

**GUIDANCE NOTE**  
**1/2017**

**ON THE APPLICATION OF ARTICLE 5 OF**  
**REMIT ON THE PROHIBITION OF MARKET**  
**MANIPULATION**

**WASH TRADES**

**1<sup>st</sup> Edition**

**19-June-2017**

## PURPOSE OF THIS DOCUMENT

Pursuant to Article 16(1) of Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency ('REMIT'), the Agency for the Cooperation of Energy Regulators ('the Agency') issues non-binding guidance in order to ensure that National Regulatory Authorities ('NRAs') carry out their tasks under this regulation in a coordinated and consistent way.

In view of this, the Agency published on 17 June 2016 the 4<sup>th</sup> edition of the ACER Guidance on the application of REMIT ('ACER Guidance')<sup>1</sup>. It contains general direction on the interpretation of the application of the definitions – set out in Article 2 of REMIT – and provides examples of the types of behaviour which may fulfil the definition of market manipulation provided in Articles 2(2) and (3) of REMIT.

In this first of a series of non-binding Guidance Notes, the Agency complements the ACER Guidance by providing more in-depth information on specific types of practices that constitute market manipulation pursuant to Article 5 of REMIT. By providing greater clarity through Guidance Notes the Agency aims to share insights on the general framework of the analysis to be used in determining whether a specific behaviour could constitute a breach of REMIT.

The Guidance Notes will include more recurrent examples and indicators related to a specific behaviour but will not be exhaustive. The evolving nature of trading strategies does not allow the identification of all types of examples and indicators associated with specific concepts. Therefore, there may be circumstances not covered in the present Guidance Note that may still constitute market abuse under REMIT. The Agency will update these notes as required in order to reflect developments in trading strategies.

In applying the principles set out in this Guidance Note, the NRAs should take into account the specific facts and circumstances of each case. Also, this Guidance Note is without prejudice to the interpretation the Court of Justice of the European Union may give to the application of Article 5 of REMIT for the concept herein covered.

**Keyword(s):** REMIT, market manipulation, wash trades, wash sales, cross trades, internal trades, self-trades, pre-arranged trading.

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<sup>1</sup> Available at <https://www.acer-remit.eu/portal/home>.

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## 1 Introduction

In this Guidance Note, the Agency aims to provide further details<sup>2</sup> on its views on the application of REMIT provisions in the context of wash trades in wholesale energy markets. The Guidance Note describes a general framework promoting a consistent approach to the assessment of this behaviour. It intends to help NRAs reviewing suspicious events involving wash trades once detected and to decide whether to open an investigation. It is out of the scope of this Guidance Note to provide specific tools to investigate wash trades.

The term wash trade refers to the act of a market participant entering into arrangements for the sale or purchase of a wholesale energy product, where there is no change in beneficial interests or market risk or where the beneficial interest or market risk is transferred between parties who are acting in concert or collusion.

It is to be noted that the term wash trade is used in the trading environment usually with a negative connotation while other terms such as cross trades<sup>3</sup>, internal trades or self-trades do not always have that same connotation but can refer to equivalent trading behaviour from a substantive point of view. Trading patterns, such as entering into arrangements where there is no change in beneficial interests, market risk or where the exchange occurs between colluding parties, are merely indicators of potential market manipulation. To qualify them as market manipulation, or attempt thereof, any of the above-mentioned types of market behaviour should be assessed against the definitions provided in Article 2(2) and 2(3) of REMIT.

The Agency selected wash trades as the first topic for this series of Guidance Notes as this behaviour represents a relevant percent<sup>4</sup> of the potential breaches of REMIT that have been either notified to the Agency by external entities or detected by the Agency through its surveillance activities. Wash trades can be part of a larger trading strategy aiming to manipulate wholesale energy markets. Wash trades have already been addressed in different jurisdictions and in the context of wholesale energy markets and sanctioned in the European Union ('EU') and non-EU jurisdictions<sup>5</sup>.

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<sup>2</sup> The Agency provides in section 6.4 of the ACER Guidance the example of wash trades as a type of practice that could constitute market manipulation, or attempts thereof.

<sup>3</sup> Several Persons Professionally Arranging Transactions ('PPATs') developed the so called 'cross request' functionalities in their platforms (allowing for 'cross trades') that enable, under very specific regimes, arrangements for the sale or purchase of a wholesale energy product, where there is no change in beneficial interests or market risk or where the beneficial interest or market risk is transferred between parties who are acting in concert or collusion. As these transactions refer to equivalent behaviour, from a substantive point of view, from the one encompassed by wash trades, they will have to be assessed *mutatis mutandis* against the definitions provided in Article 2(2) and 2(3) of REMIT using the exact same criteria.

