

IMPLEMENTATION OF REMIT IN THE ENERGY COMMUNITY

– Concept and Assessment of the impact–

Regulation (EU) No 1227/2011 and Commission Implementing Regulation (EU) No 1348/2014

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1. OBJECTIVE

The present document proposes a concept for implementation of Regulation (EU) No 1227/2011 ('REMIT Regulation') and Commission Implementing Regulation (EU) No 1348/2014 ('Implementing Regulation'; together: 'the REMIT framework') in the Contracting Parties analyzes the rationale behind, arguments in favor and discusses the impact on affected stakeholders and bodies.

The ultimate objective in implementing REMIT framework in the Contracting Parties is to achieve trust in the functioning of wholesale electricity and gas markets.

2. INTRODUCTION

A fully competitive and integrated energy market is the best mean to deliver competitive prices for end-consumers and deliver signals for investments in the Energy Community. In line with European energy policy the Energy Community *acquis communautaire* ('*acquis*') aims to give consumers access to competitive, secure and sustainable energy supplies. The creation of a true internal market in energy is crucial to each of these elements. Integrated markets bring competitive pressure to a sector which has historically been characterized by national markets dominated by incumbents. Integrated markets allow consumers to benefit from a wider choice of diverse energy resources. In addition, harmonized cross-border market operation together with efficiently operated networks will give the depth needed to allow the integration of new renewable energy sources at the lowest cost.

Experience from liberalization and integration of energy markets in Europe, and electricity markets in particular, has demonstrated the importance of integrated liquid wholesale markets. The development of power exchanges (or other organized markets) and markets in standardized over-the-counter (OTC) contracts has created liquidity for market participants. Beyond generators and suppliers, wholesale energy markets must attract a wide range of actors including utilities, large energy users, traders, financial institutions and other trade facilitators. These players have an important role in the price formation process, boosting liquidity and offering risk-taking services. The aim of the Energy Community is to set the right legal framework to enable Contracting Parties to follow the path and beneficial outcome gained on European level through significant sector reforms.

Prices established at the level of wholesale markets not only affect market participants, they also serve as the benchmark for retail prices for household consumers and industrial users. Equally important, by showing where and when the energy prices are high or low these markets send important signals for future investments in energy infrastructure. For this reason, it is crucial that citizens, business and national authorities have **confidence in such signals and therefore in the integrity of markets**. In a market that is continuously evolving, the integrity can be put into question in case market participants engage in abusive practices and market misconduct. Unless effectively addressed, such practices undermine public trust, deter investment, increase volatility of energy prices and may lead to unfair energy prices in general and less or no appetite for investments.

2.1. EU market integrity framework

Recognizing the importance of a competitive market and the need to ensure market integrity, the EU acquis includes rules that prohibit market abuse and require close and ongoing surveillance of gas and electricity markets. The market integrity¹ framework for energy markets in EU is composed of:

- Regulation (EU) No 1227/2011 ('REMIT')
- Implementing Regulation (EU) No 12348/2014 ('REMIT IR')
- The Guidance, Q&A, FAQ, etc. issued by the Agency for the Cooperation of Energy Regulators (ACER)

The impact assessment provided by the European Commission on REMIT implementation ('the impact assessment') specifically pointed out the shortcoming of the 3rd IEM Package in defining specific conduct rules for wholesale energy trading. It further highlighted the high and strong price correlation between interrelated commodities, especially between electricity and gas, in both spot and forward trading products, and products with delivery across different zones/hubs. Such correlation is even stronger between coupled market as energy bids and offers in one market affect the prices in each of its neighbours. These bids and offers are not easily visible to those charged with market oversight on national basis. Even where information can be exchanged between countries, the process is cumbersome and does not lend itself to early and efficient identification of suspicious trading patterns. In this context, the impact assessment identified lack of adequate rules governing the EU energy markets to ensure their stable and orderly functioning. The absence of the harmonized data reporting regime for the entirety of markets, hinders the ability for cross-border, cross-commodity and cross-market misconducts to be effectively detected. This view was also shared by the European Federation of Energy Traders (EFET).²

