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# Proposal for Minimum Risk Management Requirements for Power Spot Clearing

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# 1. Introduction

This memorandum provides a proposal for minimum risk management requirements for power spot clearing and settlement. Such requirements will help to create a clear and stable regulatory framework for the safe and transparent operations of power spot markets. EPEX SPOT and ECC consider such requirements necessary in order to reduce systemic risk in power spot markets. In particular such requirements shall avoid adverse incentives for competing central counterparties (CCPs) which undermine the protection of both market participants and end consumers (“race to the bottom”) and in order to ensure effective risk mitigation for market coupling transactions between different CCPs.

EPEX SPOT and ECC believe this document serves as a tangible proposal for the implementation of an additional methodology in the revised CACM Regulation, which addresses the financial risks and introduces minimum requirements for power spot clearing and settlement under Articles 68 and 77 CACM Regulation.

## 2. Background

In power spot markets, the services for the management of a CCP with regards to its market participants, as stipulated by Article 68 of the Capacity Allocation and Congestion Management Regulation (CACM Regulation<sup>1</sup>), are limited to:

1. *The central counter parties shall ensure **clearing and settlement** of all matched orders **in a timely manner**. The central counter parties shall act as the **counter party to market participants for all their trades** with regard to the financial rights and obligations arising from these trades.*
2. *Each central counter party shall maintain **anonymity** between market participants. [...]*

The remainder of the provisions in Article 68 CACM Regulation relate to the shipping activities of a CCP, the interaction between different CCPs or shipping agents and their interaction with TSOs with regards to the handling of congestion income.

### Risks stemming from close interconnection

The narrowness of the existing framework for clearing and settlement of power spot products is in stark contrast with the close interconnectedness of the respective power exchanges and their clearing entities.

Operating a power spot exchange under the CACM Regulation requires a license as a Nominated Electricity Market Operator (NEMO). Such license is granted by each Member State (Article 4 CACM Regulation). By default, the national regulatory energy authority (NRA) is the designated authority responsible for granting and monitoring the activities subject to the NEMO license. The license includes clearing and settlement activities for power spot products. Once having obtained a license a NEMO can operate in all EU Member States by the principle of passporting (Article 4(5) CACM Regulation). Absent harmonized certification requirements for NEMO designation criteria between Members States this set-up incentivizes regulatory arbitrage for the reception of a NEMO license and does not facilitate a level-playing field for competing NEMOs.

The CACM Regulation and Regulation (EU) 2024/1747 include mandatory sharing of NEMO orderbooks for the day-ahead and intraday timeframes. This results in a coupling of all NEMOs with matching of power spot transactions between different NEMO markets and cross-CCP clearing and settlement. The matching across NEMO markets comprises transactions between different market areas as well as transactions within the same market area. The interconnectedness of power exchanges increases the potential for a spillover of risks and associated knock-on effects between NEMOs or their CCP absent timely and effective decoupling measures.

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<sup>1</sup> COMMISSION REGULATION (EU) 2015/1222 of 24 July 2015 establishing a guideline on capacity allocation and congestion management

Given that the CACM Regulation restricts cross-border trading as well as clearing and settlement in power spot markets to NEMOs and their CCPs as mandatory marketplaces, EPEX SPOT and ECC are of the view that specific regulatory duties arise to

1. ensure a resilient market design
2. limit risks for market participants, stemming from the operations of these markets
3. limit the systemic risk of these markets, which are key to maintain security of energy supply in the internal electricity market.

Hence the need to establish a clear and stable regulatory framework for the safe and transparent operations of power spot markets is a regulatory imperative for the protection of market participants and end consumers. Effective mitigation of systemic risk can be reached through minimum standards in respect of risk management and governance. Such a framework should address preventive requirements and curative measures, which (1) ensure the proper management of risks by all NEMOs/CCPs and (2) in case a risk cannot be contained by a NEMO/CCP, avoid contagion between different NEMOs or CCPs.