<sup>4</sup> At the time the Guidance Note was published.

<sup>5</sup> See the Federal Energy Regulatory Commission's (FERC) Order assessing civil penalties in *FERC vs. Powhatan Energy Fund LLC*, 29 May 2015; FERC's *Enron* Docket No. EL03-77-000, 26 March 2016; FCA's case No: 121882, *The Royal Bank of Scotland*, 6 February 2013; US Court of Appeals' (7<sup>th</sup> Cir.) judgment in *Elliott v. CFTC*, 202 F.3d 926, 928, 3 February 2000; CFTC's Order instituting proceedings in *Reliant Energy Services*, 25 November 2013; CFTC's Docket No. 15-33 in *Tera Exchange LLC*, 24 September 2015; CFTC's Docket No. 15-34 in *Cargill de Mexico*, 24 September 2015. Please note that these decisions are provided for illustrative purposes only, and have been adopted under legal frameworks that might differ from REMIT and the definitions embodied therein.

In wholesale energy markets, wash trades may occur, for example, with the intention to manipulate the market by:

- creating the illusion that a market is liquid and active;
- creating the illusion that the market is moving into either the sell side or buy side<sup>6</sup>;
- sending false signals to other market participants with prices that diverge from the prevailing market price;
- affecting the average or index price reported for a market, which in turn could benefit a derivatives position; or
- hoarding transmission capacity by implicitly removing the existing capacity from the market.

Wash trades may also occur in situations where the ultimate goal is not to manipulate wholesale energy markets, but to achieve other potentially unlawful goals that may go beyond the scope of REMIT, such as:

- inflating the turnover through shell companies;
- increasing reported trading revenue figures;
- evading taxation;
- circumventing accounting or other rules; or
- inflating the commissions of persons professionally arranging transactions ('PPATs') linked to the volume of trades conducted; etc.

Even wash trades that can occur without the intention of the market participant<sup>7</sup> to manipulate the market might nevertheless qualify as market manipulation under REMIT as far as they give, or are likely to give, false or misleading signals and/or secure or attempt to secure the price of wholesale energy products at an artificial level<sup>8</sup>. Also, REMIT does not require proof of the intent or the state of mind of the market participant(s) in assessing a wash trade. It is therefore not necessary to show that the market participant(s) knew that it was infringing REMIT<sup>9</sup>.

This Guidance Note is structured in five Sections. Section 2 focuses on the concept of wash trades and provides relevant illustrative examples to wash trades. Terminologies describing wash trades may vary in the parlance of stakeholders involved in wholesale energy markets. To ensure a uniform understanding of the practice and a consistent application of REMIT, NRAs should consider the description elaborated in this Section.

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<sup>6</sup> Depending on the sequence of the orders, wash trades may be designed so that the first order always displays on one side of the order book and then is aggressed by the other matching order. This may create an indication regarding the trading direction.

<sup>7</sup> For example resulting from: mistakes in the introduction of orders; use of simultaneous divergent trading strategies (the same market participant trades the same or interrelated instruments based on different trading strategies through algorithmic trading); lack of internal coordination or optimisation mechanisms; trades placed by different traders within the same entity managing internally separated portfolios, which end up taking the opposite sides of the same transactions.

<sup>8</sup> More details on these aspects will be provided in Section 3.1.

<sup>9</sup> Nevertheless, should regulators be able to prove the intent to manipulate the market, they can also sanction a wash trade as an attempt to manipulate the market (as defined in Article 2(3) of REMIT).

Section 3 assesses wash trades against the definition of market manipulation laid down in Article 2 of REMIT. It shows that whatever the motive behind the orders/transactions, or regardless of the actual effect on the market, wash trades may be – depending on the specificities of the market and on the circumstances – considered as market manipulation, or attempt thereof, under Article 2(2) and 2(3) of REMIT, and prohibited by Article 5 of REMIT.

Section 4 sets out recommendations towards NRAs, aimed at facilitating the consistent fulfilment of the obligation of PPATs under Article 15 of REMIT via a common understanding and approach to wash trades. It presents measures aimed at increased transparency that can limit the occurrence of potential REMIT breaches through arrangements for the sale or purchase of a wholesale energy product, where there is no change in beneficial interests or market risk or where the beneficial interest or market risk is transferred between parties who are acting in concert or collusion.

