



## **Consultation document n. 1/2023**

### **Natural gas market**

**Proposal to introduce the *Trade Cancellation* procedure**

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## 1. INTRODUCTION

This consultation document is published by GME, pursuant to Article 3, paragraph 3.5, of the Natural Gas Market Regulation (MGAS Regulation), in order to illustrate to market participants the proposal regarding the introduction of the *Trade Cancellation* procedure on gas spot markets (MP-GAS) with continuous trading.

The aim of this proposal is to provide further tools, among others, which natural gas market participants already dispose of, to manage the error when entering bids on the continuous trading market. GME developed this idea in light of the significant increase in traded volumes observed on the market, as well as the increase in volatility, also intra-session, reported, after the current geo-political crisis.

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All interested parties are invited to submit their observations in writing to GME - **Governance** no later than **5 May 2023**, the closing date for this consultation, according to one of the following methods:

- e-mail: [info@mercatoelettrico.org](mailto:info@mercatoelettrico.org)
- mail: **Gestore dei mercati energetici S.p.A.**

**Viale Maresciallo Pilsudski, 122 - 124**

**00197– Roma**

Parties who intend to safeguard the confidentiality or secrecy of the documentation sent, in whole or in part, are required to state which parts of their documentation must be considered as confidential.

## 2. CONTEXT ELEMENTS OF THE CONSULTATION

### 2.1. THE PERFORMANCE OF GME'S GAS MARKETS

GME's natural gas markets have witnessed a significant increase in liquidity in the last years.

In 2022, the Gas Spot Market (MP-GAS) total amount of trades reached its new maximum of 175 TWh, showing an increment of 35% if compared to 2021. Similarly the share of the total gas consumed in the gas system, which on an annual basis reached the value of 24 %, never so high since the start of trading, with a monthly peak of 42% in July.

The increase in volumes traded in 2022 was driven by *day-ahead* markets at its new maximum, both in the continuous trading segment and in auctions. In particular, the volumes traded on the day-ahead gas market continuous trading segment reached 75.6 TWh (+66.6% on 2021), consolidating a progressive growing *trend* which in December 2022 led monthly trades to exceed 8 TWh (highest level ever).

The gas markets have also been characterized, mainly as a consequence of the current geo-political crisis, by the presence of price volatility phenomena observed not only between market sessions, but also within the same market session.

In order to take into account this change of scenario and, thus, the consequent increase in the probability of making mistakes in the formulation of bids, it was deemed appropriate to prepare and implement an additional instrument for error management, as a further supporting action to the protective measures currently provided in the MGAS.

### 2.2. ERROR MANAGEMENT - CURRENT MEASURES

The current MGAS Regulation, as known, already provide specific protective measures aimed at preventing market participants from making mistakes in submitting their bids on the gas markets.

The MGAS Technical Rule n. 8 containing, inter alia, the implementation and procedural provisions of article 31, paragraph 31.1, letter e) and article 36, paragraph 36.1, letter e), of the MGAS Regulation, provides that market participants can set and modify, even during the same market session, price or quantity control parameters customizing them to check the validity of submitted bids. GME included this provision in the MGAS Technical Rules with the specific aim to prevent errors in the valorisation of bid's price and quantity.

Specifically, it is provided that each user can set both "threshold" and "limit" parameters, related to both the bid's quantity and price:

- The "threshold" parameter requires the market platform to send an alert to the user if the he or she submits a bid in which the price and/or quantity does not respect the threshold values previously set. Thus, the user is required to confirm the correctness of the bid that he or she intends to submit before it enters the *book*<sup>1</sup>.
- The "limit" parameter, on the other hand, provides that if the user were to enter a bid with price and quantity indications, by mistake, not in line with the previously set parameters, the same bid would automatically be rejected by the market information system<sup>2</sup>.

These kind of protections, which are part of the offer submission phase, operate as prevention measures rather than error management measures.

For this reason, it was deemed appropriate to enrich the *set* of measures available in the MGAS, adding, to the current prevention measures, a procedure for cancelling *mistrades*, with the primary aim of offering market participants a further tool in case of, after sudden changes in the reference context, the same does not promptly adjust the offer parameters and thus concludes transactions which are not supported by a real willingness to negotiate.