3. RATIONALE FOR IMPLEMENTATION OF REMIT IN THE CONTRACTING PARTIES

In this assessment, no alternative market integrity framework is analyzed. Having said this, the feasibility of the REMIT framework to ensure market integrity is not questioned. Thus, the questions to be addressed are more around the timeline and right time for implementation. Is now the right time to start introducing REMIT? Have the markets in the Contracting Parties sufficiently evolved to signal the need for market abuse regime? What is the roadmap of the Contracting Parties in terms of integration into internal European market, market

¹ A step-wise implementation approach was applied on EU level: on 28 December 2011 the prohibitions under REMIT of insider trading, market manipulation, the obligation for market participants to publish inside information and the requirement for persons professionally arranging transactions (PPATs) to establish and maintain effective arrangements to detect market abuse and to notify suspicious cases to NRAs, came into force in the EU. Reporting obligation became effective later on 7 October 2015 for contracts executed via organized markets and 7 April 2016 for contracts executed bilaterally after the entry into force of Implementing Regulation (REMIT IR) on 7 January 2015.

²EFET, response to public consultation by the Directorate General for Energy on measures to ensure transparency and integrity of wholesale markets: "Based on the above-mentioned regulatory gaps and shortcomings - a sub-optimal oversight of energy wholesale markets exists, which hinders further market development. The current regulatory situation does not, in particular, take into account the factual situation that energy wholesale markets are increasingly characterized by a wide range of actors (including utilities, pure traders, financial institutions and other wholesale trading market participants and platforms), cross-border trade, important derivatives markets around markets in the underlying energy products and increasing liquidity in energy wholesale trading activities. Various different national regimes and authorities do not fit in with such an EU-wide wholesale trading market." Similarly also other responses to the public consultation showed widespread agreement for an EU-level transparency and market integrity regime.

coupling, etc.? What are the similarities and correlations of the Contracting Parties with the EU Member States? These are the main assessment areas of this document.

3.1. Policy Target

Effective markets are served by **competition and transparency**. Prices set in the market should reflect the fair interplay of supply and demand conditions. Access to fundamental information, and in particular to information regarding the use of generation, transmission and consumption of energy is key to market participants. The price can only be fair if all market participants have non-discriminatory access to such information.

On the other hand, it is very important that prices established on the wholesale markets serve as the benchmark for retail prices for household consumers and industrial users in order to ensure demand responsiveness. The energy sustainability agenda in the EU and also in the Energy Community continues to attract investments on electricity production using renewable sources. Short-term demand elasticity is considered cornerstone of this agenda, therefore new types of activity are emerging. With such evolution of the market and liquidity boosting, the wholesale market signals are becoming key also for even very short-term operational decision, both on demand and supply side.

The complexity in understanding the price formation results with the new kind of risks. The **risk of abusive behavior** by certain market participant(s) would drive the prices to a level where they would normally not be if the access to fundamental information was open to all and fair competitive behavior prevailed. The incentive for abusive behavior is the financial gain, however in a liquid market where many products of different types and timeframes are traded, detecting such behavior becomes very difficult. With an increased potential of abusive behavior the market lacks the confidence. This may result in reluctance to trade and reluctance to take position (risk) in the market. In the absence of risk takers -and certain market participants are risk takers because they specialize in managing and mitigating certain risks- there are less opportunities for market participants, not specialized to manage market risk, to offset those risks, creating therefore a vicious circle.

For a competitive market to function properly **an adequate market integrity framework is needed**. Such framework should detect, prevent where possible and sanction market abuse. Ultimately, the aim is to protect consumers and ensure sound operation of the wholesale market.

