

Amendments to IRGiT's regulations

Summary

Izba Rozliczeniowa Giełd Towarowych S.A. ("Commodity Clearing House", "IRGiT") is introducing a comprehensive package of amendments including:

- 1) adaptation of the provisions of the Regulations allowing IRGiT to provide financial service of transactions concluded on the Agricultural Commodity Market (Rynek Towarów Rolno-Spożywczych, RTRS), which the Polish Power Exchange ("POLPX") intends to launch as part of its commodity exchange operations,
- 2) change of the amount of equity required from House Members,
- 3) introduction of the possibility for IRGiT to apply cross-period and cross-product netting in the calculation of collateral margins,
- 4) introduction of the possibility for the guarantee fund to also cover spot transactions and the possibility of making contributions to the fund also in a non-cash form.
- 5) change of the rules governing the use of IRGiT's own funds for guaranteeing liquidity of clearing operations,
- 6) introduction of an obligation on a House Member, which has terminated its House membership agreement, to close open positions.

The amendments will affect:

- 1) Regulations of the Exchange Clearing House (commodity market) ("ECH Regulations"),
- 2) Resolution to define the organizational rules for the Guarantee Fund of the Exchange Clearing House.

Implementation of the package of regulations is a next step in the development of the House's offering, in terms of improving safety on the markets subject to clearing but also in terms of optimizing the clearing guarantee system.

The Risk Committee at IRGiT has issued its positive opinion on the amendments and they will come into effect on 4 November 2019.

Detailed description of amendments

1. Financial service of the Agricultural Commodity Market

In connection with the launch of the new RTRS market on the commodity exchange operated by POLPX planned for March 2020, amendments were made to the ECH Regulations allowing IRGiT to provide financial service of transactions concluded on the new category of exchange commodities, i.e. agricultural commodities.

The ECH Regulations has received a definition of agricultural commodities and appropriate provisions concerning risk management and provisions governing the settlement and clearing of such exchange commodities.

Because of the unique characteristics of the risks associated with the organization of trade on the RTRS, mainly with the delivery of commodities, provisions have been added to the ECH Regulations in order to mitigate these risks:

- a) the rules have been defined for collecting, storing and refunding the bid deposits, which secure the correct performance of obligations under exchange transactions concluded as a result of auctions for agricultural commodities in the cases defined by the Polish Power Exchange (§ 45p and § 45r of the Regulations),
- b) the term of the cash settlement of amounts due to House Members resulting from transactions concluded as a result of auctions subject to the obligation to pay a bid deposit has been set at T+16 (§ 47 sec. 2 of the Regulations),
- c) the possibility to execute transactions through clearing of the bid deposit has been introduced in the event IRGiT receives information from POLPX about justified notification of irregularities as to the quantity or quality of the purchased agricultural product (§ 45r sec. 3 and § 47 sec 2 of the Regulations).

Also, the new § 52b has been added to the Regulations, which describes the rules for delivering the agricultural commodities and appropriate changes have been introduced to the fee schedule.

2. Amendment pertaining to equity of House Members

In order to facilitate access to the Agricultural Commodity Market, § 18 sec. 1 of the Regulations was amended by reducing the equity requirements for brokerage houses and commodity brokerage houses operating solely on the Agricultural Commodity Market or on the Property Rights Market. Because of the nature of those markets, in particular the pre-validation of orders, the level of equity required to carry out clearing in this respect was set at the level of equity required from commodity brokerage houses under Article 41b sec. 1 of the Act on Commodity Exchanges.

3. Amendments pertaining to netting of initial margins

The amendment to § 39 of the ECH Regulations allows IRGiT to launch the initial margin netting model for forward contracts, both at the level of cross-product netting (BASE/PEAK/OFFPEAK for electricity), and cross-period netting (for electricity and gas). The method used to set the value of collateral margins for forward contracts, including the algorithms used to calculate the net value of initial margins, will be described in the Detailed Clearing Rules at a later dates.

At present, the clearing system with the implemented cross-product netting functionality is undergoing an acceptance testing phase. The required changes in the area of cross-period netting will be implemented in the next stage.