Finally, Section 5 provides conclusions and highlights the most important insights of this Guidance Note.

## 2 Concept of wash trade

Article 5 of REMIT specifies that any engagement in, or attempt to engage in, market manipulation on wholesale energy markets shall be prohibited. Although REMIT does not contain specific provisions detailing different types of behaviour that constitute market manipulation, Article 2 of REMIT provides the meaning of the concept of market manipulation. That broad delimitation is further refined in the ACER Guidance where wash trades are presented as one of the practices that could constitute market manipulation under REMIT.

According to section 6.4.1, of the ACER Guidance a **wash trade is a practice consisting of: 'entering into arrangements for the sale or purchase of a wholesale energy product, where there is no change in beneficial interests or market risk, or where beneficial interest or market risk is transferred between parties who are acting in concert or collusion'<sup>10</sup>.**

This concept exhibits several elements that need to be assessed in order to categorise some trading arrangements as wash trades:

- the change in the beneficial interest;
  - the involvement of only one entity; **or**
  - multiple colluding entities.
- the change of the market risk of the involved parties.

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<sup>10</sup> This concept is *mutatis mutandis* the same contained in the Commission Delegated Regulation (EU) No 2016/522 of 17 December 2015 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council as regards an exemption for certain third countries public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers' transactions.

Figure 1 provides an indication of how the interlinkage of these elements should be used in order to determine whether a trading arrangement constitutes a wash trade.

**Figure 1: The elements included in the wash trade concept**

		Change in beneficial interest		
		NO	YES	
			Between parties in concert or collusion	Between parties <u>not</u> in concert or collusion
Change in market risk	NO	wash trade	wash trade <sup>11</sup>	wash trade <sup>12</sup>
	YES	wash trade	wash trade <sup>13</sup>	not a wash trade

An entity is considered to have a 'beneficial interest' in the arrangement for the sale or purchase of a wholesale energy product if it has the opportunity, directly or indirectly, to profit/loss or share any profit/loss derived from the arrangement for the sale or purchase of that wholesale energy product<sup>14</sup>.

A transaction in wholesale energy products leads to no change in beneficial interests where it represents the same interests on both sides. For the purposes of applying this concept, it is considered that the following entities represent the same beneficial interest:

- the same legal or natural person; or
- a legal or natural person and its parent<sup>15</sup> or related<sup>16</sup> undertaking; or

<sup>11</sup> Many times labelled as 'pre-arranged' trading.

<sup>12</sup> This is more a theoretical scenario as it is difficult to envisage it in practice.

<sup>13</sup> Many times labelled as 'pre-arranged' trading.

<sup>14</sup> According to the Securities and Exchange Commission General Rules and Regulations, Securities Exchange Act of 1934 (§ 240.16a1 Definition of Terms (a)(2)): 'The term beneficial owner shall mean any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares a direct or indirect pecuniary interest in the equity securities, subject to the following: (...) (i) The term pecuniary interest in any class of equity securities shall mean the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities'.

Currently, taking into consideration the limited use of trustees in the arrangements for the sale or purchase of wholesale energy products, typically the same legal or natural person holds the 'beneficial interest' and the 'beneficial ownership'.

<sup>15</sup> 'Parent undertaking' means a parent undertaking within the meaning of Articles 1 and 2 of the Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts, OJ L 193, 18.7.1983, p. 1.

<sup>16</sup> 'Related undertaking' means either a subsidiary or other undertaking in which a participation is held, or an undertaking linked with another undertaking by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC.

- a legal or natural person and its controlled<sup>17</sup> subsidiary; or
- a legal or natural person and a subsidiary that is controlled<sup>18</sup> by the same parent; or
- different legal or natural persons that perform the transactions using accounts with common ownership<sup>19</sup>.

Wash trades can be executed in several different ways, using different PPATs<sup>20</sup> and involving one or more market participants. Also, these types of wash trades can occur between different bidding areas when there are implicit capacity allocation regimes in place. Below, three non-exhaustive examples are introduced to illustrate the most common types of wash trades executed in wholesale energy markets. A brief analysis of each situation is also included.

### Example 1: Wash trades A to A

**Situation:** A market participant submits an order to buy an intraday hourly product on the wholesale electricity market using a trading platform. This order is visible to third parties. At the same/similar time it submits an opposite order (sell order) for the same product, at the same or similar (matching) price and for the same or similar quantity, which leads to a transaction.

