



# UNC TRANSMISSION WORKING GROUP

OCM AND CENTRAL COUNTERPARTY CLEARING  
UNC MOD 0568

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## OCM and Central Counterparty Clearing

- Introduction On-the-day Commodity Market
- ICE Clear Europe and Central Counterparty Clearing

# **INTRODUCTION**

ON-THE-DAY-COMMODITY MARKET (OCM)

# ON-THE-DAY COMMODITY MARKET

## REGULATORY FRAMEWORK

- ICE Endex has been appointed by National Grid Gas and was designated by OFGEM to provide and operate the trading system and clearing services for the On-the-Day Commodity Market (“OCM”).
- The Unified Network Code (TPD, section D) provides the trading arrangements for the OCM and therein a distinction is made between the rights and obligations of the Trading System Operator (i.e. exchange) and the Trading System Clearer (i.e. the clearing house or CCP).
- The Trading System Operator has to provide and maintain the trading system whilst the Trading System Clearer provides the clearing services for the purpose of the Trading System. The Trading System Operator can also fulfill the role of Trading System Clearer but may also designate another person to fulfill the latter role. Subject to certain conditions being met, NGG has to admit the Trading System Clearer as a User (i.e. shipper) for the purpose of making Trade Nominations.
- Once admitted as a User, the Trading System Clearer has to meet all the requirements set forth by the UNC, including the provisions of Section X (Energy Balancing Credit Management) and the EBCR.
- APX has been appointed by ICE Endex as the Trading System Clearer and is the User for the purpose of making Trade Nominations (short code ENO). Per clearing migration ICE Endex will fulfil the roles of Trading System Operator and Trading System Clearer (short code IEN). The clearing services will be provided by ICE Clear Europe on the basis of a Clearing Service Agreement between ICE Endex and ICE Clear Europe.

