Consultation document no. 01/2019

INTEGRATED MANAGEMENT OF GUARANTEES ON THE ENERGY AND GAS SPOT MARKETS

With this consultation document, GME wishes to collect observations and comments regarding the proposal for integrated management of guarantees among the interested parties, to be introduced in the energy and gas spot markets.

This proposal aims to favor a reduction of the costs incurred by market participants for the provision of financial guarantees required for participation in the aforementioned markets, as well as a simplification of operational and management processes for market participants.

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Interested parties must send their comments to GME - Governance in writing, no later than **4 February. 2019**, closing date of this consultation, through one of the following methods:

- **e-mail:** info@mercatoelettrico.org
- facsimile: **06.8012-4524**
- post: **Gestore dei mercati energetici S.p.A.**
  Viale Maresciallo Pilsudski, 122/124
  00197 – Roma

Parties wishing to fully or partly safeguard the confidentiality or secrecy of the documentation sent are required to indicate the parts of their documentation to be considered confidential.

1. FOREWORD

The current guarantee system in force on the markets managed by GME is based on separate guarantees (deposits and/or bank guarantees) which are managed in segregated way among the different markets and platforms in order to hedge the exposures of market participants. As a consequence, such a segregation does not allow the offsetting of financial positions with opposite sign that market participants may have accrued, respectively, on the electricity market and on the gas market.
Without prejudice to the need to continue to ensure the correct and prudential risk management, GME illustrates in this document the netting mechanism between electricity and gas spot markets. In particular, this mechanism allows having, on the markets involved, a single net exposure which will be hedged by a single guarantee amount, without any segregation being necessary, as well as reducing, to just two, the bank guarantee models that can be provided on all the electricity and gas markets managed by GME.

2. INTEGRATED MANAGEMENT OF GUARANTEES

NETTING

The integrated management of guarantees ("netting"), with the offsetting between the positions accrued on the various markets managed by GME, will be applied to those markets having a greater liquidity and homogeneity in the payment timing (settlement on a weekly basis), namely the Day-Ahead Market and the Intra-day Electricity Markets (MGP/MI), as well as the Spot Gas Market (MPGAS).

Specifically, the proposal provides the establishment of an integrated exposure on these markets through the offsetting of mutual positions.

On the forward energy market (MTE) and Delivery of electricity derivatives (CDE) market, on the daily products market (MPEG) as well as on the OTC Registration Platform (PCE), the exposures remain segregated, according to the current methods of calculation, and the related collateral is required with a specific guarantee amount, specifically allocated. Moreover, due to the inclusion of MP-GAS within the framework of netting, also on the forward gas market (MT-GAS), similarly to what set out for the futures segment of the electricity market, exposures are calculated differently. This means that all positions on the futures market, including the ones delivered to the PSV, are not included in the netting.

As for the netting markets (MGP/MI and MPGAS), in the event of default on one of the markets involved, the direct consequence of the identification of a single position is that the pro-quota mechanism applies to all net creditors market operators belonging to the same netting - regardless of the market where the default originates - pending the collection of the amount due as a result of GME's enforcement of the guarantees given by the defaulting market participant[1]. However, no changes shall be made to the management of the temporary pro-quota mechanism for the remaining markets/platforms (MPEG and PCE, MTE and MT-GAS) not involved in netting.

With regard to defaulting market participants on the electricity market and the gas market, including the markets subject to netting, the management of the default involves first the enforcement of the guarantees provided by the defaulting market participant, then the recourse to GME's own funds[2] and, at last, the activation of the risk pooling mechanism defined by ARERA, without prejudice to the various decisions that may be made by the Institutions.

With reference to the management of the defaults, it has to be highlighted that, upon the occurrence of a financial default by a market participant on one of the markets subject to netting, the market participant shall be suspended[3] both on the electricity market and on the gas market, if the defaulting market participant is admitted on both markets[4]. Likewise, such a suspension measure is taken - in the event that a market participant is admitted to both ME and MGAS - even if the default arises from the non-compliance of the market participant on a non-netting market[5], in order to protect the integrity of the electricity market and the gas market, as well as promoting the virtuous behaviour of the market participants. In this way, opportunistic behaviours on the part of market participants would be limited, with the same being encouraged to use available resources to be compliant on the most profitable markets, subtracting these resources from further trading already undertaken on other markets.

As for the aspects concerning the invoicing and settlement of the netting markets, there are no significant changes compared to the current *modus operandi*; therefore, an invoicing segregated by market and a

[1] By way of example, even in the event of non-payment of the economic items deriving from transactions concluded on MPGAS by a party admitted to the MGAS only, the pro-quota is applied to all market participants that are net creditors, in the period considered, both on MPGAS and on MGP/MI.

[2] Within the limits of €2.5 million per year provided for by the relevant legislation.

[3] In line with the current provisions, the suspension is revoked when the reason for such suspension is no longer valid.

[4] By way of example, in the event of a default on the netting markets by a market participant admitted to ME and MGAS, the suspension of the same market participant applies both on the ME and the MGAS, regardless of the MGP/MI or MPGAS markets where the trading was carried out.

[5] By way of example, if the default on MTGAS is caused by a market participant admitted to ME and MGAS, the market participant shall be suspended on both the ME and the MGAS.

unified settlement for all markets remain, according to a periodically published calendar, which takes into account the specific payment times of each market.

SIMPLIFICATION OF THE FORMS OF GUARANTEES

In addition to netting, GME also provided for the simultaneous introduction of an operational simplification - through a harmonization of the documentation envisaged to date - of the forms of guarantee that can be provided on all the electricity and gas markets - including those that will not be subject to netting - and on the PCE.