**Interpretation:** This type of behaviour is sometimes labelled as 'Wash trades A to A' and it refers to the practice of entering into arrangements for the sale or purchase of a wholesale energy product where there is no change in beneficial interest or market risk.

**Considerations:**

- These type of wash trades can occur between different bidding areas when there are implicit capacity allocation regimes in place, for example in electricity intraday markets in line with the Capacity Allocation and Congestion Management Regulation (i.e., Commission Regulation (EU) 2015/1222 - see OJ L 197, 25/7/2015).
- These types of wash trades can also occur with orders inserted through one single or two different PPATs (for example through the use of trading aggregators).

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<sup>17</sup> The concept of control should be understood here as defined in competition law by Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation).

<sup>18</sup> Ibid.

<sup>19</sup> For example, when two independent legal or natural persons jointly own an account and trade using this joint account.

<sup>20</sup> Some PPATs have arrangements in place that either eliminate the existence of wash trades or mitigate the risks of them sending false or misleading signals. In Section 4 of this document the Agency includes a recommendation on best practices to be used by PPATs.



## Example 2: Wash trades A to B to A

**Situation:** In agreement, two market participants enter respectively a buy and a sell order for a wholesale electricity product on a trading venue, at nearly the same time, for the same or similar amount and for the same or similar (matching) price. Then, after some time, the same parties enter at nearly the same time orders in the reverse direction that match at a price that may be the same or different from the first transaction.

**Interpretation:** This type of behaviour is sometimes labelled as 'Wash trades A to B to A' and refers to the practice of entering into arrangements for the sale or purchase of a wholesale energy product where the transfer of beneficial interest or market risk is only between parties (two or more) who are acting in concert or collusion.

**Considerations:**

- In these types of wash trades, the prices may be different between the two offsetting transactions involving the market participants.
- Also, more than two different market participants may be involved (i.e. 'B' can be interpreted as a chain of market participants).

## Example 3: Wash trades A to B + C to A

**Situation:** A market participant (A) contacts another market participant (B) with access to a certain organised market place ('OMP') to buy a specific amount of gas. A bilateral trade occurs between A and B where A buys from B and B introduces a buy order through the OMP to be able to meet its obligations arising from the bilateral contract signed with A. In parallel market participant (A) contacts a third market participant (C) with access to the same OMP to place a sell side order. A bilateral trade occurs between A and C where A sells to C and C introduces a sell order in the OMP to be able to meet its obligations arising from the bilateral contract signed with A. The buy and sell orders introduced match at least partially at the OMP.

**Interpretation:** 'Wash trades A to B + C to A' refers to the practice of entering into arrangements for the sale or purchase of a wholesale energy product where there is no change in beneficial interests, in a situation where one or more third parties or parties acting on their behalf are involved (not necessarily in a collusive way).

**Considerations:**

- This practice may occur, for example, as part of a tax fraud or money laundering scheme. As part of tax fraud, two market participants from the same group could use wash trades to sell a wholesale energy product from one country A to another country B VAT-free (exploiting the way VAT is treated in the case of multi-jurisdictional trading, where the movement of goods between jurisdictions is VAT-free) to then resell the energy product in country B including VAT. The company in country B in charge of paying the VAT would become inactive before doing so. This is a simplified example of tax fraud where a wash trade is used.
- These types of wash trades can also happen with orders inserted through one single or different PPATs (for example through the use of trading aggregators).

### 3 Assessment under Article 5 of REMIT

#### 3.1 Introduction

In this Section, the concept of wash trades is analysed against the definition of market manipulation and attempted market manipulation outlined in REMIT, so as to provide a general analytical framework for this type of behaviour.

Article 5 of REMIT provides that any engagement in, or attempt to engage in, market manipulation on wholesale energy markets shall be prohibited. In that respect, Article 2(2) and Article 2(3) of REMIT distinguish four different categories of market manipulation or attempts to manipulate the market through:

- a) false/misleading signals,
- b) price positioning,
- c) orders/transactions involving fictitious devices/deception, and
- d) dissemination of false or misleading information.

Depending on the specificity of each case, wash trades considered to be manipulative will typically fall into one or both of the first two categories outlined above because:

- a) they give or are likely to give false or misleading signals to the market as to the supply, demand or price, and therefore fall under the category of market manipulation, or attempted market manipulation, through **false/misleading signals** according to Article 2(2)(a)i and Article 2(3)(a)i of REMIT;
- b) they may secure or attempt to secure the **price** of a wholesale product at an artificial level, and therefore fall under the category of market manipulation through price positioning according to Article 2(2)(a)ii and Article 2(3)(a)ii of REMIT.

