the posting of so-called margins to CCPs - typically in the form of cash collateral - as a performance guarantee.

In most cases, energy companies access CCPs via a clearing member, which is a regulated credit institution (i.e. banks). All cleared trades in EU-based CCPs are governed by the European Market Infrastructure Regulation (EMIR)[4], which implements internationally agreed standards in the EU. In terms of margins and related collateral, EMIR only regulates the

[1] Among derivatives, futures are financial contracts that require parties to buy or sell an asset at a predetermined future date and price. The buyer must purchase or the seller must sell the underlying asset at the set price, regardless of the current market price at the expiration date.

[2] A spot contract is based on the spot price, i.e. the current price in the marketplace at which a given asset—such as a security, commodity, or currency—can be bought or sold for immediate delivery.

[3] A CCP is an entity, which reduces systemic risk and enhances financial stability by standing between the two counterparties to a derivatives contract (i.e. acting as buyer to the seller and seller to the buyer of risk), thereby reducing the risk for both parties. A CCP's main purpose is to manage the risk that could arise if one of the counterparties is not able to make the required payments when they are due – i.e. defaults on the transaction.

[4] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L 201, 27.7.2012, p. 1–59, latest consolidated version available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R0648

relationship between the CCP and the clearing member. The relationship(s) between the clearing member and end clients – in this case, the energy companies - is mostly based on contract law allowing the possibility of more flexible arrangements for margin and related collateral (e.g. the use of collateral other than cash).

Amid the sharp rise in gas and electricity prices over the past months, energy companies have been required to post correspondingly increasing amounts of cash collateral to CCPs as margin calls have risen in line with prices. This has resulted in liquidity problems for some energy companies and prompted calls to reassess the rules governing collateral requirements for margin calls for non-financial corporations.

Possible measures

In considering possible amendments to the rules applicable to collateral for margin calls, the Commission focuses on measures under EMIR that would be temporary and apply only to gas and electricity derivatives, notably the following actions:

- The Commission invited, in a letter dated 13 September, the European Securities Market Authority (ESMA) to assess respective trends in regulated markets and over-the-counter transactions, and to consider and present appropriate amendments to Commission Delegated Regulation (EU) No 153/2013. Such amendments could relate to broadening the list of eligible collateral and the conditions under which bank guarantees could be accepted as collateral. ESMA is invited to report back with concrete proposals by 22 September.

- The Commission also invited, in a letter dated 13 September, the European Banking Authority (EBA), in cooperation with ESMA and the Single Supervisory Mechanism (SSM), to assess how banks currently provide collateral transformation services (i.e. using one type of collateral to get cash). The EBA is invited to report back with concrete proposals by 29 September.

- ESMA and the EBA will also be invited to look at ways to improve the transparency and predictability of initial margin models vis-à-vis clients and the modalities under which a CCP can call intraday[5] margins, as well as to explore whether such intraday calls should be replicated for non-financial counterparties, e.g. energy firms, with a view to improving the predictability of margins for non-financial firms.

- Additionally, given the increase in energy prices in 2022, the Commission has invited ESMA to assess the appropriateness of the recommendation[6] to increase the clearing threshold for commodities and other derivatives in Commission Delegated Regulation (EU) No 149/2013 to €4bn.

- In parallel, DG FISMA will invite, in the coming days and weeks, Member State experts as well as European Parliament representatives, ESMA, the EBA, the European Central Bank (ECB) and the European Systemic Risk Board (ESRB) to discuss measures to facilitate the provision of margins by energy firms.

[5] Intraday margin is a risk management tool of central counterparties to cover increased risk exposure during the day.

[6] https://www.esma.europa.eu/press-news/esma-news/esma-proposes-eur-1-billion-increase-commodity-derivatives-emir-clearing.

2. Pricing of gas imports

Current situation

Currently, there is no comprehensive database reflecting the price and volumes of gas imports into the EU. This creates a situation where import prices are based on proxies, such as the price of gas already in the European pipeline network ("entry-paid" gas). The use of such proxies results in import prices for the EU as a whole that are not truly representative of supply and demand conditions in international gas markets. The majority of LNG (liquefied natural gas) imports into the EU are linked to prices at European trading hubs that are no longer suitable proxies for the broader LNG market: recently, these prices have been consistently higher than the gas price on international markets.

Possible measures

The Commission is working on a complementary transactions-based price benchmark that more accurately reflects the market for gas imports, including on EU gas imports. To be more representative and reliable, this benchmark should notably cover LNG tanker deliveries to regasification terminals in the EU. An alternative benchmark for imported gas would reduce reliance on futures markets for "entry-paid" gas as the main reference price for gas imports. The aim is not to phase-out futures markets for "entry-paid" gas but to provide market participants with an alternative reference price that reflects the supply and demand dynamics of international gas markets. Compared to the futures market for "entry-paid" gas, the new benchmark would not reflect internal bottlenecks in the EU's pipeline network.

In working towards the creation of this alternative benchmark, the Commission will take action as follows in the coming days and weeks:

- As a first step, the Commission will undertake a feasibility assessment of the entity best placed to possibly operate a European reporting and data consolidation hub for all transaction data from gas deliveries to the EU. Indeed, the collection and aggregation of transaction data concerning gas imports to the EU will enable greater transparency on the price importers are paying for gas. Once a sufficient level of market coverage is reached, the reporting hub would establish a price-weighted benchmark on the basis of either daily (or weekly) transaction data.
- In a second step, the provision of the price-weighted benchmark would be tendered to an authorised benchmark administrator established in the EU. The chosen administrator would publish the price-weighted benchmark levels on a daily basis, giving market participants an independent and objective view of gas import prices and their evolution.
- The third step would consist in the promotion of an active futures market referencing the new benchmark. This could create the liquidity that any purely transactions-based benchmark will initially be missing.

3. <u>Circuit breakers on trading venues</u>

Current situation

Circuit breakers are safeguard mechanisms that allow energy exchanges to interrupt trading in case of significant price movements. MiFID II requires trading venues "to be able to temporarily halt or constrain trading if there is a significant price movement in a financial instrument on that market or a related market during a short period". Therefore, all EU trading venues are required to have "circuit breakers" (CBs) in place. They are also required to report on how they calculate circuit breakers to their respective regulators. However, those rules are not harmonised at EU level and, under the current rules, none of the European energy exchanges have applied CBs in response to volatility in gas and electricity prices on their respective venues.

Possible measures

In these circumstances, the Commission will take action as follows:

- First, the Commission has requested ESMA, in a letter dated 13 September, to investigate why circuit breakers have not been triggered in the course of the current energy crisis, and to explore whether the rules on circuit breakers need to be aligned across the EU. This is to ensure that all electricity exchanges take a coherent line when confronted with excessive gas price volatility. ESMA is invited to report back with concrete proposals by 29 September.

- Second, the Commission has invited ESMA in the same letter to consider a more harmonised approach to "limit pricing". Currently, Article 48(4) of MIFID requires trading venues to have in place procedures to manage excessive price movements in very short periods of time by rejecting certain orders once they breach certain price limits (either "limit up" or "limit down"). Such price limits should be able to mitigate excessive volatility and should also slow down intraday margin calls resulting from large price movements over short periods. ESMA is invited to report back with concrete proposals by 17 October.