

EUROPEAN REMIT REGULATION AS THE LATEST DETERMINANT OF CORPORATE RISK MANAGEMENT STRATEGIES IN ENERGY SECTOR

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Abstract. *The purpose* of the paper is to summarize and present the fundamental trends of the past few decades related to the financial crisis of 2008 and growing integration of European sovereign economies, including the integration of energy markets, that led to development of regulation of relationships and preventing manipulation in such markets. This regulation has become a powerful new determinant for the European multinational enterprises of the energy sector (MNE) when developing their own risk management strategies. *Methodology.* The analysis is based on the recent studies of the pan-European power exchange company Nord Pool Group, international organization Energy Community and relevant regulations and recommendations of the European Parliament and of the Council and European Union Agency for the Cooperation of Energy Regulators. *Results* of the analysis showed the growing demand for transparency and stability in the European wholesale energy markets. This demand was reflected in the EU Regulation 1227/2011 on Wholesale Energy Market Integrity and Transparency (REMIT) that was adopted by the European Parliament and the Council of the EU in 2011. While REMIT Regulation, on one hand, provides reliable and equal conditions for MNE, on the other hand, it increases the risk and burden of REMIT compliance obligations for such MNE. The consequences of misconduct can potentially be serious – both high fines and personal liability of MNE employees. Today the European multinational enterprises of the energy sector must develop the respective risk management strategies to ensure effective governance of this type of risks. *Practical implications.* MNE participants of the EU energy market should develop efficient risk management strategies to comply with REMIT requirements, in addition to existing commitments on the transparency of the Third Package. The REMIT compliance risk management strategies will support MNE market participants in complying with rules and policies, creating a secure structure for employees of such enterprises and promoting fair and equal conditions for trade, trusting the energy market. Furthermore, proper REMIT compliance risk management strategy will help to avoid or minimize the risk of fines and other regulatory sanctions and potential civil lawsuits. It will also help to avoid or minimize the risk of reputation loss, such as negative media reviews or poor customer experience. *Value/originality.* The conducted analysis provides deep understanding of the main drivers of the European wholesale energy markets regulations that create a compelling determinant for the risk management strategies of multinational enterprises of the energy sector. Ukraine has committed itself to the Energy Community to implement the REMIT Regulation in its regulatory field, which increases the relevance of developing appropriate multinational enterprises risk management strategies within the country.

Key words: risk management strategies, multinational enterprises, regulation, REMIT, insider trading.

JEL Classification: G32, F23, G18, G14

1. Introduction

Over the last few decades, Europe's wholesale energy markets have become increasingly interconnected. Therefore, the abuse of the energy market in one country often affects not only

wholesale prices for electricity and natural gas across national borders, but also retail prices for consumers and micro-enterprises. Hence, concern for the integrity of markets cannot be a matter for individual Member States alone. Strong cross-

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border market monitoring is important for the full functioning, interconnected and integrated internal energy market.

EU Regulation 1227/2011 on Wholesale Energy Market Integrity and Transparency, REMIT is an EU legal act adopted in 2011 with the aim of increasing transparency and ensuring stability in European wholesale energy markets (The European Parliament and of the Council, 2011). It was important for the European Parliament and the Council of the EU to ensure that Europe's multinational enterprises of the energy sector (MNE) and consumers can have confidence in the integrity of the electricity and gas markets, and that prices in wholesale energy markets reflect fair and competitive the interaction between supply and demand, and that one cannot make a profit from the market due to abuse. The aim of increasing the integrity and transparency of wholesale energy markets should be to promote open and fair competition in wholesale energy markets for the benefit of final energy consumers.

REMIT Regulation is based on four basic principles:

1. Transparency – obligation to disclose energy market data and information:

- public disclosure – obligation to disclose inside information;

- regulatory disclosure – submission of data to ACER and national regulators.

2. Integrity – prohibition of abuse in wholesale energy markets:

- prohibition of insider trade;

- prohibition of market manipulation.

3. Monitoring system developed for wholesale energy markets:

- registration of market participants;

- market monitoring by ACER and national regulators.

4. Cooperation at EU and national level.

While the REMIT Regulation, on one hand, provides reliable and equal conditions for MNE, on the other hand, it increases the risk and burden of REMIT compliance obligations for such MNE. The consequences of misconduct can potentially be serious – both high fines and personal liability of MNE employees.

The REMIT Regulation covers three main elements: the obligation to disclose insider information, the prohibition of market manipulation and the reporting of MNE trade data.