The next two sub-Sections further explain how wash trades, under certain circumstances, fulfil the general definition of market manipulation under REMIT.

#### 3.2 False or misleading signals

Article 2(2)(a)(i) and Article 2(3)(a)(i) of REMIT entail that transactions or orders that give, or are likely to give, false or misleading signals to the market as to the supply, demand or price of a wholesale energy product constitute market manipulation.

Wash trades are transactions that can give, or can be likely to give, false or misleading signals to the market as to the supply, demand or price of a wholesale energy product. Indeed, by giving other market participants a misleading representation of the liquidity, price, price volatility or by creating an expectation about potential changes in the available demand or supply, a wash trade can lead (or can be likely to lead) other market participants to act in a way they would not have considered in the absence of the wash trade.

Wash trades can create false or misleading signals regarding the **liquidity** of a given product. This false or misguided impression might then cause other market participants to take trading decisions based on misleading information. This practice also excludes other market participants from the opportunity of matching their orders, thereby reducing competition.

Wash trades can also create false or misleading market signals regarding the **price** of the product thereby misguiding market participants to make trading decisions based on misleading information. For this reason, wash trades are often instrumental in the execution of some other types of manipulative behaviour, as for example, 'marking the close' or 'pump and dump', among many others<sup>21</sup>.

Wash trades can have an effect on **price volatility** (in particular when they diverge from the prevailing market price) and generate uncertainty in the market about price levels. This may lead other market participants to engage in more conservative strategies (changing or delaying decisions) eventually reducing liquidity.

Wash trades representing unusual volumes are likely to be interpreted by market participants as reflecting **changes in market fundamentals** (for example, changes in unavailability of generation units or on forecasts) that are not widely known by all market participants. This can create mistrust in the market and lead (or could be likely to lead) other market participants to act in a way they would not have considered in the absence of the wash trade(s).

Moreover, wash trades, when perceived or suspected by other market participants, may create **mistrust** in the market integrity, leading investors to feel that the orders on the order book are not representative of the real market situation, thus negatively impacting liquidity.

The likelihood of sending false or misleading signals can be inferred in a variety of ways, for example, from the percentage of average daily/hourly volumes, the volume comparisons with previous days or other relevant periods, the average transaction size or the divergence from prevailing market prices.

The specific market circumstances under which wash trades are being executed are important to take into consideration. For example, carrying out a wash trade in an illiquid market can obviously increase the likelihood of the aforementioned adverse effects by creating an illusion of liquidity in a product, which should be deemed sufficient to trigger the likelihood of sending false or misleading signals.

An illustrative example is presented below, describing a wash trade that sends false or misleading signals about the liquidity of the market.

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<sup>21</sup> This Guidance Note will not cover these other types of behaviours. The listed behaviours, presented for illustrative purposes, can constitute market manipulation even if not materialised through wash trades and therefore are out of the scope of this Guidance. They may be covered by future Guidance Notes by the Agency.

#### Example 4: Wash trades sending false or misleading signals

**Situation:** Two market participants introduced orders for a wholesale electricity product at the same price and volume on opposite sides of the order book through an OMP. In the first transaction, market participant A sold 1,000 MW electricity to market participant B; after a few minutes, market participant B sold to market participant A the same volume at the same price. After all the transactions were concluded there was no change in the beneficial interest.

**Interpretation:** These transactions gave the impression to the market that liquidity at that price level was higher than genuine trades would have justified. Other market participants adjusted their behaviour by, for example, introducing new orders closer to the price levels of the wash trades, cancelling or changing existing orders. Some market participants were misled by the market signals and were led to believe that, for instance, some new generation capacity was back online without a proper disclosure.

One important element to keep in mind when assessing whether a wash trade meets the definition in Article 2(2)(a)(i) of REMIT is that it is sufficient that a false or misleading signal as to the supply of, or demand for, or the price of a wholesale energy product is likely to be given. The likelihood that a certain behaviour would give false or misleading signals to the market has to be evaluated *ex-post*, taking into consideration the circumstances existing at the time when the suspicious transaction occurred.