### 2.3. STUDY OF THE SOLUTIONS ADOPTED IN NATIONAL AND INTERNATIONAL FIELDS

There are different procedures for cancelling *mistrades* adopted at national and international level by other market operators, both in the *commodities* and the financial sector. Some solutions provide that the cancellation request - which in any case must be presented within a limited timeframe with respect to the momentum in which the transaction itself has been concluded - can be submitted by only one of the counterparties. Other solutions suggest that it is possible to request the cancellation only with the agreement of all the participants involved in the transaction, whose anonymity is guaranteed. With specific reference to the latter solution, in case there is no agreement between the counterparties, the market operator reserves the right to cancel the transaction. Additional solutions to reduce the probability of error of the market participants when submitting bids, consist in using special tools, known as "*configuration facilities*", which allow to set *alerts* when specific price, volume and

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<sup>1</sup> This functionality is active in case the participant operates directly through the MGAS platform, but not through the Trayport portal.

<sup>2</sup> This functionality is active both in case of operation through the MGAS platform and through the Trayport portal.

equivalent value parameters are exceeded, similarly to what is currently in place on GME's gas markets (see paragraph 2.2).

In addition, in some cases, for a cancellation request to be presented, it is required that the transaction price must fall outside a given *range* determined according to the theoretical market price: if the price of the transaction to be eliminated falls within *the range*, the transaction cannot be cancelled. In this regard, some market operators also define *Price Reasonability Limits*, i.e. reasonable price limits beyond which the platform does not accept the transactions proposed. In such cases, it is identified a corridor between the *No Cancellation Range* and the *Price Reasonability Limit* within which transactions can be cancelled.

Finally, there are other solutions in which, instead of determining whether the transaction can be cancelled in relation to price deviations, an economic criterion is identified according to which, if the loss resulting from the transaction is contained within a certain threshold, no cancellation is made.

Clearly, the different solutions arise from the need to ensure that the tools adopted are effective and at the same time compatible with the characteristics of each market, and this applies with regard to both the asset being traded and, above all, the chosen *market model*.

Different market operators also provide a transaction cancellation penalty, regardless of the solution they adopt.

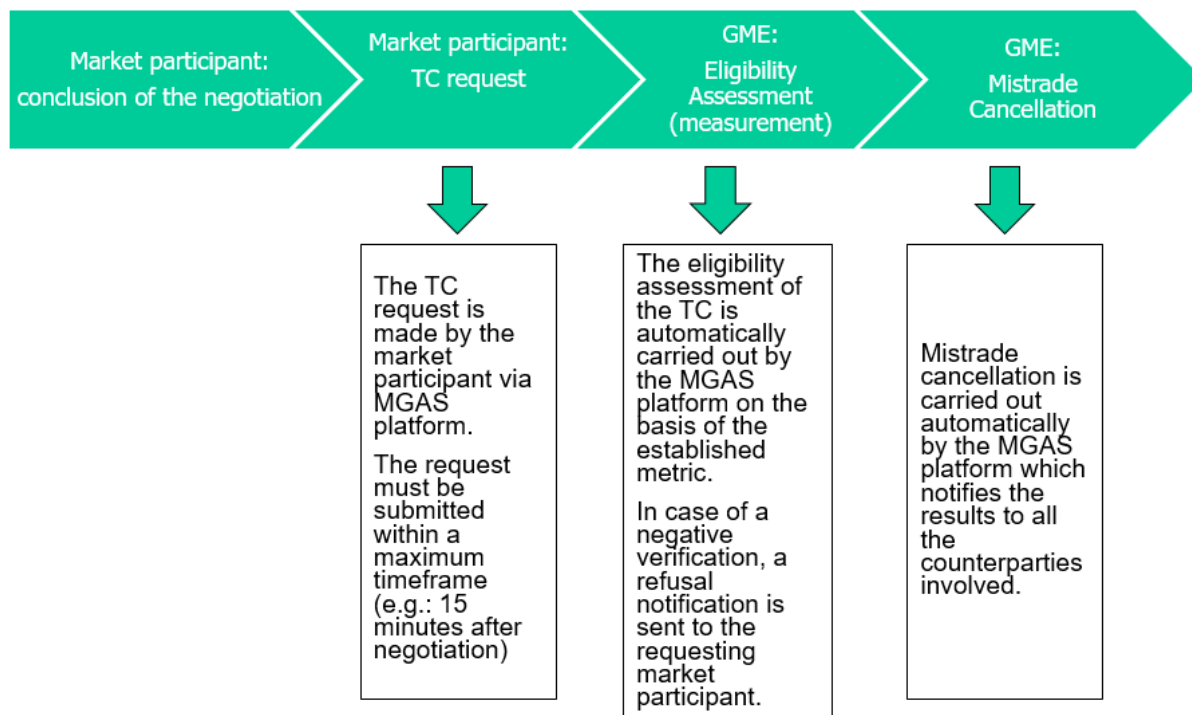
### 3. TRADE CANCELLATION (TC) PROCEDURE

#### 3.1. DESCRIPTION OF THE PROCEDURE

The GME proposal envisages the introduction of a *Trade Cancellation* procedure (hereinafter referred to as TC), aimed at allowing the cancellation of trades concluded on MGAS and induced by an error made by one of the market participants when submitting bids.