The Regulation also empowers the EU Agency for the Cooperation of Energy Regulators (ACER) and national regulators to investigate and enforce energy markets in countries that have implemented the REMIT Regulation.

Ukraine has committed itself to the Energy Community to comply with Article 1 of Decision 2018/10 / MC-EnC, as well as Articles 6 and 89 of the Treaty by November 29, 2019 (Energy Community, 2021).

2. General information on remit compliance mode

According to section 5 of the ACER Guidelines (European Union Agency for the Cooperation of Energy Regulators, 2020), MNE participants of the EU energy market should develop a clear compliance regime for the disclosure of real-time or near-real-time insider information, as well as further REMIT requirements, in addition to existing commitments on the transparency of the Third Package. In addition to ACER's recommendations, the REMIT compliance regime will support MNE market participants in complying with rules and policies, creating a secure structure for employees of such enterprises and promoting fair and equal conditions for trade, trusting the energy market. Furthermore, proper REMIT compliance will help to avoid or minimize the risk of fines and other regulatory sanctions and potential civil lawsuits. It will also help avoid or minimize the risk of reputation loss, such as negative media reviews or poor customer experience.

Based on the above, each MNE market participant should develop a REMIT compliance regime specifically tailored to the MNE characteristics, where the specific risks faced by the market participant should be the basis for prioritizing compliance.

Ensuring compliance with the REMIT is a complex task that requires MNE to actively address and manage related risks, taking into account the nature, size and complexity of the MNE business, as well as the nature and range of wholesale energy products. This requires a strong REMIT compliance culture, adequate and clear policies and procedures, regular training of staff and proper documentation of the measures taken.

Although each MNE market participant must develop an individual REMIT compliance regime, ACER identifies its following components

(European Union Agency for the Cooperation of Energy Regulators, 2020):

1. Compliance with REMIT requirements, namely the obligation to register, disclose and report and prohibit market abuse.

2. Creation of corporate culture in accordance with the requirements of REMIT.

3. Defining roles and responsibilities in the internal structure of the MNE.

4. Identification / assessment of specific risks of REMIT compliance.

5. Description of specific actions to determine appropriate / inappropriate behavior.

6. Notification of rules and regulations to be followed:

- the concept of internal communication and training (raising employee awareness);
- external communications and reporting to ACER / national regulators;
- reporting processes: internal compliance reports, reports of violations, the status of current processes, etc.

7. Improvement of monitoring: internal control, audit, reporting lines for monitoring results; documenting processes and actions.

3. Technical features of REMIT

At the technical level of regulation, REMIT requires all EU electricity and gas market participants who make transactions and / or electronic platforms through which transactions are made to report to the RRM (Registered Reporting Mechanism). The role of the RRM is to provide a secure communication channel to meet market participants' reporting obligations and to standardize and simplify the reporting process (European Union Agency for the Cooperation of Energy Regulators, 2020).

Data on transactions submitted by market participants through RRM is recorded and then transmitted to ACER and its ARIS IT system (ACER REMIT information system). This surveillance system collects, stores, processes and analyzes the submitted data, automatically detecting anomalies, sending alerts and supporting investigations. As part of the development of the RRM reporting system, the REMIT Implementing Regulation (№ 1348/2014) was adopted in 2014, which obliges MNE market participants to also provide "fundamental data".

This is usually information on the capacity and use of facilities for the production, storage,

consumption or transmission of electricity or natural gas, or on the capacity and use of liquefied natural gas (LNG) facilities, including planned or not-planned unavailability of these objects. Typically, fundamental data is reported by transmission system operators on behalf of market participants (Hritsyshyna, 2021).

REMIT has created a relatively reliable platform for cooperation between ACER and national regulators and has significantly increased the risk of fraud detection. If you compare ACER's annual and quarterly reports, the number of cases is constantly growing. As of 2019, there were more than 15 000 registered participants in EU energy markets. According to REMIT, EU energy market participants report annually on about 2,5 billion deals.

4. Remit compliance risk management

As noted in the analysis above, an important component of the individual REMIT compliance regime is effective MNE risk management, which should be based on the following principles (Nord Pool Group, 2020):

- REMIT-compliance function of the MNE must assess the areas of compliance-risk on a regular basis according to the following steps:
 - identification of REMIT compliance zones inherent in MNE area of activity;
 - identification of the main sources / areas of REMIT-compliance risk;
 - identification of existing means of control (including internal);
 - identification of key stakeholders for identified areas of REMIT-compliance risk to bring MNE business activity to REMIT requirements;
 - MNE REMIT Compliance function can interview key MNE stakeholders for the following purposes:
 - obtaining a description of the activities of MNE business unit, within which REMIT compliance risk may arise;
 - preliminary structuring of the potential flow of internal and insider information;
 - receiving additional comments on REMIT compliance risks from key stakeholders.