The general energy market evolution in the Contracting Parties is mimicking the market evolution in the EU Member States. The markets in the Contracting Parties are less developed and less liquid than markets of the Member States, but the path towards the European target model is clear and embedded in the Contracting Parties strategies and legal framework. The volume of cross-border trading is increasing significantly between the Contracting Parties and between the Contracting Parties and Member States. Energy markets in general are experiencing significant reforms and changes. Wholesale prices of electricity and gas are set based on supply and demand in several countries or regions. If prices go up in one country, market participants would buy electricity in another and export it to a higher-priced area. This is supported by the high correlation between prices of neighboring countries and coordinated cross-border capacity allocation processes. With the increasing level of liquidity and market depth, the number of contracts and different products increases. While

this brings efficiency in the market it brings also a greater potential for market abuse and therefore less confidence in the market.

The 3rd IEM Package defines obligations for Contracting Parties to provide for competitive and non-discriminatory market arrangements, **but does not set out standards to ensure the integrity of such markets**. In the EU this gap is filled with introduction of REMIT framework. It is crucial for the well-functioning of the pan-Energy Community market that this gap is filled in the Contracting Parties as soon as possible to avoid any loopholes which create potential for market abuse both in EU Member States and Contracting Parties due to well interconnected markets. The arguments hereinafter identify the need to implement REMIT in the Contracting Parties.

3.2. Arguments

3.2.1. Importance of harmonized regime to avoid any loopholes

Member States and Contracting Parties are very well interconnected and trading activity between them is increasing with significant pace, in particular electricity trading between Member States and Contracting Parties of Southeast Europe and gas trading between Member States and Ukraine, increasing therefore the level of correlation between the prices. This increasing level of correlation means that activity of a market participant in one market may significantly affect the neighboring markets creating possibilities for cross-border market abuses without having the need to conclude a single transaction between two countries. An abusive activity (under REMIT) in a Contracting Party may have significant impact in the Member States surrounding such Contracting Party. Furthermore, an information which is considered an inside information under REMIT is not considered as such in the Contracting Parties although the very same information may be considered as inside under existing regime in the EU due to its impact in the prices of wholesale energy products.

3.2.2. Importance of market integrity and transparency

Notwithstanding progress made in transposing the 3rd IEM Package, electricity markets in the Contracting Parties are still characterized with the lack of transparency and subsequently lack of confidence. It is already a practice that vertically integrated companies coordinate and share information on the availability or unavailability of the generation or consumption assets before such information is published. In the absence of level playing field and clear definition of what constitutes market abuse, market participants may engage in activity which according to REMIT is prohibited. Market participants in Contracting Parties are allowed to trade on an information which in EU would be considered an inside information. Market participants can also negotiate and pre-agree before they put the offers on screen and execute them. There are also other activities which are not explicitly defined as market abuse, which in turn result with market uncertainty and distorted signals for trading and investments.

Unbundling of national incumbents in the Contracting Parties, together with de-regulation of wholesale and retail prices and other measures, starts having a positive impact on trading activity in the Southeast European region. Furthermore, the Secretariat has started working with Contracting Parties for necessary adaptation and implementation of 3rd IEM package related electricity and gas network codes and guidelines in the Energy

Community. Together with this the commitment³ of Contracting Parties to establish day-ahead markets and subsequently market coupling as well as regional balancing mechanism has set a clear target for regional market integration between Contracting Parties and with Member States. As we move towards open and competitive energy markets in the Energy Community it is of crucial importance that in parallel we work on market integrity regime to ensure that the national regulatory authority of Contracting Parties are equipped with necessary powers to detect and take measures against any abusive behavior in the market. This is important for boosting the confidence in the energy markets of the Energy Community.

3.2.3. ACER's involvement: less costs and better monitoring

Considering the interconnected nature of energy markets and pace with which the Contracting Parties are moving towards EU target model it is clear that a regime which guarantees market integrity is implemented in the Energy Community as soon as possible and as early as possible while the Contracting Parties are already going through significant market reforms. It would be costly and non-efficient from the monitoring point of view if a separate regime is put in place for Contracting Parties. In this context, ACER's role is crucial. The role of ACER in collecting market data and monitoring should remain the same for Contracting Parties as it currently is for Member States under REMIT. This would, not only make the process more efficient for Contracting Parties, but would ensure better and a more effective monitoring regime is implemented for EU as well, in particular for the markets where behavior in CPs may significantly affect trading activity and prices in the surrounding Member States.