### **Risks stemming from increased competition**

Besides the close interconnection between power spot CCPs there is another element that urges the introduction of minimum risk requirements. The CACM Regulation fosters competition between NEMOs with the objective of contributing to efficient electricity markets by customer-oriented services and – in case of shared liquidity with little service differentiation potential – by lower cost. Lowering security standards (e.g. margin calculation, quality of accepted collateral, default fund) to reduce the cost to individual members can become a viable option for CCPs in order to be commercially attractive. However, it worsens the risk situation for the system of interconnected CCPs. Each CCP in trying to be commercially more attractive than its competitors could further reduce this cost while further increasing systemic risk. Therefore, these decisions can result in a “race to the bottom” among CCPs to incentivize new customers. Such development is to the detriment of the security and stability of the internal electricity market in general.

### **Financial regulators’ increased focus on risks stemming from spot commodity markets**

The upcoming publication of the revised Regulation (EU) 648/2012 (“EMIR 3.0”) includes a mandate for the European Securities and Markets Authority to “[...] submit a report to the Commission, to the European Parliament and to the Council on the appropriateness and implications of extending the definition of a CCP, as referred to in Article 1, point(1) [EMIR], to other markets beyond financial markets, such as commodity markets, including wholesale energy markets [...]” (Art. 85(1e)). In this context, ESMA representatives have specifically mentioned their intention to analyze the extension of EMIR to power spot market “CCPs”. Due to their different nature, EPEX SPOT and ECC do not advocate for a full extension of derivative market financial regulation to power spot markets. We believe a methodology in the revised CACM Regulation with clear references to international principles for proper financial risk management by CCPs (CPMI-IOSCO), as laid down further below in this document, could also meet the goals of financial risk reduction and effective supervision.

## ACER proposal

ACER made the following proposal in Article 45 of its Recommendation 02/2021<sup>2</sup> to the European Commission for a review of the CACM Regulation.

### Article 45

#### Methodology for clearing and settlement between NEMO trading hubs

- (1) *All NEMOs shall jointly develop, review and, where necessary, propose amendments to the methodology for clearing and settlement between the NEMO trading hubs.*

*This methodology shall define:*

- (a) *standard requirements for fair, effective and efficient clearing and settlement that limit the systemic risk including at least:*
- i. standardised contractual obligations, rules and liabilities;*
  - ii. standardised processes and timelines for clearing and settlement and avoiding unnecessary processes and financial flows;*
  - iii. single unified deadline for payments;*
  - iv. standardised requirements on collaterals avoiding the need for multiple securities.*
- (b) *requirements for monitoring and reporting on the fulfilment of the requirements for clearing and settlement.*

## EPEX SPOT and ECC proposal

Taking into account the competitive situation between NEMOs and the increased potential for a “race to the bottom” between competitive NEMOs to lower CCP security standards, EPEX SPOT and ECC

- are generally supportive of ACER’s proposal for a methodology for clearing and settlement between NEMO trading hubs, reflecting the need for an improved and stable regulatory framework for clearing and settlement.
- request that these requirements should not be limited to clearing and settlement arrangements between NEMO trading hubs. Instead, they should also cover the clearing and settlement relationship between the NEMOs / CCPs and their market participants.
- trust the methodology is put forward and implemented within a reasonable timeframe and appropriately reflects the IOSCO principles when approving this methodology in accordance with Article 4(8) lit. m of ACER’s proposal to the reviewed CACM Regulation.

Chapter 3 of this memo makes a proposal for an accountable and effective implementation of such risk management requirements by all NEMOs and CCPs.

<sup>2</sup> RECOMMENDATION No 02/2021 OF THE EUROPEAN UNION AGENCY FOR THE COOPERATION OF ENERGY REGULATORS of 17 December 2021 on reasoned proposals for amendments to the Commission Regulation (EU) 2015/1222 of 24 July 2015 establishing a guideline on capacity allocation and congestion management

### 3. Draft “Requirements for Clearing and Settlement”

A draft proposal to implement the proposed methodology by ACER can be found below. The proposal is primarily based on the principles of the *Committee on Payment and Settlement Systems* and the *Technical Committee of the International Organization of Securities Commissions (CPMI-IOSCO)*<sup>3</sup>. These principles and additional requirements have been taken into consideration in Regulation (EU) 648/2012 (European Market Infrastructure Regulation, EMIR), which are relevant for the regulation of CCPs in Financial Instruments markets. However, the selection of the elements addressed in this proposal for the CCP minimum risk management requirements takes the specificities of the power spot markets regulated under the CACM Regulation (e.g. compared to derivative markets) into account.