Risk assessment may be based on the impact of the potential incident and its likelihood, and may include existing controls. The approach to risk assessment should take into account the size and complexity of the MNE market participant, as well as the results of any previous monitoring

activities and the relevant conclusions of the REMIT-compliance function of the MNE.

When assessing the risks of REMIT compliance, the results can be divided by descriptions (e.g. low, medium, high or very high), colors or numbers. Each MNE market participant decides which level of risk is acceptable for each area / activity.

Risk assessment is a good starting point for identifying a REMIT compliance program that includes a REMIT compliance plan, as well as for ensuring that the right steps are taken to comply with REMIT compliance risk reduction requirements. In particular, high-risk areas should be considered and managed to maintain them at an acceptable level. It should be noted that different MNE market participants have different REMIT compliance risks, and that the risks and consequences may also differ between different MNE market participant activities.

The risk assessment should include an assessment of all types of market abuse, as well as the obligation to publish insider information.

5. Typology of market abuse in wholesale energy markets

The following types of market abuse are considered in accordance with the ACER Guidelines for the Application of Regulation (EU) № 1227/2011 of the European Parliament and of the Council of 25 October 2011 on the integrity and transparency of the wholesale energy market (European Union Agency for the Cooperation of Energy Regulators, 2021):

1. Insider trading, which affects the transparency of the market:

- *insider trading* – cases when an insider trades or tries to trade in wholesale energy products on the basis of internal (insider) information related to this wholesale energy product. A market participant in possession of insider information is also obliged to refrain from making any changes or selective revocation of the placed order ("non-interference approach") in order to comply with the ban on insider trading;
- *improper disclosure of insider information* – cases when the carrier of confidential (insider) information improperly discloses insider information to another person, unless such disclosure is made in the ordinary course of employment, professional activity or official duties;

- *recommendations based on insider information* – cases when the carrier of confidential (insider) information recommends or encourages, on the basis of inside information, another person to buy or dispose of wholesale energy products to which this information belongs;

2. Market manipulations (including attempts to manipulate the market) that affect market integrity:

- *false and misleading agreements* – trade or placing orders for trade that give or may give false signals or mislead about the demand, supply or price of wholesale energy products;
- *price positioning* – trade or placing orders for trade that provides or seeks to provide, to a person or persons acting in cooperation, the price of one or more wholesale energy products on an artificial level, unless the person who concluded the agreement or issued the trade order establishes that its reasons for doing so are legitimate and that this agreement or trade order is in line with accepted market practice in the wholesale energy market;
- *transactions using false techniques / misleading* – trade or placing orders for trade in which fictitious methods or any other form of deception are used;
- *dissemination of false or misleading information* – providing information that creates a false impression of a wholesale energy product or is misleading when a person doing so knows or should have known that the information is false or misleading.

6. Building an effective MNE strategy for managing market manipulation risks

According to the REMIT Regulation (The European Parliament and of the Council, 2011), market manipulation means the following:

1. Performing any transaction or issuing any order to trade in wholesale energy products that:
 - a) gives or may give false or misleading signals about the supply, demand or price of wholesale energy products;
 - b) provides or attempts to provide a person or persons cooperating with the price of one or more wholesale energy products on an artificial level, unless the person who entered into the transaction or issued the trade order establishes that his reasons are legitimate and that this the transaction or trade order is in line with accepted market practice in the relevant wholesale energy market;

c) uses or attempts to use a fictitious measure or any other form of deception that gives or may give false or misleading signals about the supply, demand or price of wholesale energy products.

2. Disseminating information through the media, including Internet, or in any other way that gives or may give false or misleading signals about the supply, demand or price of wholesale energy products, including rumors and false or misleading news, when a person who disseminates information, knew or should have known that the information was untrue or misleading.

The following measures are recommended to build an effective MNE strategy for managing market manipulation risks:

1. *General measures:*

- to ensure awareness among MNE employees about what behavior can be manipulative;
- mandatory trainings for traders, training on specific scenarios of market manipulation;
- risk assessment of market manipulation. The assessment of the risks of market manipulation should be based on all types of market manipulation specified in the ACER Guidelines for the Application of the REMIT Regulation. In addition, one should consider whether there are other types of manipulation.