Furthermore, it is to be noted that the definition of market manipulation in Article 2(2)(a)(i) of REMIT does not require the examination of the intent or the state of mind of the market participant(s) when executing the wash trade. It is therefore - under this Article - not necessary to show that the market participant(s) knew that it was infringing REMIT. The intent to manipulate the market will only have to be demonstrated to qualify a wash trade as attempted market manipulation, i.e. entering into transactions with the intention of giving false or misleading signals as defined in Article 2(3)(a)(i) of REMIT.

### 3.3 Price positioning

Article 2(2)(a)(ii) and Article 2(3)(a)(ii) of REMIT entail that either an artificial price level is actually secured (in that sense, the artificial price level must be secured by the market manipulation) or there is an attempt to secure the price at an artificial level (in that case, no actual effect on the price is required to conclude the potential REMIT breach).

Artificiality entails that the price should deviate from the price level absent any manipulation (i.e. the counterfactual price) irrespective of the size of the deviation. In other words, it is not necessary to examine whether a price is abnormally high or low to qualify it as artificial. In the event prices are at an artificial level, the market participant's conduct and its potential impacts on the market should be further assessed (existence of legitimate reasons, compliance with accepted market practices).

The price at which a wash trade is executed is therefore an important element when assessing such behaviour against the market manipulation prohibition in REMIT. A price will be considered

artificial if it does not correspond to the genuine intersection of demand and supply reflecting market fundamentals.

Various factors can be considered when assessing the achievement of securing the price of a wholesale energy product at an artificial level through a wash trade. For instance, if the price of the wash trade was outside the bid-ask spread preceding the transaction it should be considered that this trade secured the market price at an artificial level. Nevertheless, even wash trades executed at prices within the bid-ask spread could be considered a market manipulation.

The specific market circumstances under which wash trades are being executed are important to take into consideration. In illiquid market situations, a few wash trades are more likely to secure a price. Indeed, it could be envisaged – given a low liquidity situation – that a single order could secure the price. Similarly, a wash trade could secure a closing price, especially if it was performed at the end of a trading day.

An illustrative example describing a wash trade that positions the market price at an artificial level is presented below.

#### **Example 5: Wash trades positioning the price**

**Situation:** On the closing day for the contract, market participant A is placing multiple buy orders at 19.65 EUR/MWh for the next four months contract for physical delivery through the transfer of rights in respect of natural gas at the Title Transfer Facility (TTF) Virtual Trading Point and matching sell orders at 19.60 EUR/MWh under the price of the last transactions (20 EUR/MWh) at an organised market place.

**Interpretation:** These trades are likely to put a downward pressure on prices and may influence other market participants to adjust their orders to the new price levels. There may also be transactions executed at the same price levels. Another possibility is that these orders were considered for the calculation of indexes or by price reporting agencies in their price assessments and indirectly affected a multitude of contracts indexed to these price references.

**Considerations:** Market participant A may have benefited from marking the closing price through other positions that it may hold indexed to it.

#### **4 Indicators for identifying suspicious wash trades**

The following non-exhaustive list of indicators shall be taken into account when analysing trading behaviour in order to identify wash trades which were possibly arranged to manipulate the market:

- unusual concentration of transactions and/or orders to trade, whether generally, or by only one person using one or different accounts, or by a limited number of persons;
- unusual repetition of transactions by only one person (using one or different accounts), or by a limited number of persons over a certain period of time;
- unusual concentration of transactions taking place while settlement prices or indicators are determined;
- transactions or orders to trade which modify, or are likely to modify, the valuation of a position while not decreasing/increasing the size of the position;
- the matching timing between the transactions or orders to trade that is generally instantaneous or short; or
- sudden change of the price or volume level traded in the product.

These indicators – among others – may be used to identify suspicious wash trades by the Agency, PPATs as well as by the NRAs that actively monitor their markets.

#### **5 Best practices in PPAT's market conduct rules**

It is critical for all stakeholders, including market participants and in particular PPATs, to obtain a clear understanding of the notion of wash trades and to adopt a consistent approach towards them. In this respect, Article 15 of REMIT puts an explicit responsibility on PPATs to monitor trading and contribute to the integrity, transparency and proper functioning of the European wholesale energy markets.

Not all arrangements for the sale or purchase of a wholesale energy product, where one or more of the following conditions (hereinafter: “Conditions”) have been met - i.e. there is no change in beneficial interests, or market risk, or where the beneficial interest, or market risk is transferred between parties who are acting in concert or collusion - are market manipulation under REMIT. This is why any mitigation measure on arrangements for the sale or purchase of a wholesale energy product, that meets one of the Conditions, should focus on the elimination of the potential misleading signals or artificial price impact, without inhibiting the actual trades to take place.