# OCM BY THE NUMBERS (2014)

77,197

Trades

160,000

Orders

4,421,314,000

Therms

2,211,207,726

GBP

70

Members

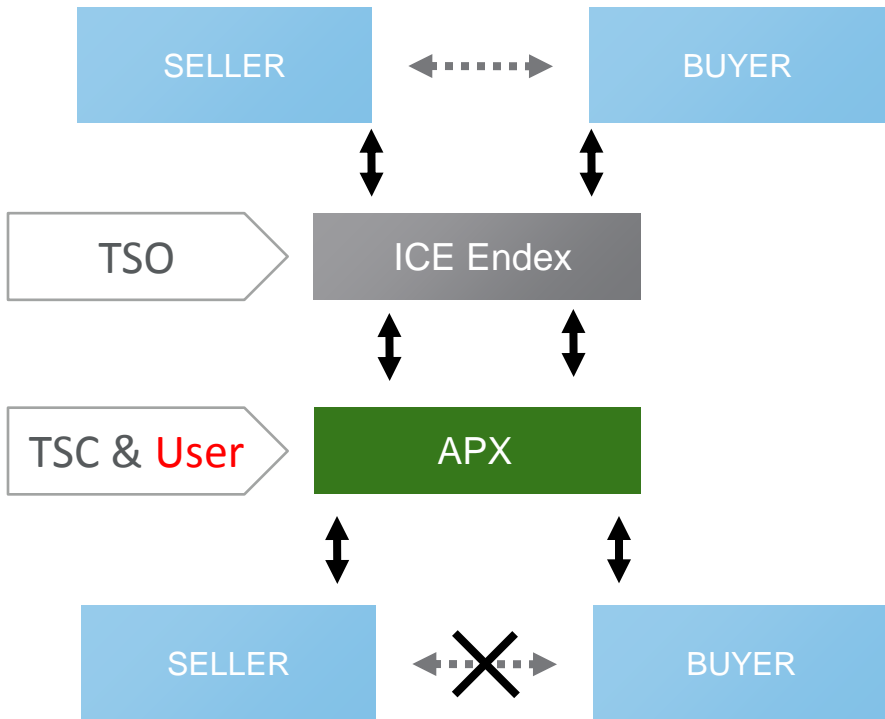


# **ICE CLEAR EUROPE**

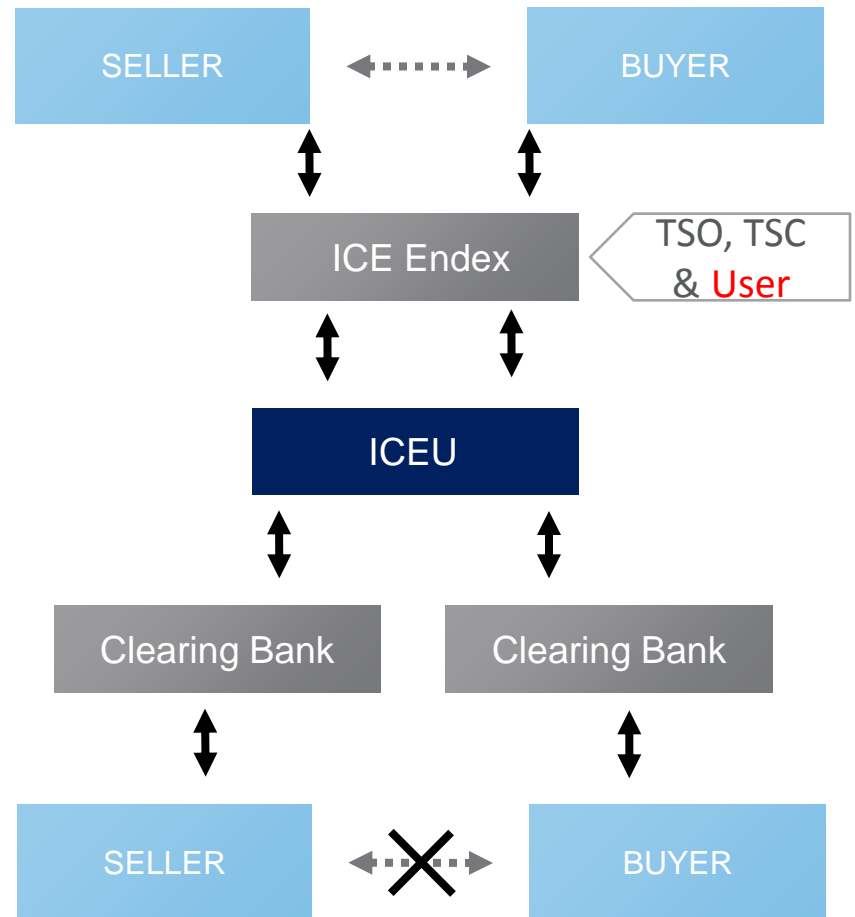
CENTRAL COUNTERPARTY CLEARING

# APX AND ICE CLEAR EUROPE MODELS COMPARED

Current Model - APX



Future Model - ICEU



# ICE CLEAR EUROPE

## THE ROLE OF A CLEARING HOUSE

- Upon a transaction's acceptance ICE Clear Europe imposes itself as the legal counterparty to every trade. This substitution of counter parties is accomplished through the legal process of open offer and creates two new, legally binding contracts – one between each of the original trading counter parties (buyer and seller) and ICE Clear Europe who thereby becomes the Buyer to every Seller and Seller to every Buyer
- This creates a principal-to-principal contract between Clearing Member and Clearing House which is in turn replicated by a back-to-back contract between the Clearing Member and the OCM trading members (i.e. NGG and other Users)
- A Clearing Member is always the counterparty for an underlying client
- ICE Clear guarantees the financial performance of contracts registered for clearing and takes over a Clearing Member's portfolio in the event of a default
- The presence of a central counterparty is an important advantage for NGG and participants of the OCM members as compared to over-the-counter markets as a central counterparty delivers operational and financial efficiencies to market participants, while eliminating the counterparty risk inherent to trading activities.