In place of the current four bank guarantee models[6] and the related update letters, only two types of bank guarantee models[7] are introduced. They can be used for the ME, the MGAS and the PCE; specifically:

a) guarantee without expiration term, which may be used as collateral:
- for the single netting exposure between MGP/MI and MPGAS for the amount of the guarantee allocated to this single exposure;
- for the exposure relating to MPEG, PCE, MTE/CDE and MT-GAS, for the corresponding and remaining portions of the amount of the guarantee allocated to hedge such positions;

b) guarantee with expiration term, which may be used as collateral:
- for the single netting exposure between MGP/MI and MPGAS for the amount of the guarantee allocated to this single exposure;
- for the exposure relating to MPEG and PCE, for the corresponding and remaining portions of the amount of the guarantee allocated to hedge such positions.

Another form of simplification is envisaged for the deposit, with the identification of a single bank account for ME, PCE and MGAS, to be used by market participants in place of the two bank deposits.

Therefore, compared to the current guarantee mechanisms that require a market participant to provide GME with separate and dedicated guarantees (bank guarantees/deposits) for each market and platform[8],

[6] Currently, specific guarantee models are provided for: 1) MGAS; 2) ME / PCE; 3) MPE and 4) MPE/PCE.
[7] With as many update letters.

this simplification will allow the use of the same guarantee (i.e. the same bank guarantee/deposit), to hedge emerging exposures on separate markets. In this way, by submitting a single guarantee, the market participant notifies GME only the portion of this guarantee allocated to each of the markets on which he/she/it wishes to operate, bearing in mind that, for netting markets, a single net exposure resulting from the offset of debts and credits arising on these markets is to be hedged. Furthermore, the market participant may change the amounts of the guarantee allocated to individual markets, adjusting them according to changes in exposures and operational needs, through a specific communication to GME. Lacking such indication, GME will identify a default allocation criterion in the relevant technical rules.

In order to avoid operational issues for market participants admitted exclusively to the PCE, given the specific features of this platform, the current model of guarantee provided for in Annex 3 of the PCE Rules remains unchanged, subject to minimal adjustments only. Therefore, market participants may continue to use the guarantees already submitted prepared, therefore, according to the current Annex 3 without interruption, regardless of the launch of the integrated management of guarantees on the netting markets. Automatically a PCE market participant that is also admitted to the electricity market and/or gas market can use, in order to cover the obligations resulting from the registration applications on the PCE, the aforementioned models of integrated guarantees, notifying GME the amount of guarantees intended exclusively for operations on the PCE.

Lastly, compared to the new models of guarantees, a further form of simplification has been introduced in order to avoid additional processes of alignment of the new integrated guarantees if, for example, a market participant admitted to the ME, subsequently wishes to become qualified as market participant also on the MGAS and/or PCE, and/or vice versa. In fact, in this case, the integrated guarantee initially provided on the ME - or, where appropriate, made compliant with the new models introduced with the netting - will automatically be extended, in terms of hedging, also to the new markets to which the market participant will subsequently be admitted.

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[8] Currently, a market participant registered on the electricity market and on the gas market must submit two separate bank guarantees, one for the electricity market and one for the gas market.

TRANSITIONAL PERIOD: SHIFTING TO THE NEW SYSTEM

In order to ease the shifting from the current to the future guarantee system, a gradual approach is expected to be adopted, so as to avoid the general obligation to adjust the guarantees provided to date[9], regardless of the markets in which the participants are admitted. The underlying approach is in fact to minimize the obligations for market participants, limiting them exclusively to those which will obtain the benefits resulting from the introduction of netting on the spot energy and gas markets. Therefore, for market participants already admitted to the ME only or to the MGAS only, wishing to maintain their activity after the start of netting, on only one of these markets, the non-application of the offsetting between the economic items of the various netting markets for such market participants, will allow them to avoid any adjustment with reference to the guarantee models already submitted[10] and to avoid the obligation to submit new guarantees on the basis of the new models. Indeed, for these market participants, the adjustment of the guarantees to the new models envisaged for netting is a requirement only to extend their operations to the markets subject to netting.

Likewise, market participants admitted to ME wishing to obtain, after the start of the integrated management of guarantees, the status of MGAS market participants (and vice versa) and, when joining another market, failing to make compliant the previous guarantees for the new integrated models - namely the submission of guarantees prepared on the basis of the new models - although pending the adjustment they cannot benefit from the features introduced by netting[11], may in any case continue to operate in the market where they were originally admitted.

Lastly, GME will assure to the interested parties a reasonable timeframe in order to allow them to become acquainted with the provisions introduced and with the fulfilments resulting from the launch of the integrated guarantee system.

[9] The general adjustment of the guarantees is expected to lead to the updating of around 90% of outstanding guarantees, while with the above approach, approximately half of the guarantees would be subject to adjustment (data source updated as of 31 December 2018).

[10] By way of example, the market participant only admitted to the MGAS and not to the ME, with a guarantee to hedge the operations on the MGAS, although the MGAS is included in the netting together with the MGP/MI of the ME, is not required to adjust any guarantee already submitted.

[11] As the forms of guarantees provided prior to the launch of the integrated management of guarantees do not provide for coverage of the emerging obligations on the ME and the MGAS, but only on one of them.

Idea for consultation

With aim of having the approval of the competent Institutions within the first semester of the year, so as to:

- *ensure a complete and suitable learning of the new dispositions;*
- *enable interested operators to proceed with the necessary adjustments of the guarantees;*
- *carry out the related blank test sessions with the operators,*

is a period of three months – from the publication on the GME website of the proposals for amendments described in this consultation paper until the operational launch of the proposed mechanism – deemed enough, or would a six-month period be preferable?