Providing the market with information about arrangements for the sale or purchase of a wholesale energy product that meet one or more Conditions can have the effect of discouraging manipulative or fraudulent behaviour, but also dispelling some potential false or misleading signals. On the other hand, mitigation through increased transparency is not likely to prevent any genuine trade or redirect any trade from PPATs to off-market venues.

In this respect, this Guidance Note recognises two measures that are considered best practices to be considered in PPATs' market conduct rules<sup>22</sup> to mitigate some of the potential manipulative effects related to the Conditions:

1. **Pre-notification** – Consists of a notification issued by the Market Participant to the market (for example through an Urgent Market Message – UMM) prior to entering the orders into the trading system. The notification may appear on a message board available to all exchange members and detailing the product, the size and price of the transaction and the estimated timing of the trade<sup>23</sup>.
2. **Flagging transactions as wash trades** – market participants can themselves mark these trades, through the PPAT system, in such a way that these transactions would be indicated on the screen of other market participants. This allows the market participants to inform the market when executing in the trading system arrangements for the sale or purchase of a wholesale energy product that meet one or more Conditions, keeping however the anonymity of the market participant behind the trades.

The pre-notification or the flagging of trades can certainly reduce the potential to mislead the market but further complementary measures are necessary to mitigate that risk. This note therefore recognises that these best practices need to be complemented by the following additional measures:

1. **Price tunnel** – The system should only allow the introduction of orders related to arrangements for the sale or purchase of a wholesale energy product that meet one of the Conditions, when the price of the orders is within the prevalent bid-ask spread of the market<sup>24</sup>.
2. **Correction** – Excluding these trades from the calculation of indexes has the potential to remove misleading signals created by the volume of wash trades that is not reflective of market fundamentals. It is to be emphasised that any corrective action must adhere to a strict and transparent methodology.

The combination of either a pre-notification system or a transaction flagging system complemented by the two measures presented above should reduce the incentives for market participants to engage in manipulative arrangements for the sale or purchase of a wholesale energy product that meet one of the Conditions.

For **unintentional trades** that are potentially harmful to the integrity and transparency of wholesale energy markets, the Agency considers **double confirmation** as a best practice. This

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<sup>22</sup> Several PPATs developed the so called 'cross request' functionalities in their platforms (allowing for 'cross trades') that enable, under very specific regimes, arrangements for the sale or purchase of a wholesale energy product, where there is no change in beneficial interests or market risk or where the beneficial interest or market risk is transferred between parties who are acting in concert or collusion. As these transactions refer to equivalent behaviour from a substantive point of view from the one encompassed by wash trades, they will have to be assessed *mutatis mutandis* against the definitions provided in Article 2(2) and 2(3) of REMIT, using the exact same criteria.

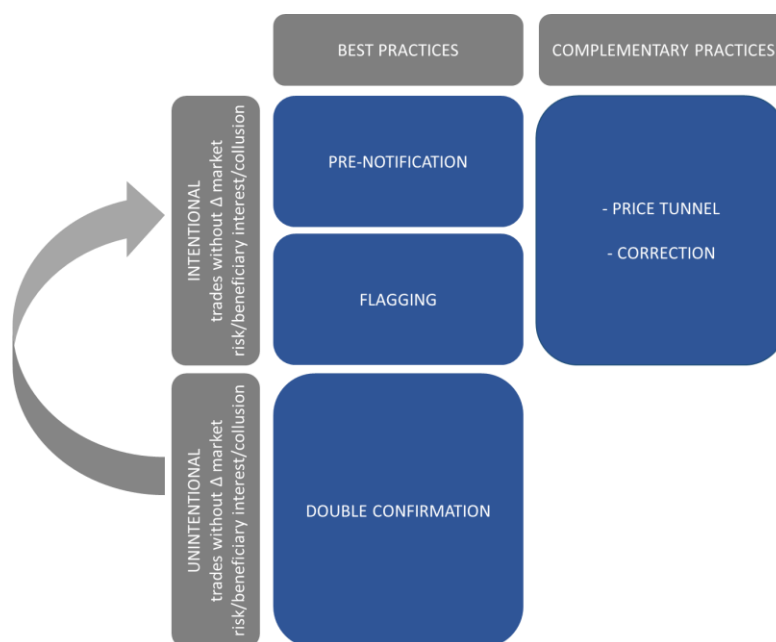
<sup>23</sup> Such practices are not yet employed by PPATs in the wholesale energy markets to mitigate wash trades (although some PPATs already require a notification to the market surveillance team) but are used in equivalent situations in other markets (for example on equity markets the disclosure of management transactions and open market repurchases promote the provision of information to investors, and contributes to the prevention and prosecution of market abuse).

