

DRAFT IMPACT ASSESSMENT FOR THE IMPLEMENTATION OF

Regulation (EU) No 1227/2011 (REMIT) and Commission Implementing Regulation (EU) No 12348/2014 (REMIT IR) in the Contracting Parties of the Energy Community

I. INTRODUCTION

A fully competitive and integrated energy market is the best means to deliver competitive prices for end-consumers and deliver signals for investments in the Energy Community. European energy policy partly adopted and partly in the process of being adopted also in the Contracting Parties (CPs) of the Energy Community (EnC) 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 strong and efficiently operated networks will give the depth needed to allow the integration of new renewable energy sources at the lowest cost.

Experience of the liberalization and integration of energy markets in Europe, and electricity markets in particular, has demonstrated the importance of liquid European wholesale markets. The development of power exchanges (or other organized markets) and broker facilitated markets in standardized over-the-counter (OTC) contracts has created liquidity for market participants. Beyond generators and suppliers, wholesale energy markets now attract a wide range of actors including utilities, large energy users, pure traders, financial institutions and other trade facilitators. These players have an important role in the price formation process, creating liquidity and offering risk-taking services. This is a positive and beneficial outcome of over a decade of successive European energy liberalization packages. This is the path and the target that Contracting Parties of the Energy Community are aiming to achieve through significant sector reforms and implementation of EU energy policies.

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 energy prices are high and where they are low these markets send important signals for future investments in energy infrastructure. For this reason, it is crucial that citizens, business and national authorities can have confidence in the integrity of such 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 higher energy prices in general and less or no appetite for investments.

II. ISSUE AND 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. Fundamentals play an important role around supply and demand conditions. Access to fundamental information, and in particular to information

regarding 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 fundamental information.

On the other hand, it is very important that prices established on 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 Europe, including Contracting Parties of the Energy Community, continues to bring investment 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 improving, 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 risk. The risk of abusive behavior by certain market participant(s) that 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 such behavior is 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 risks. In the absence of risk takers -and certain market participants are risk takers because they specialize in managing certain risks- there are less opportunities for market participants, not specialized to manage market risk, to offset such 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.

III. EU MARKET INTEGRITY FRAMEWORK

Recognizing the importance of a competitive market and the need to ensure market integrity, in 2010, European Commission (EC) proposed adoption of a framework that prohibits market abuse and requires close and ongoing surveillance of the markets. European Commission prepared an impact assessment as accompanying document to the proposal for a regulation on energy market integrity and transparency.

In the impact assessment EC pointed out that 3rd Energy Market Liberalization Package establishes new institutional framework for the gas and electricity sectors, ensuring non discriminatory access to networks, enhancing regulators' powers and independence and establishing new European bodies to create harmonized network and market operation standards like the Agency for Cooperation of the Regulators (ACER) and the European Network of Transmission System Operators for Electricity and Gas (ENTSOs) but it does not define specific conduct rules for wholesale energy trading. It further points out at high and strong price correlation between:

- interrelated commodities, especially between electricity and gas, in both spot and future trading, and
- products with delivery across different zones/hubs.

Such correlation is even stronger between coupled market and what it means is that energy bids and offers in one country affect prices in each of its neighbours. These bids and offers are not easily visible to those charged with market oversight. 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.

EC highlighted that the existing rules governing energy markets are insufficient to ensure their stable and orderly functioning. The rules only capture a fraction of relevant transactions and do not provide for consistent or easily applicable definitions of acceptable practice. The lack of rules and the divergence of rules regarding reporting of data do not allow for the totality of markets to be monitored and specific misconducts, such as cross-border, cross-commodity and cross-market misconducts to be effectively detected.

In their response to public consultation by the Directorate General for Energy on measures to ensure transparency and integrity of wholesale markets, the European Federation of Energy Traders (EFET) stated the following: "... 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." Other responses to the public consultation showed widespread agreement for an EU-level transparency and market integrity regime.

The framework proposed by the EC and adopted 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)

A step-wise approach was applied regarding implementation. 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 (contracts executed via organized markets) and 7 April 2016 (contracts executed bilaterally) after the entry into force of Implementing Regulation (REMIT IR) on 7 January 2015.

IV. RATIONALE FOR IMPLEMENTATION OF REMIT FRAMEWORK IN THE CONTRACTING PARTIES

In this assessment, no alternative market integrity framework is analyzed. The feasibility REMIT framework to ensure market integrity is not questioned. Energy Community Secretariat has discussed with different stakeholder in order to assess the impact of REMIT implementation in the

Contracting Parties of the Energy Community. Nevertheless, a few important factors make REMIT implementation rather a necessity.