These CCP minimum risk management requirements shall allow the NRAs to apply harmonized NEMO designation criteria with regards to CCP activities and thus avoid a “race to the bottom”. Each of the described requirements shall leave room for specifics of individual markets if it can be demonstrated by the NEMOs or their CCPs that the same level of security is achieved as when following these minimum requirements.

Following the usual form for such methodologies being developed under the CACM Regulation the subsequent requirements have the form of a legal text, being structured in recitals and articles. Where needed reference is made to the existing CACM Articles, indicating the need for amendment.

#### Whereas:

- a. [ Article 68 of the amended [Commission Regulation (EU) 2015/1222 of 24 July 2015 establishing a guideline on capacity allocation and congestion management] (the “amended CACM Regulation”) ] constitutes the legal context of this document. In particular, [Article 68(x)] of the amended CACM Regulation shall state:

*[ “All NEMOs shall jointly develop, review and, where necessary, propose amendments to the methodology for clearing and settlement in day ahead and intraday electricity markets. This methodology shall be based on the recommendations for counter parties issued by the Committee on Payment and Settlement Systems and the International Organisation of Securities Commissions.” ]*

- b. The main objective of these requirements for CCPs are to enhance safety and efficiency in payment, clearing, settlement, and recording arrangements, and more broadly, to limit systemic risk and foster transparency and financial stability in the power spot markets governed by the CACM Regulation. CCPs can contribute to and exacerbate systemic crises if the risks of the CCPs are not adequately managed. As a result of the Single Day-Ahead Coupling (SDAC) and Single Intraday Coupling (SIDC) financial shocks could be passed from one participant or CCP to others (“knock-on effects”). The effects of such a disruption could extend well beyond the

<sup>3</sup> <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD377-PFMI.pdf>

CCPs and their participants, threatening the stability of the European market coupling, electricity system operations, financial markets and the broader economy.

- c. CCP functions have been shown to be an important service in power spot markets, giving market participants the confidence to fulfil their obligations on time, even in periods of market stress. The implementation of safe and efficient CCP operations in the power spot market is key because the CACM Regulation requires mandatory cross-border trading and clearing at NEMOs and CCPs in the internal market. This elevated status for cross-border trading and clearing results in specific requirements how NEMOs/CCPs organize and operate their businesses.
- d. A CCP and its participants may generate significant negative externalities for the entire system and real economy if they do not adequately manage their risks. In addition, factors such as economies of scale, barriers to entry, or even legal mandates, may limit competition and confer market power on a CCP, which could lead to lower levels of service, higher prices, or under-investment in risk-management systems. Caution is needed, however, as excessive competition between NEMOs may lead to a competitive lowering of risk management standards of their CCPs (“race to the bottom”) to the detriment of secure and stable operations of the internal market in electricity.
- e. To ensure their safety and promote financial stability more broadly, CCPs should robustly manage their risks. A CCP should first identify and understand the types of risks that arise in or are transmitted by the CCP and then determine the sources of these risks. Once these risks are properly assessed, appropriate and effective mechanisms should be developed to monitor and properly mitigate them. These risks include (but are not limited to) legal, credit, liquidity, general business, investment, and operational risks. The requirements for CCPs in this [document] provide guidance to CCPs and relevant authorities during the designation and continuous supervision of NEMOs’ operations on the identification, monitoring, mitigation, and management of the full range of these risks by their CCP.
- f. A CCP should be not only safe, but also efficient. In making choices about design and operation, however, CCPs ultimately should not let other considerations take precedence over the establishment of prudent risk-management practices.
- g. These requirements shall provide guidance for addressing risks and efficiency in CCPs acting in power spot markets covered by [the amended CACM Regulation]. With a few exceptions, these requirements do not prescribe a specific tool or arrangement to achieve their goal and allow for different means to satisfy a particular requirement. As such, these requirements define principles on the operations and organization of a CCP. Where appropriate, some principles establish a minimum requirement to help contain risks and provide for a level playing field between NEMOs/CCPs. The principles and requirements are designed to be applied holistically because of the significant interaction between principles; principles should be applied as a set and not on a stand-alone basis. Some principles build upon others and some complement each other.