The main objective is to enrich *the set* of tools available for market participants on MGAS, who can already mitigate the risk of errors by making proper use of the prevention measures provided in the MGAS Regulation (see paragraph 2.2).

The *Trade Cancellation* (TC) procedure allows **the cancellation of a trade at the request of a market participant that, upon positive verification by GME, would be carried out without confirmation from the counterparties.**



In detail, it is expected that:

- The TC procedure is activated exclusively upon request of a market participant (“requesting participant”) in relation to a trade<sup>3</sup> that the latter has concluded due to an error (“mistrade”);
- The request is made through an appropriate functionality of the market Information system (SIMGAS<sup>4</sup>) within a maximum time after the conclusion of the trade (**i.e. 15 min**);
- The eligibility of the request is assessed by GME against objective parameters (“evaluation metrics”<sup>5</sup>) defined *ex ante* by GME and disclosed to market participants: merely upon a positive GME verification and without confirmation by the counterparty participant, the TC shall produce the “mistrade” cancellation”;
- The successful conclusion of the procedure (hence, the acceptance of the request) results in the cancellation of the “mistrade” and of its effects both towards GME and towards Snam Rete Gas (SRG) for all counterparty participants:

<sup>3</sup> Trades are treated as single matches even if they originate from a single offer.

<sup>4</sup> This functionality is active if the participant operates directly through the MGAS platform, but not through the Trayport portal.

<sup>5</sup> See paragraph 3.3

- On MGAS: the *mistrade* is cancelled and does not give rise to commercial purchase/sale of gas between participants and GME
  - To the PSV: the *mistrade* shall not be taken into account for the purpose of determining the balance to be appointed to the PSV
- The *mistrades* cancelled must be considered as not concluded for the purposes of market statistics (traded volumes, reference prices, indicators);
  - The error shall relate only to the price being negotiated. In the case of a quantity error, the price is assumed to be around the market price and, therefore, the participant will always be able to carry out an opposite transaction equal to the excess quantity<sup>6</sup>;
  - It is possible to request TC for several transactions involved in a single trading operation (→ simplification of the request in case of multiple matches of an incorrect order);
  - For each TC request, regardless of the outcome, a *fee* is charged to the requesting participant (and not to the number of transactions whose cancellation is requested);
  - In order to discourage abuse of requests, the *fee* on TC requests shall increase proportionally to the number of requests made.

At first, it is proposed to introduce the TC procedure only on the continuous trading MP-GAS markets, and subsequently to consider its extension to the gas forward market (MT-GAS) as well.

### 3.2. TC PROCEDURE SELECTION CRITERIA

The procedure for cancelling *mistrades* in the terms described above was identified following a careful compatibility and feasibility analysis of the different potential solutions, carried out considering, above all, the current functional characteristics of GME's gas markets.

In this regard, a fundamental aspect to consider is that gas quantities related to purchase and sale transactions concluded by the market participants on the MGAS, with the exception of the MGS:

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<sup>6</sup> Further considerations must be taken into account for what concerns the following: while an error related to the price can be identified with respect to a reference index which is useful for all market participants, any error related to the quantity of an offer/transaction requires a "customized" assessment for each market participant, on the basis, for example, of the volumes usually traded. Furthermore, given that MGAS is not a mandatory market, market participants can decide to change, from one session to another, the volumes traded on MGAS, if compared to what has been traded as OTC, while maintaining constant the overall volumes traded and registered on the PSV. Hence, given that the definition of criteria to identify possible errors on volumes would be highly discretionary, there would be a risk of being ineffective or even introducing potentially discriminating elements among market participants with different trading strategies. Finally, it must also be noted that to mitigate the risk of errors on volumes (as well as on prices) the "threshold" and "limit" parameters mentioned in MGAS Technical Rule N. 8 and in paragraph 2.2 of this document are always available.



- are recorded, every hour (h), in the PSV system by the GME, on behalf of the same market participants;
- the registration of gas quantities at the PSV, once properly executed, are irrevocable since there is no procedure, at the moment, to cancel them as a result of a possible cancellation of the related market transactions.

Therefore, the identification of the procedure for the cancellation of *mistrades* was undoubtedly guided by **the objective of not affecting and, therefore, avoiding a change, in the mechanism and timing of the PSV operation, including the cyclicity with which the process of registering transactions concluded on the GME markets at the PSV takes place.**

In this regard, it was ruled out the hypothesis that the TC procedure was subject to:

1. the approval of the *mistrade* counterparties,
2. the possible intervention of the GME in case of disagreement between counterparties;
3. the possible involvement of the PSV system operator (SNAM), in case cancellation requests were allowed after their registration at the PSV.