The volume of cross-border trading is increasing significantly between the CPs and between the CPs and Member States (MSs). Energy markets in general are evolving. Wholesale prices of electricity and gas are set based on supply and demand in several countries or regions. If prices go up in the 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 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 third energy package defines obligations for CPs 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 and therefore it is crucial for the well-functioning of the pan-Energy Community market that this gap is filled in the CPs as soon as possible to avoid any loopholes which create potential for market abuse both in EU MSs and CPs due to well interconnected markets.

We have identified the following as to why we need to implement REMIT in the CPs:

Importance of harmonized regime to avoid any loopholes

EU MSs and CPs of the EnC are very well interconnected and trading activity between them is increasing with significant pace, in particular electricity trading between MSs and CPs of Southeast Europe and gas trading between MSs and Ukraine, increasing therefore the level of correlation between the prices. The 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 CP may have significant impact in the MSs surrounding such CP. Furthermore, an information which is considered an inside information in the EU under REMIT is not considered as such in the CPs 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.

Importance of market integrity and transparency in the CPs

Notwithstanding great progress made in transposing the third energy package, electricity markets in the CPs 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 CPs 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 CPs together with de-regulation of prices and other measures starts having a positive impact on trading activity in general in the Southeast Europe region. Furthermore, the Secretariat has started working with CPs for necessary adaptation and

implementation of electricity and gas network codes and guidelines in the EnC. Together with this the commitment¹ of CPs 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 CPs and with MSs. As we move towards open and competitive energy markets in the EnC it is of crucial importance that in parallel we work on market integrity regime to ensure that the national regulatory authority of CPs 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 EnC.

ACER's involvement: less costs and better monitoring

Considering the interconnected nature of energy markets and pace with which the CPs are moving towards EU target model it is clear that a regime which guarantees market integrity is implemented in the EnC as soon as possible and as early as possible while the CPs 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 CPs. In this context, ACER's role is crucial. The role of ACER in collecting market data and monitoring should remain the same for CPs as it currently is for MSs under REMIT. This would, not only make the process more efficient for CPs, 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 MSs.

V. CONCEPT FOR IMPLEMENTATION IN THE CONTRACTING PARTIES

The Secretariat has prepared adapted versions of REMIT and REMIT IR and will discuss this with all the relevant stakeholders, such as European Commission, ACER, ENTSO for Electricity, ENTSO-for Gas, CPs and market participants.

The following is the step-wise approach for implementation in the CPs:

STEP 1

Deploying REMIT regime in the CPs for implementation of market transparency and integrity measures:

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

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

The following are the Articles of REMIT adapted text for CPs that become effective under this step:

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

¹ 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

INTERMEDIATE STEP

This is an intermediate step before the requirement for trade data and fundamental data reporting kicks in as per STEP 2 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 adapted text for CPs becomes effective under this step.

STEP 2

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 adapted text for CPs that become effective under this step:

- Articles 7-8 (market monitoring, data reporting)
- Articles 10-12 (information sharing, data protection, operational reliability)
- Articles 16-17 (cooperation, professional secrecy)

In the same transposition deadline with the Articles from this step, REMIT IR adapted for CPs should also become effective.

An alternative approach for STEP 2 is to have bilaterally traded contracts reported at a later stage, i.e. new step.

VI. COMPETENCES OF ACER, ENTSO FOR ELECTRICITY AND ENTSO FOR GAS

To ensure full and harmonized implementation of REMIT in the CPs, the competences of ACER, ENTSO for Electricity and ENTSO for Gas pursuant to Regulation (EU) 1227/2011 (REMIT applicable in the EU) for EU MSs should remain the same for CPs under the adapted text of REMIT.

It is the view of Secretariat that with regards to ENTSO for Electricity and ENTSO for Gas, assuming such competences for CPs, would not require significant changes to the existing processes. This is considering the fact that anyway CPs have the obligation to submit the fundamental data to ENTSO for Electricity and ENTSO for Gas under the third energy package² and electricity transparency regulation³.

Secretariat understands that ACER may need an agreement in order to assume such competences 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.