3.2.4. An appropriate regime and the ADEQUATE timeline for REMIT implementation

The key conclusion is the fact that electricity and gas markets lack a framework that ensures sound operation of the market. In the short run, based on the existing level of trading activity in the Contracting Parties, and also looking at these markets in isolation from the EU markets, the natural conclusion is that an alternative, potentially lighter, market integrity regime is more appropriate. This indeed would have been a rationale choice but only in short term. In longer run, the REMIT implementation should be looked and assessed in conjunction with other EU energy policies that are transposed and implemented in the Contracting Parties, such as the 3rd IEM Package, or those that will be transposed, such as network codes and guidelines. Whilst the need and importance of harmonized regime is not questioned, the timing for introduction of such regime, i.e. REMIT framework, should also be considered and decided as soon as possible. Having a policing regime in place as the market evolves would help not only market participants to gain confidence in the market but also national regulators to understand the market and be able to advance their monitoring role as the market evolves. In few years, it is expected that most of Contracting Parties markets' will be coupled and the cultural change which REMIT brings is important for market participants and national regulators sooner rather than later.

³ Under the Berlin Process the six Contracting Parties of Western Balkans (WB6) committed to implement the so-called 'soft measures' https://www.energy-community.org/portal/page/portal/ENC_HOME/AREAS_OF_WORK/WB6

4. PROPOSED CONCEPT FOR IMPLEMENTATION IN THE CONTRACTING PARTIES

4.1. Step-wise implementation

Following the EU example, a step-wise approach is suggested for implementation of REMIT.

4.1.1. STEP 1: implementation of market transparency and integrity measures

STEP 1 deploys REMIT regime in the Contracting Parties for implementation of market transparency and integrity measures, namely:

- Prohibition of insider trading
- Requirement for publication of inside information
- Prohibition of market manipulation

This step includes also the requirement to ensure that the national regulatory authorities are equipped with necessary powers to detect and take measures against abusive behavior

The following are the Articles of REMIT should become effective under this step:

- **Articles 1-5** (scope, definitions, prohibition of market abuse)
- **Articles 13-15** (enforcements powers for regulators, right to appeal and obligations for PPATs)
- **Article 16-18** (cooperation, professional secrecy, penalty regime)

4.1.2. STEP 2: registration

This is an intermediate step before the requirement for trade data and fundamental data reporting kicks in as per STEP 3 below. Market participants engaged in reportable products or are owners of fundamental information should register with national regulatory authority. National regulatory authorities should use ACER's registration platform for registration of market participants to ensure consistency.

Articles 9 (registration of market participants) of REMIT becomes effective under this step.

4.1.3. STEP 3: reporting and monitoring

This step includes the requirement for trade data and fundamental data reporting as well as market monitoring regime.

The following are the Articles of REMIT become effective under this step:

- **Articles 7-8** (market monitoring, data reporting)
- **Articles 10-12** (information sharing, data protection, operational reliability)

In the same transposition deadline with the Articles from this step, also **REMIT IR should become effective** (adapted for Contracting Parties). This link acknowledges the need to provide for comprehensive reporting and monitoring, including the coverage of related human and financial resources, only once a relevant level of market liquidity and activities are in place. The Secretariat proposes adoption of REMIT Regulation and

Implementing Regulation in a package while granting longer and linked transposition deadlines for different requirements, in particular those with IT and operationally heavy burden.⁴

An alternative approach for STEP 3 is to have bilaterally traded contracts reported at a later stage, for example one year after reporting requirement for standard contracts executed via Organized Market Places become effective.

4.2. Competences of ACER, ENTSO-E and ENTSG

To ensure full and harmonized implementation of REMIT in the Contracting Parties, the competences of ACER, ENTSO for Electricity and ENTSO for Gas for EU Member States pursuant to Regulation (EU) 1227/2011 should be extended to the Contracting Parties.