The reason is that waiting for the confirmation of the cancellations (*or trade recall*), or for GME's intervention, or even SNAM's one, would clearly be incompatible with the characteristics and timing of the current registration cycle at the PSV.

At present, as mentioned above, these registrations are made according to a specific hourly time window. This period could be eventually reduced in the future, thus it is appropriate, at the moment, not to bind the registration period to any kind of discretion, not even to those which might characterize the *mistrade* cancellation.

Given this situation, GME considered to introduce a TC procedure which provides the activation of the cancellation request of the *mistrades* only in a period of time that precedes their registration at the PSV and which subordinates its execution exclusively to a verification of the request.

Hence, assuming to allow a period of 15 minutes, starting from the moment the transaction is concluded, to submit the request for the activation of the TC procedure and a minimum time of 5 minutes to allow the MGAS information system to evaluate the TC request against the evaluation metric (see par. 3.3), the recording window at the PSV for each hour h would be accordingly delayed. It is considered that the registration at the PSV would be made, on an hourly cycle, not earlier than h+20 minutes (e.g.: *trades* concluded since the last registration until 16:30 would not be recorded before 16:50) when any TC procedures activated for that time have already been completed.

In this way, the TC procedure would not only have the advantage of leaving the current patterns of interaction between market functioning mechanisms and the PSV system unchanged, but above all, it would guarantee :

- **Certainty**, as the TC request for *a mistrade* would only be triggered upon an input from the requesting market participant. The TC shall result in the cancellation of *a mistrade* following only a positive verification of the GME and without further confirmation from the counterparty participant, nor SNAM's involvement, within a specific timing, compatible with the registration process at the PSV;
- **Absence of discretion**, which GME is required to comply with, pursuant to Article 3 of the MGAS Regulation, in the management of the market, given that the TC procedure results in cancellation as a result of the positive verification of GME. The eligibility assessment of the TC is automatically carried out by the market platform, conducted on the basis of an assessment metrics defined *ex ante* by GME and shared to market participants in full transparency.

### 3.3. ASSESSMENT METRICS

GME verifies the TC eligibility, based upon a trade price assessment metrics.

For this purpose, it must be defined a:

- **REFERENCE PRICE  $P_{rif}$** 
  - specific to each session/market product
  - with possible different determination criteria for divergent phases of a market session (opening, closing)
  - connected with the transactions observed in session S for product related to gas day G
  - the calculation should exclude any transactions that were previously subject to TC during the session
  - it will result in the arithmetic average price of the previous N transactions recorded in session S for the product related to gas delivery day G
  - in particular, for a *trade* carried out in time t, the  $P_{rif}$  will be equal to the arithmetic average price of the previous N transactions recorded in session S for the product related to gas delivery day G until a time of t-15 minutes. This time constraint reflects the need to exclude all potential TC-subject transactions from the  $P_{rif}$  calculation (15

minutes is the time allowed to the market participant to activate the cancellation procedure). In the first application phase, GME proposes to consider a value of parameter N equal to 5, which can be confirmed/reviewed annually.

- in the absence of references (e.g.: opening session), the control price ( $P_{contr}$ ) of the product will be used as  $P_{rif}$ . This solution enables the identification of the data necessary for the reference price assessment within the running session.
  - Until N is reached,  $P_{rif}$  will be calculated as the average of  $P_{contr}$  and the T transaction prices (with  $T < N$ ) that will progressively take place in session S for the product related to gas delivery day G based on the following formula  $[1/(T+1)] * [P_{contr} + \sum_i(P_i)]$  per  $i = 1, \dots, T$ .
  - **A PRICE RANGE ( $R_{TC}$ )** compared to  $P_{rif}$ : the  $R_{TC}$  must be large enough to suggest that trades concluded outside it were induced by an obvious material error.

The procedure will positively assess the TC request if the related transaction is outside the  $R_{TC}$  interval centred on  $P_{rif}$  and delimited by  $P_{min}$  and  $P_{max}$  values, which are defined on the basis of a percentage threshold  $R_{TC}\%$  as follows:  $P_{max} = P_{rif} * (1 + R_{TC}\%)$ ;  $P_{min} = P_{rif} * (1 - R_{TC}\%)$

In the first application phase, GME proposes to consider a value of  $R_{TC}\%$  equal to 40%, which can be confirmed/reviewed annually.

The activation of the procedure, and thus the *trade* evaluation by formula, will only take place for transactions that are subject to TC request by the participants.

When cancelling the *mistrade*, GME shall inform both the requesting market participant and the counterpart of the *mistrade*.