² Electricity Directive (2009/72/EC), Natural Gas Directive (2009/73/EC), Electricity Regulation (714/2009/EC) and Natural Gas Regulation (715/2009/EC)

³ Regulation (EU) No 543/2013

VII. KEY CONTENT ADAPTATIONS OF REMIT AND REMIT IR FOR CONTRACTING PARTIES

Energy Community Secretariat proposes implementation of REMIT framework on its entirety, with the below listed caveats. General adaptations that are necessary for implementing REMIT in the CPs are applied. In addition to general adaptations the following are the main content changes:

- The key content change is the omission of derivatives from the scope of REMIT for CPs. In the EU, derivatives are outside REMIT scope because they are covered in the framework of financial regulation. In the REMIT adapted version for CPs, Secretariat proposes a change in the definition of wholesale energy products by removing 'derivatives' from the definition of wholesale energy products. Cooperation and data sharing with ESMA and national competent authority is removed in line with omission of derivatives.
- As mentioned above, the Secretariat proposed an Article that deals with the competences of ACER, ENTSO for electricity and ENTSO for Gas. This is to ensure same competences for CPs as for MSs.
- Article 6 and 20 of REMIT that empowers European Commission to adopt delegated acts under REMIT is not applicable for CPs. This aim is to have an article in the Ministerial Council's decision adopting REMIT for the EnC which states that the "... *Energy Community shall endeavor to apply delegated or implementing acts adopted by the European Commission under the acts referred to in Article ...*".
- Requirements of ACER regarding data protection and operational reliability, etc. are not duplicated as such requirements are already applicable for ACER under REMIT.
- Article 19 (International relations) and Article 21 (Committee procedure) of REMIT are not applicable for CPs therefore has been deleted from the adapted text.

Other adaptations are mainly to ensure proper applicability in the CPs and avoid duplications.

VIII. IMPACT ON STAKEHOLDERS

In line with Energy Community Secretariat's proposal the following stakeholder are impacted:

1. ACER

ACER's role in implementation of REMIT in the Contracting Parties is as foreseen in part VI above. This is subject to two fundamental matters:

- ACER needs additional resources to fulfill such role. Resources need to be confirmed by the European Commission and included in ACER's budget.
- Certainty regarding legality of ACER involvement is needed. What will be the legal basis for ACER to undertake such role for non-EU Member States.

The amount of resourced based on the following parameters:

- Nine (9) Contracting Parties of the Energy Community: Albania, Bosnia and Hercegovina, FYR of Macedonia, Kosovo*, Montenegro, Serbia, Ukraine, Moldova and Georgia.
- 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 Parties
 - Market participants: 20-50
 - Contracts on annual basis: 50-350
 - Group II – 2 Contracting Parties (Ukraine, Serbia)
 - Market participants: 50-300
 - Contracts on annual basis: 350-1000
- 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 an 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, however our view is 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). We expect more day-ahead PXs to be established in the next couple of years, increasing therefore the number of contracts to be reported. This would be already standard OMP contracts.
- 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 all. Here we see the importance of Ukrainian gas market and to some extent, Serbia.

2. Contracting Parties

Contracting Parties will have to ensure that, once REMIT framework is adopted in the Ministerial Council of the Energy Community, is transposed and implemented. This would be a standard procedure as with transposition of Third Package.

In addition, Contracting Parties should ensure that National regulatory Authorities are equipped with power to exercise their responsibilities under REMIT. They should ensure that a penalty regime is in place by the effective date of relevant Article.

3. National Regulatory Authorities

In line with REMIT National Regulatory Authorities (NRAs) 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 Participates – NRAs should utilize ACER's guidance and also, if offered and applicable, to use ACER's platform for Registration. As discussed with ACER this may be offered for free to NRAs.
- Data security – once exchanging the data with ACER, NRAs should ensure that they have all the cyber protection necessary to fulfill the requirement for data sharing and protection.
- If no monitoring department is functioning with NRAs then depending from size of the market, number of market participants NRAs will need additional staff (1-2 per NRA).

- Surveillance systems should be in place only in case market is big enough, liquid and the NRAs 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. IN terms of surveillance it is important to note the responsibly 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.

4. Organized market places (Day-ahead market operators-PXs, Brokers)

Ensure data reporting on behalf of market participants. Put in place surveillance systems and report any suspicious activity.

5. Market participants

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.

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 therefore the main implementation issue would be with national incumbents.

EC on its impact assessment has assumed the overall costs on market participants and ACER. The costs related to extending REMIT framework in the Contracting Parties would be minimal given that the framework, system and guidance is already in place.