The Secretariat understands that in order to assume such competences it is required to put an agreement in place with ACER in line with Article 19 of REMIT. This would ensure full and harmonized implementation of REMIT in the Energy Community, ensuring therefore ACER's data collecting and monitoring regime.

It is the view of the Secretariat that with regards to ENTSO for Electricity and ENTSO for Gas, assuming such competences for Contracting Parties, would not require significant changes to the existing processes. This is considering the fact that Contracting Parties anyway are already obliged to submit the fundamental data to ENTSO for Electricity and ENTSO for Gas under 3rd IEM Package and electricity transparency Regulation (EU) No 543/2013.

4.3. Key content adaptations of REMIT and REMIT IR for Contracting Parties

The Secretariat proposes implementation of REMIT framework in its entirety, with the below listed caveats.

4.3.1. Standard adaptations

Standard adaptations are as a general rule used for implementation of EU acts in the Energy Community acquis such as replacement of the terms 'European Union' by 'Energy Community', 'Member State' by 'Contracting Party', 'European Commission' by 'Energy Community Secretariat'.

4.3.2. Other ('ad hoc') adaptations

- The key content change is the omission of derivatives from the scope of REMIT for Contracting Parties.
⁵Cooperation and data sharing with ESMA and national competent authority is removed in line with omission of derivatives.
- Extension of ACER, ENTSO-E and ENTSG competences to the Contracting Parties.

⁴ The alternative would be, first, putting REMIT for approval only defining a transposition deadline for STEP 1 and 2, while linking implementation of STEP 3 to the approval of the REMIT Implementing Regulation at a later stage. The Secretariat considers this option less predictable for stakeholders and market participants. It also creates administrative burden to reinitiate the process for approval of second part of REMIT framework at a later stage.

⁵ In the EU, derivatives are outside the scope of REMIT because they are covered in the of financial regulation framework.

- Articles 6 and 20 of REMIT that empowers European Commission to adopt delegated and implementing acts are replaced by the commitment to apply the delegated or implementing acts adopted by the European Commission.
- Duties of ENTSO-E/G and the ACER under the EU version of REMIT are not duplicated to the extent not directly linking to Contracting Parties' stakeholders.
- Article 19 (International relations) and Article 21 (Committee procedure) of REMIT are not applicable for CPs therefore has been deleted from the adapted text.

4.3.3. Implementation deadlines

The Secretariat suggests the following transposition and implementation deadlines⁶ for all Contracting Parties

- Transposition: 6 months after the decision of the Ministerial Council
- Implementation of STEP 1: 6 months after the decision of the Ministerial Council
- Implementation of STEP 2: 18 months after the decision of the Ministerial Council
- Implementation of STEP 3: 48 months after the decision of the Ministerial Council

4.4. Procedures

Incorporating REMIT and REMIT IR in the Contracting Parties requires adoption by the Ministerial Council.

5. ASSESSMENT OF THE IMPACT ON STAKEHOLDERS

5.1. Market characteristics

In terms of number of market participants qualifying for REMIT registration within a Contracting Party and the number of contracts expected on yearly basis there are two groups:

- Group I – 7 Contracting Parties⁷: 20-50 market participants; 50-350 contracts on annual basis
- Group II – 2 Contracting Parties⁸: 50-300 market participants; 350-1000 contracts on annual basis

Figures above do not include transmission contracts, nevertheless the expectation is that by the time of reporting obligation, all such contracts should be reported via SEE CAO (which is already a RRM). Gas transmission capacity will need to be reported by TSOs using available RRM. It is rather difficult to distinct brokered contracts from bilaterally traded contracts from the figures above. The Secretariat however estimates that such number is relatively small on average and would be mainly executed via phone (rather than screen).

Currently only Serbia has day-ahead PX (EPEX platform with ECC clearing). Establishment of more day-ahead PXs can be expected in the next couple of years, increasing therefore the number of contracts to be reported. These would be already standard OMP contracts.

⁶ Dates may be adjusted, subject to further discussions with Contracting Parties, ACER and EC.