# ICE CLEAR EUROPE

## OVERVIEW (1/2)

- ICE Clear's regulatory status is as follows:
  - Recognised Clearing House and systemically important payment system supervised by the Bank of England;
  - Designated under the Settlement Finality Directive;
  - Derivatives Clearing Organisation supervised by the U.S. Commodity Futures Trading Commission; and
  - Securities Clearing Agency supervised by the U.S. Securities and Exchange Commission
- ICE Clear currently clears:
  - Futures and Options executed on ICE Futures Europe, ICE Endex and ICE Futures US Energy Division contracts (together "F&O"); and
  - iTraxx Europe indices and Single Name OTC CDS contracts (together "CDS")
- Futures & Options (F&O) clearing:
  - 74 F&O Clearing Members\*
  - \$36.14bn collateral held\*
  - A pre-funded Guaranty Fund of \$1.85bn\* plus \$100mn contributed by ICE ahead of the Member contributions

\* As at 01/07/2015

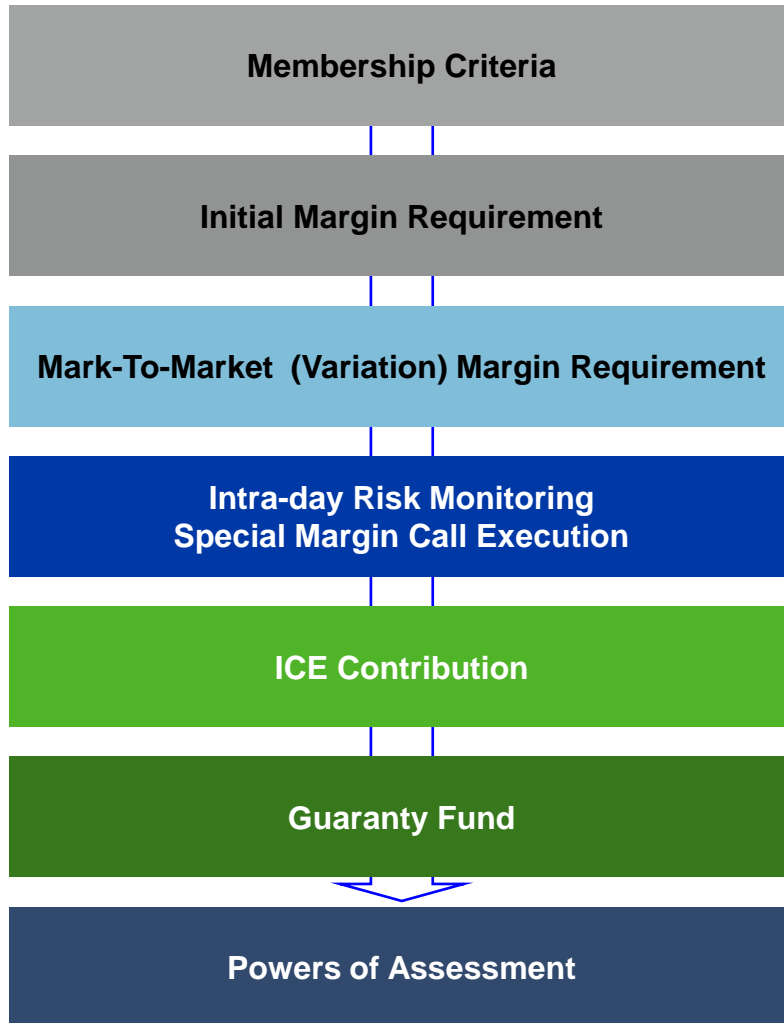
# ICE CLEAR EUROPE

## OVERVIEW (2/2)

- CDS clearing:
  - 21 CDS Clearing Members\*
  - \$8.95bn collateral held\*
  - A pre-funded Guaranty Fund of \$1.492bn\* plus \$28mn contributed by ICE ahead of the Member contributions
- Risk Governance:
  - Separate CDS & F&O Product Risk Committees together with the Board Risk Committee play a key role in ensuring that the Clearing House maintains and implements procedures, processes and controls that are designed to protect the integrity of the guaranty fund; manage and mitigate credit and market risks; consider applications for membership; and review the clearing of new products