- h. These requirements may evolve and improve over time. In addition, CCPs have the flexibility to consider applying higher requirements for their business in the power spot markets either on the basis of specific risks posed by a CCP or as a general policy.

## Title 1 – General provisions

### Article 1 – Subject matter and scope

These requirements shall apply to a CCP's relationship with its market participants and for the exchange of energy between NEMO trading hubs in accordance with [Article xx of the amended CACM Regulation].

### Article 2 – Definitions

1. If not stipulated otherwise, all definitions in these requirements shall have the meaning as in the [amended] CACM Regulation.
2. In addition, the following definitions shall apply:
  1. 'Collateral investment risk' means the risk of loss faced by a CCP when it invests its own or its participants' resources, such as collateral, or the risk the CCP causes by the selection of eligible collateral locations for pledged cash collateral to its participants.
  2. 'Commercial bank money' means a liability of a commercial bank, in the form of deposits held at the commercial bank, which can be used for settlement purposes. Settlement in commercial bank money typically occurs on the books of a commercial bank.
  3. 'Credit risk' means the risk that a counterparty, whether a participant or other entity, will be unable to meet fully its financial obligations when due, or at any time in the future.
  4. 'General business risk' means any potential impairment of the financial condition (as a business concern) of a CCP due to declines in its revenues or growth in its expenses, resulting in expenses exceeding revenues and a loss that must be charged against capital.
  5. 'Legal risk' means the risk of the unexpected application of a law or regulation, or non-enforceability of its rulebook resulting in a loss.
  6. 'Liquidity risk' means the risk that a counterparty, whether a participant or other entity, will have insufficient funds to meet its financial obligations as and when expected, although it may be able to do so in the future.
  7. 'Operational risk' means the risk that deficiencies in information systems or internal processes, human errors, management failures, or disruptions from external events will result in the reduction, deterioration, or breakdown of services provided by a CCP.
  8. 'Systemic risk' means the inability of one or more participants to perform as expected could cause other participants to be severely impaired or unable to meet their obligations when due.

## **Title 2 – Requirements for CCPs**

### *Chapter 1 – General organization*

#### **Article 3 – Legal basis**

A CCP shall have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions.

#### **Article 4 – Governance**

A CCP shall have governance arrangements that are clear and transparent for a CCP's participants, promote the safety and efficiency of the CCP, support the stability of the SIDC and SDAC, other relevant public interest considerations, and the objectives of relevant stakeholders.

#### **Article 5 – Framework for the comprehensive management of risks**

A CCP shall have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational, and other risks. It shall contain a clear definition of responsibilities and reporting lines.

### *Chapter 2 - Credit and liquidity risk management*

#### **Article 6 – Credit risk management**

1. A CCP shall effectively measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes.
2. A CCP shall cover its credit exposures to its participants through an effective margin system with a high level of confidence of at least 99%.
3. In addition, a CCP shall maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions. Such market conditions shall at least reflect the most severe market conditions within a look back period of 10 years, or as far as reliable historic data is available.

#### **Article 7 – Collateral**

A CCP that requires collateral to manage its or its participants' credit exposure shall accept collateral with low credit and liquidity risk. A CCP shall also set and enforce appropriately conservative haircuts and concentration limits for the accepted collateral.

#### Article 8 – Liquidity risk

A CCP shall effectively measure, monitor, and manage its liquidity risk. A CCP shall maintain sufficient liquid resources to effect the settlement of all transactions at the time specified with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the CCP in extreme but plausible market conditions.

### *Chapter 3 – Settlement*

#### Article 9 – Settlement finality

A CCP shall provide clear and certain final settlement towards its participants. A CCP shall implement a short settlement period to lower credit and other relevant risks. It shall control the credit and liquidity risk arising from the use of commercial bank money.

#### Article 10 – Physical deliveries

A CCP shall clearly state its obligations with respect to the delivery of physical instruments or commodities and shall identify, monitor, and manage the risks associated with such physical deliveries.

### *Chapter 4 – Default, general business and operational risk management*

#### Article 11 – Participant-default rules and procedures

A CCP shall have effective and clearly defined rules and procedures to manage a participant default. These rules and procedures shall be designed to ensure that the CCP can take timely action to contain losses and liquidity pressures and continue to meet its obligations. A CCP shall prepare for a participant default via regular default testing.