⁷ Albania, Bosnia and Herzegovina, FYR of Macedonia, Kosovo*, Montenegro, Moldova and Georgia.

⁸ Serbia, Ukraine.

The assumption is that fundamental data for electricity would be reported by the ENTSO-E. For gas, market participants should use available RRM or become RRM where applicable.

Gas markets are generally underdeveloped and in three Contracting Parties there is no gas network/market at all⁹. Only the Ukrainian and, to some extent, Serbia gas market is significant.

5.2. Impact on stakeholder

Based on the proposed REMIT implementation concept the following stakeholder are impacted and the following measures need to be undertaken by them:

5.2.1. ACER

ACER's targeted role in implementation of REMIT in the Contracting Parties is described above. This is subject to a fundamental and crucial matter, namely ACER's requirement for additional resources to fulfill such role. Such resources need to be confirmed by the European Commission.

The related budgetary impact can be assumed as follows [.....].

5.2.2. Contracting Parties

Once REMIT is adopted by the Ministerial Council of the Energy Community, the Contracting Parties will have to ensure that it is adequately transposed into national legislation and implemented. This is considered a standard procedure as the case for all *acquis*.

In addition, Contracting Parties should ensure that national regulatory authorities are equipped with power to exercise their responsibilities under REMIT, including an effective penalty and investigation regime. The related requirements do not significantly go beyond the requirements of the 3rd IEM package and are thus to a prevailing extent already represented in the Contracting Parties' national legislation.

5.2.3. National Regulatory Authorities

In line with REMIT, the national regulatory authorities of the Contracting Parties will have to be equipped with powers and recourses to exercise their duty under REMIT as listed, but not limited to:

- Registration of market participants – national regulators should utilize ACER's guidance and also, if offered and applicable, to use ACER's platform for registration. This may be offered for free to NRAs.
- Data security – in order to exchanging the data with ACER and receive from ACER the reported data, national regulators should ensure that they have all the cyber protection necessary to fulfill the requirement for data and information protection.
- Set-up a monitoring department if no such department is already functional with national regulators. The size of monitoring department should be proportional to the respective market activity, but in any case it is assumed that the national regulators will need additional staff (1-2 per regulator).

⁹ Albania, Kosovo* and Montenegro.

- Surveillance systems should be in place only in case market is big enough, liquid and the regulators need to keep an eye on it as the potential for market abuse and the impact increases. In any case surveillance system, (if any) should be proportional to the size of the traded market. Given the characteristics at this stage the surveillance from ACER on cross-border level should be sufficient, so national regulators could receive the data, understand the information but would only put a surveillance platform in place once that is really needed. In terms of surveillance it is important to note the responsibility of the persons professionally arranging transactions (PPAT). Such entities, because they have an intermediary role in the market, should have in place surveillance system proportional to trading activity going through the market they operate.

The national regulators have stressed the need for additional resources and this is something that needs to be well understood by the Contracting Parties upon transposing REMIT into national legislation.

5.2.4. Organized market places (Day-ahead market operators-PXs, brokers)

Intermediaries such as day-ahead market operators (known as Power Exchanges - PXs) are considered organized market places (OMPs) and PPATs under REMIT. As OMPs they have the obligation to report the data on behalf of market participants should market participants request so. In their role as PPATs they should ensure that they have in place surveillance systems and report any suspicious activity.

5.2.5. Market participants

Market participants should ensure prohibitions under REMIT are understood and necessary controls and processes are in place to manage the risk of market abuse. They need to put in place systems for reporting contracts when traded bilaterally and request OMPs to report on their behalf when traded via OMPs

Most of the companies that are active in the SEE region, are either foreign companies or subsidiary of an EU Member State which are familiar with REMIT framework therefore the main implementation issue would be with national incumbents.

European Commission on its impact assessment has assumed the overall costs on market participants and ACER. Without diminishing the potential impact on ACER, the costs related to extending REMIT framework in the Contracting Parties should be minimal given the characteristics of the region and that the framework, system and guidance is already in place.