Association of European Energy Exchanges

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**Subject: Letter on the proposed market correction mechanism in reference to the Commission's proposal for a Council Regulation on joint purchasing, efficient operation of gas infrastructure, gas demand reduction and improving security of supply**

Dear Executive Vice-President Timmermans,
Dear Commissioner Simson,
Dear Commissioner McGuinness,
Dear Energy and Finance Ministers of the Member States,

Europex largely welcomes the Commission's proposals on joint purchasing, efficient operation of gas infrastructure, gas demand reduction and improving security of supply, as set out in the draft Council Regulation on enhancing solidarity through better coordination of gas purchases, exchanges of gas across borders and reliable price benchmarks. We believe that the aforementioned measures can be effectively implemented to alleviate the current energy crisis caused by reduced Russian gas supplies to Europe.

**However, we are deeply concerned about the development of the market correction mechanism as set out in Article 23 of the draft Council Regulation and further outlined in a recent Commission non-paper**[1].

Gas derivatives, such as the TTF front-month futures contract, are a crucial tool for producers and consumers, including the energy-intensive industry, to hedge against the risk of changes in future gas spot prices. If a change to future supply or future demand becomes apparent, market participants need to be able to immediately reconsider their open contracts in order to remain properly hedged.

If a maximum price ceiling to the TTF front-month contract becomes applicable without prior evaluation of the safeguards set out in Article 23 (2) we see major risks to financial stability and security of supply.

[1] Commission non-paper on "Elements of a Market Correction Mechanism".

1. **Financial stability**:

If the real price of gas exceeds the artificially capped price of the TTF front month future, market participants will immediately move trading into the bilateral OTC space. Such a move would not only lead to a significant decrease in transparency, but also poses serious financial stability risks. As warned by the European Central Bank in its November 2022 Financial Stability Review[2]: *"A more significant shift by utilities and energy firms towards the OTC space would imply greater risks for counterparties and the financial system. Non-centrally cleared contracts require less collateral for trading firms, but imply higher counterparty risk and less transparency for the wider market. Additional concerns arise from the fact that the partial move to the OTC space is occurring in an environment of higher volatility and hence of increased counterparty default risk."*

Moreover, the suggested mechanism is incompatible with the primary obligation of an operator of a MiFID regulated trading venue, i.e. to provide for fair and orderly markets. Market participants holding open interest would be exposed to incalculable uncertainty. Since a market participant holding open interest has the obligation to make or take delivery, triggering a price limit would lock the market participant into an obligation, as it could no longer have the ability to modify its position. A hard price cap on the energy derivatives markets will therefore fundamentally undermine their orderly functioning.

The mechanism would also immediately pose serious risks to CCP clearing of these markets, ongoing margining of open positions as well as the management and containment of any defaults. It is also likely to significantly increase the margin requirements on EU gas and power derivatives.

2. **Security of supply:**

Alternatively, when the mechanism is triggered, market participants may decide not to hedge their production or consumption in the TTF front-month contract any longer. Instead, they will balance their positions by trading in the spot market. This would put immediate and considerable pressure on spot prices, with no certainty that it would leave security of supply unaffected.

Considering LNG specifically, the EU must ensure it remains competitive to avoid that LNG shipments are not simply redirected towards destinations that are willing to pay the real price of the commodity. Frontier Economics explains the implications of a wholesale gas price cap as proposed by the Commission in more detail in their paper called 'A wholesale gas price cap in Europe'[3]. The paper concludes that *"the risks of any wholesale price cap approach […] – namely reduced supply, increased demand and need for non-price rationing – do also apply to the 'gas market correction mechanism' as proposed by the Commission. […] Before taking such a measure, it will be crucial that its design and impacts are assessed more thoroughly, to avoid significant unintended negative consequences.*

Finally, the implementation of a price cap will be a direct intervention in the matching engine of the exchange. Any such invasive interventions will have to be properly designed and built, and rigorously tested including through market consultation to guarantee the changes do not negatively affect the

[2] https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr202211~6383d08c21.en.html

[3] https://www.frontier-economics.com/media/5550/a-wholesale-gas-price-cap-in-europe.pdf

orderly functioning of markets and the ability of market participants to use them. It is unrealistic to assume this can be achieved within a short timeframe and certainly not before the end of this winter.

In conclusion, the mechanism proposed by the Commission fails to take into account the aforementioned risks and, when implemented, can effectively be triggered without any safeguards or substantial impact assessment. The fact that the mechanism can merely be suspended by the Commission after it is triggered will lead to irreversible damage. To guarantee financial stability, an ex-ante assessment should be conducted by the ECB. Similarly, conditions related to security of supply should be assessed by ACER and ESMA before the mechanism is applied.

We are convinced that the proposal for a market correction mechanism will not achieve its primary objective of lowering energy prices but will seriously threaten the EU's security of supply situation and introduce severe risks to financial stability in Europe. In addition, it will have serious and potentially irrevocable negative effects on the functioning and competitiveness of the European energy wholesale market that may last well beyond the current crisis.

Yours sincerely,

Chr. Baer

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### About

Europex is a not-for-profit association of European energy exchanges with 31 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

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