#### Article 12 – General business risk

A CCP shall identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue operations and services as a going concern if those losses materialise. Further, liquid net assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services.

#### Article 13 – Collateral investment risks

A CCP shall safeguard its own and its participants' assets and minimise the risk of loss on and delay in access to these assets. In order to minimize the risk of loss, all investments shall be deposited at financial institutions or other counterparties with adequate supervision by competent authorities. A CCP should offer a segregation of the assets, if requested by its participants. A CCP's investments should be in instruments with minimal credit and liquidity risks.

#### Article 14 – Operational risk

A CCP shall identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. A CCP shall hold sufficient liquid net assets funded by equity to cover potential losses from sources of operational risk so that it can continue operations and services as a going concern if those losses materialize. Business continuity management should aim for timely recovery of operations and fulfilment of the CCP's obligations, including in the event of a wide-scale or major disruption to ensure minimal impact on participants.

### *Chapter 5 – Access*

#### Article 15 – Access and participation requirements

A CCP shall have objective, credit risk-based, and publicly disclosed criteria for participation, which permit fair and open access.

#### Article 16 – CCP links

A CCP that establishes a link with one or more CCPs or shipping agents should identify, monitor, and manage link-related risks according to the rules in Article [6 to 15]. A CCP shall handle its relationship with one or more CCPs [or shipping agents] in a non-discriminatory manner compared to its market participants. CCPs shall not be obliged to contribute to a linked CCP's default resources or default fund if such exists.

### *Chapter 6 – Transparency*

#### Article 17 – Disclosure of rules, key procedures, and market data

A CCP shall have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks, fees, and other material costs they incur by participating in the CCP. All relevant rules and key procedures (including risk management rules and procedures) shall be accessible to a CCP's participants in a transparent manner and be publicly disclosed on its website. This shall also include a simulation tool allowing a CCP's participants to determine the amount of margin, on a gross basis, that the CCP may require upon the clearing of a new transaction. The results of the simulation shall not be binding.

## **Title 3 – Reporting requirements and CCP supervision**

### **Article 18 – Reports**

1. By [6] months after the entry into force of these requirements each NEMO or its CCP shall submit a report to the competent national authorities of the Member States where it offers day-ahead or intraday services and to the Agency, which demonstrates that it complies with these requirements.
2. A CCP shall demonstrate its continuous adherence to these requirements by submitting a report at least once per year to the competent national authorities of the Member States where it offers day-ahead or intraday services and to the Agency.

### **Article 19 – Compliance with NEMO designation criteria**

The competent national authorities shall take the reports described in [Article 18] into account for the regular review and confirmation of the NEMO designation in accordance with Articles 4, 5 and 6 of the [amended] CACM Regulation.

## **Title 4 – Transitional and final provisions**

### **Article 20 – Transitional provisions**

The NEMOs and their CCPs shall implement these requirements within [6] months after they have entered into force.

### **Article 21 – Applicability**

These requirements shall apply in all Member States. The relevant national authorities shall take these requirements into account when designating or re-designating NEMOs in accordance with Article 4 or 5 [of the amended CACM Regulation].

### **Article 22 – Entry into force**

This decision shall enter into force on [...].

## 4. About

**The European Power Exchange EPEX SPOT SE** and its affiliates operate physical short-term electricity markets in Central Western Europe, the United Kingdom, Switzerland, the Nordics and Poland. As part of EEX Group, a group of companies serving international commodity markets, EPEX SPOT is committed to the creation of a pan-European power market. Over 400 members trade electricity on EPEX SPOT platforms. 49% of its equity is held by HGRT, a holding of transmission system operators.

**European Commodity Clearing (ECC)** is a central clearing house which specialises in energy and commodity products. ECC assumes the counterparty risk and guarantees the physical and financial settlement of transactions, providing security and cross-margining benefits for its customers. As part of EEX Group, ECC provides clearing services for EEX, EEX Asia and EPEX SPOT and for the partner exchanges BSP Energy Exchange, HUPX, HUDEX, NOREXECO, SEEPEX and SEMOpX.

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