\* As at 01/07/2015

# ICE CLEAR EUROPE: RISK WATERFALL



- Ensure each Clearing Member has sufficient financial resources, operational capabilities and risk management experience
- Collateralize potential Clearing Member portfolio loss under normal market conditions
- Adjust Clearing Member collateral through a daily debit/credit based on EOD mark-to-market
- Identify additional margin requirements based on a comparison of unrealized P/L to Risk Margin, understanding unusual market fluctuations, etc.
- ICE contribution of \$100mn ahead of the mutualized Guaranty fund
- Mutualize losses under extreme but plausible market scenarios (i.e., 99.9% confidence interval).
- Oblige Clearing Members to contribute a limited amount of additional default funding

# ICE CLEAR EUROPE: LINES OF DEFENCE

## Limits and procedures



### Monitoring credit risk

- Watch-list
- Credit review
- Capital movement monitoring
- Counterparty rating system
- Capital-to-Margin Limits
- Holistic credit approach incl. treasury functions

### Mitigating market risk

- Margin parameter settings
- Collateral valuation & haircuts
- Concentration risk limits
- Intraday market monitoring
- Intraday margin call limits

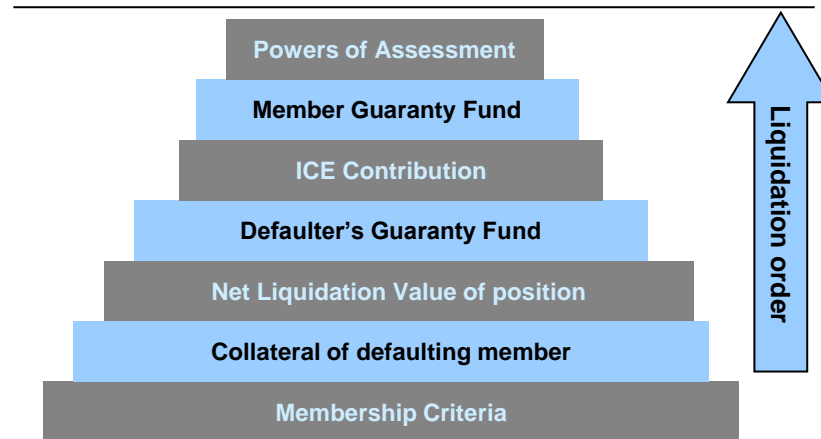
### Operational risk tools

- 4 eye principle
- New product approval process
- Extensive testing and simulation programs

### Default procedures

- Clear escalation lines
- Default fire drills
- Extensive rule book powers

## Risk waterfall



**2<sup>nd</sup> line of defence worth of over USD 5.650 bn**

- Powers of Assessment max members have legal obligation (max 2 times their initial contribution) USD 3.700 bn
- Member Guaranty Fund cash or collateral by Clearing members; USD 1.850 bn
- ICE 1<sup>st</sup> Level Contribution ahead of the Guaranty Fund USD 100 mn