<sup>24</sup> For products where the bid-ask spread is a relevant percentage of the price of the product, the price tunnel should use as reference the price level of previous transactions instead of the bid-ask spread.

solution provides an automatic control built into the trading system to prevent wash trades of the A to A type. Under such a regime, where orders – introduced with the same trader ID or different trader IDs but representing the same beneficiary interest – are accidentally matched, an automated message in the trading system alerts the market participant. A confirmation is then required from both sides of the trade before the order is executed. In this way the unintentional trade becomes intentional, hence it has to comply with procedures developed for intentional arrangements for the sale or purchase of a wholesale energy product that meet one of the Conditions.

Figure 2 below summarises the best practices that the Agency recommends NRAs advocate to be implemented by the PPATs in their jurisdiction:

**Figure 2: Best practices by PPATs regarding trades where there is no change in beneficial interests or market risk or where the beneficial interest or market risk is transferred between parties who are acting in concert or collusion**



In conclusion, PPATs should implement rules and procedures so as to mitigate the occurrence of wash trades that may be deemed as market manipulation under REMIT. The use of their own IT systems to create these procedures seems critical. The combination of either a pre-notification system or a transaction flagging system with the price tunnel and the correction measures outlined above is likely to reduce the likelihood of market manipulation using wash trades.

Lastly, it is to be emphasised that the above measures only offer ex-ante mitigation and not a guarantee that manipulative wash trades will never happen. Even if the recommended mitigation measures are implemented and followed, and depending on the specific circumstances of a case, a wash trade could still be considered manipulative. This assessment will be performed ex-post on a case-by-case basis.



## 6 Conclusion

This Agency's Guidance Note aims to establish a common understanding of the concept of wash trades in order to promote the integrity, transparency and proper functioning of the European wholesale energy markets with a view to ensuring that NRAs apply REMIT in a consistent way. Furthermore, the aim of this Guidance Note is to promote best practices among PPATs in order to avoid manipulative wash trades and to mitigate the potential manipulative effects on the market deriving from wash trade practices, while not undermining the liquidity of the markets.

The first insight of this Guidance Note is that three main elements need to be assessed in order to categorise some trading arrangements as wash trades: the absence of change in the beneficial interest, the absence of change in market risk of the involved parties, and the involvement of multiple colluding entities. Each one of these elements is by itself sufficient to categorise the trading arrangement as a wash trade.

Depending on the specificity of each case, wash trades will be considered manipulative if they (i) give or are likely to give false or misleading signals to the market as to the supply, demand or price of a wholesale energy product, and therefore fall under the category of market manipulation, or attempt to manipulate the market, through **false/misleading signals** according to Article 2(2)(a)i and Article 2(3)(a)i of REMIT; or (ii) secure or attempt to secure the price of a wholesale product at an artificial level, and therefore fall under the category of market manipulation through **price positioning** according to Article 2(2)(a)ii and Article 2(3)(a)ii of REMIT.

The second insight is that for a wash trade to be considered (attempted- in case of intent) market manipulation under Article 5 of REMIT, the existence of one of the following three elements is a sufficient condition: intent to send false/misleading signals and/or secure the price; likelihood to send false/misleading signals; actual sending of false/misleading signals and/or price securing at artificial levels. Proving the existence of only one of these elements is enough, even though more than one of these elements may be present in the same behaviour.

Finally, this Guidance Note advocates recommendations towards the NRAs, aimed at facilitating the consistent fulfilment of the obligation of PPATs under Article 15 of REMIT, via a common understanding and approach to wash trades. It presents measures providing increased transparency that can limit the occurrence of potentially manipulative wash trades. PPATs are recommended to implement rules and procedures so as to mitigate the occurrence of wash trades that may be deemed as market manipulation under REMIT. The combination of either a pre-notification system or a transaction flagging system with a price tunnel and the correction measures outlined are likely to reduce the likelihood of market manipulation using wash trades. These measures only offer ex-ante mitigation thought, and do not guarantee that manipulative wash trades will not happen.