4. Amendments pertaining to Guarantee Funds

The amendments pertaining to the Guarantee Fund (§ 41 - § 45n of the Regulations) remove references to forward markets as the scope of transactions covered by this fund has been extended to include spot market transactions as well. The Guarantee Fund covering spot markets is an element of the planned collateral model for the XBID market and it strengthens the clearing guarantee system.

The changes will affect the scope of transactions covered by the Guarantee Fund, the method used to calculate the Guarantee Fund as well as contributions of individual Members towards the fund. The detailed rules or organization of the Guarantee Fund are set forth in the Resolution of the IRGiT Management Board to define the organizational rules for the Guarantee Fund of the Exchange Clearing House.

The main goal of the changes is to ensure that risk is reflected more precisely in both the value of funds accumulated in the Guarantee Fund and in the contributions of the individual House Members. At the same time, implementation of a single Guarantee Fund for the markets on which both electricity and gas are delivered, is the next step in the optimization of the collateral model applied by IRGiT.

Also § 45 of the ECH Regulations has introduced the possibility of making contributions to the Guarantee Fund also in a non-cash form. The regulations governing payments in this form will be defined after the next stage of work is completed, by a resolution of the IRGiT Management Board.

Method used to calculate the sum total of the Guarantee Fund

As of the effective date of the Resolutions adopted by the IRGIT Management Board to define the organizational rules for the Guarantee Fund of the Exchange Clearing House, the guarantee funds, which currently operate as two separate Funds: the Guarantee Fund for the forward electricity market and the Guarantee Fund for the forward gas market will be replaced by a single common Guarantee Fund, which will additionally cover transactions from the spot markets for electricity and gas.

Taking into account all the exposures of House Members from all the markets, on which electricity and gas are delivered, offers potential benefits from the netting within the limits of a given deliverable commodity, and a much more precise reflection of risk generated by each House Member.

The sum total of the Guarantee Fund will be calibrated in such a way so as to cover the largest of the larger of: the largest uncovered risk, or the sum of the second and third largest uncovered risks of the House Members operating on the electricity and gas delivery markets, in the period of 60 days preceding the date of updating the Guarantee Fund. Such a solution will reduce the relative variation in the Guarantee Fund's size between the successive updates.

Method to calculate contributions to the Guarantee Fund

In the new methodology, contributions of each House Member are calculated *pro rata* to the average daily uncovered risk generated in the period since the most recent update. Then, in line with the existing practice, IRGiT determines the value of the Guarantee Fund multiplier, which is provided to all the House members and used to calculate the contributions.

The revision of the contribution calculation model also included a change in the minimum contribution of a House Member which, after the changes are implemented, will amount to PLN 10,000, or PLN 30,000 for entities admitted to operate on the Commodity Forward Instruments Market

Necessity to supplement contributions to the Guarantee Fund by House members operating on spot markets only

In connection with the fact that the Guarantee Fund will now also cover spot markets, the House Members operating to date on those markets only and maintaining no contributions in any of the existing Guarantee Funds are obligated to make a contribution to the newly-established Guarantee Fund.

5. Ensuring the possibility for IRGiT to use a credit facility

The amendments introduced in the new ECH Regulations also extend the liquidity risk management mechanisms to include the possibility of using the credit facilities from commercial banks that are available to IRGiT. Based on the amendment made to § 45o of the ECH Regulations, IRGiT would use a credit facility when the funds accumulated in the clearing guarantee system proved to be insufficient to effect payments of a House Member.

6. Changes pertaining to the closing of positions

Provisions have been added to § 67 of the ECH Regulations, under which a House Member which has terminated its House membership agreement is obligated to take actions aimed at closing its positions for the clearing of which it is responsible or transfer such positions to another House Member. At the same time, given the need to ensure security of the clearing operations, provisions have been added to § 54 of the Regulations allowing IRGiT to close positions if a House



Member does not satisfy the obligation described above and also in the situation of a justified risk that a House Member may lose its capacity to enter into forward contract transactions on the Exchange Commodity Market.

Should you have any questions, do not hesitate to contact us.

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