**1<sup>st</sup> line of defence worth of over USD 34 bn**

- Collateral held to cover Risk (Margin) USD 34 bn

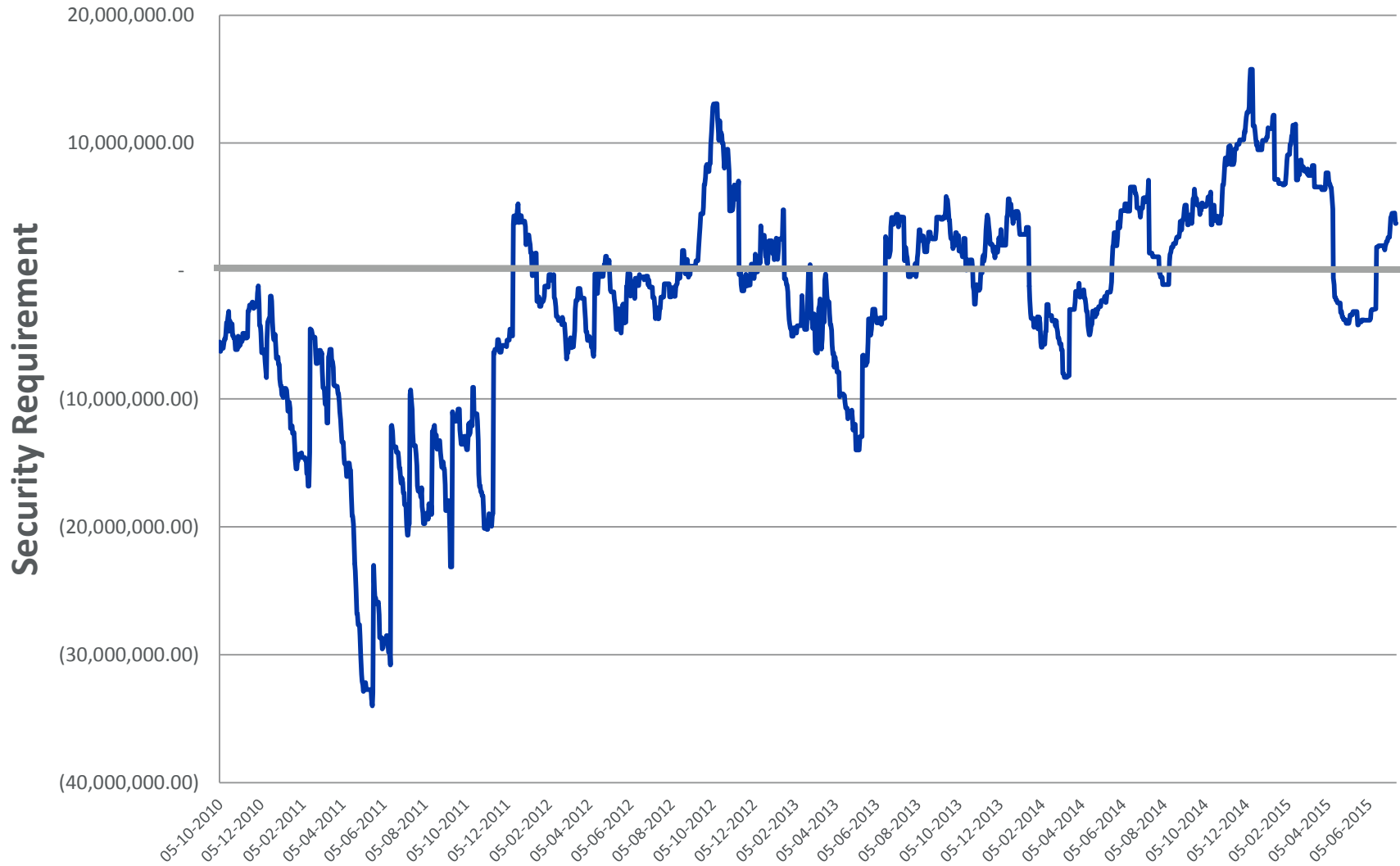
# **SECURITY REQUIREMENTS**

FOR THE TRADING SYSTEM CLEARER OF THE OCM

# APPROACH OF UNC AND EBCR TO SECURITY REQUIREMENT

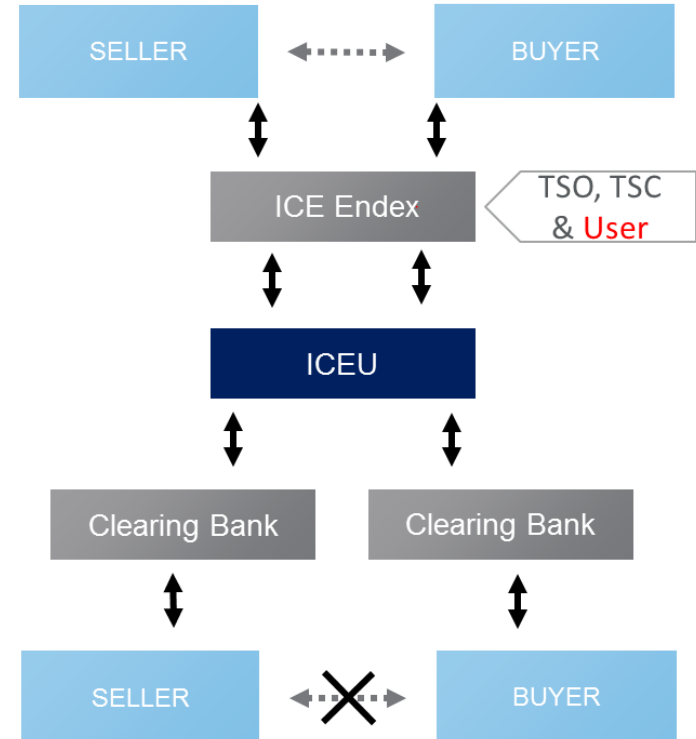
- UNC and the Energy Balancing Credit Rules (EBCR) neither recognizes the advantages of central counterparty clearing nor the fact that the credit risk to which NGG is exposed on the OCM is almost negligible.
- The approach that the UNC and EBCR take to the management of the credit risk that results from NGG trading on the OCM, is to treat ICE Endex (as the Trading System Clearer) as if it were any other User. Put simply, if NGG sells gas on the OCM, ICE Endex owes money to NGG which is seen as a credit risk to NGG. To manage this credit risk the UNC and EBCR require ICE Endex to provide a financial security equal to indebtedness to NGG which is calculated as the contract value of the net amount of gas sold each day by NGG on the OCM.
- As a result of the existing policies set forth by Xoserve and the UNC, the financial security requirement that the Trading System Clearer (APX or ICE Endex) has to meet can be very significant (GBP 35 million on May 19, 2015). It is important to note that the amount of financial security that ICE Endex has to provide to cover this perceived credit risk is allowed to build up over time because of the existing settlement cycle of Xoserve and NGG which the Trading System Operator has to adhere to as well (neutrality mechanism).

# HISTORICAL SECURITY REQUIREMENTS



# OBSTACLES TO MEETING THE SECURITY REQUIREMENTS

- APX currently uses the margin provided by its trading participants to meet the Security Requirements. This is because APX is not a regulated central counterparty. It does not have the same systemic risk management systems of a regulated central counterparty and it is not subject to same regulatory restrictions on placing collateral with third parties.
- Per clearing migration ICE Endex will fulfil the roles of Trading System Operator and and Trading System Clearer. The clearing services will be provided by ICE Clear Europe on the basis of a Clearing Service Agreement between ICE Endex and ICE Clear Europe.
- ICE Endex, as a User, is subject to the Security Requirements. However, although it is the Trading System Operator and the Trading System Clearer, it will not actually hold collateral received from ICE Clear members, and so would not be in a position to post collateral with NGG or Xoserve either.
- As a regulated central counterparty, ICE Clear is required, under Articles 44 - 45 of Commission Regulation 153/2013, to hold the assets that it has received as collateral only with central banks or securities settlement systems, or in limited situations, commercial sector regulated banks or custodians. There is no ability under these provisions or EMIR itself for ICE Clear to hold collateral that it has received from clearing members with NGG or Xoserve.





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