2. *Measures to prevent market manipulation through orders and agreements:*

- traders should have clear authorities and instructions on how to trade with the risk of market manipulation in mind. Authorities must be approved on paper. It is recommended to record deviations from trade authorities;
- in the case of any investigations conducted by National Regulators or persons authorized to regulate agreements, it is important to have carefully established procedures for documenting trade authorities. In addition, traders themselves are encouraged to document their behavior in situations where they have either entered into atypical or exceptional transactions (high / low prices; profitable agreement to publish important information; trades outside the standard spread), or made atypical or exceptional profits / losses. Or if there have been other atypical or exceptional situations or market conditions that may be of interest to regulators. Such measures are important in order to be able to clarify the agreements and relevant circumstances, as well as to provide documentation in the case of both internal investigations of National Regulators;

- internal instructions and procedures on what a trader can and cannot do should be developed and communicated to all relevant employees. They must be dynamic and updated in the event of any regulatory changes inside and outside the market;

- standard trading error prevention procedures: these can be automatic signals / checks, manual checks or a combination of these;

- prohibition of cooperation, exchange of information with other market participants or discussion of pricing strategy with them;

- in terms of strategy building, it is considered common practice to assess how the proposed trading strategy will affect the market. In addition, MNE market participants need to assess whether a combination of different trading strategies can send erroneous or misleading signals to the market.

3. *Measures to prevent market manipulation by disseminating false or misleading information:*

- Policy on communication with mass media:

- only authorized persons can communicate with the media; the persons concerned must receive special training in the field of communication so that they do not disseminate false or misleading information;

- information must be correct and accurate (not rumors).

- Staff policy on information provided on social networks and other forums.

Typical reasons for market manipulation that require appropriate risk management measures include the following:

- deliberate manipulation to increase profits;

- unintentional or careless manipulations:

- ignorance of what is forbidden;

- technical or human errors;

- dissemination of insufficient or incorrect information.

7. Building an effective MNE insider risk management strategy

According to the REMIT Regulation (The European Parliament and of the Council, 2011), insider information means accurate information that has not been disclosed and relates, directly or indirectly, to one or more wholesale energy products and which, if disclosed, could significantly affect the prices of these wholesale energy products. Within this definition, the term "information" means:

- information to be made public in accordance with Regulations (EU) № 714/2009 and (EU) № 715/2009, including guidelines and network codes adopted in accordance with those Regulations;
- information concerning the capacity and use of facilities for the production, storage, consumption or transmission of electricity or natural gas or related to the capacity and use of underground gas storage facilities, including planned or unplanned unavailability of such facilities;
- information to be disclosed in accordance with legal or regulatory provisions at national or EU level, market rules, and contracts or practices in the relevant wholesale energy market, as this information may have a significant impact on wholesale energy prices;
- other information that the MNE market participant is likely to use as part of its decision to enter into a wholesale energy trade agreement or to issue a wholesale energy product order.

It is recommended that the following measures be taken to build an effective MNE insider risk management strategy:

1. Identification of insider information and display of information flows:

- determine which of the available information may be insider information;
- identify all objects (production / consumption / transmission) and indicate in which situations insider information may arise;
- identify which situations exist in general, not related to specific objects, where insider information occurs or may occur (for example, access to customer orders);
- identify MNE concentration / subdivision points that are vulnerable to intentional and unintentional information leaks;
- display information flow to identify any information that may be classified (or potentially classified) as insider or hold it;
- determine in which situations a MNE market participant can obtain insider information from third parties.

2. Protection and handling of insider information:

- availability of appropriate written manuals and instructions on the procedure for handling insider information, including liability and the procedure for processing insider information;

- ensure that insiders do not have access to insider information prior to its publication;
- traders must be physically separated from any person who has access to insider information;
- if the personnel processing the insider information are located in the same building as the traders, additional measures may be required to document that the insider information is not available to traders, such as controlling access to the trader's place by registering;
- ensure the introduction of sufficient restrictions in the relevant IT systems;
- insider information from third parties: it is necessary to ensure the protection of such information, to prevent the conclusion of agreements based on this information, etc.;
- it is recommended to conclude confidentiality agreements with external contractors.

3. Measures to prevent insider trading:

- tracking products / markets related to different types of insider information: trade in other products may be allowed;
- tracking information:
- recording of telephone conversations of relevant employees;
- compiling maps of insider information flows and keeping a log of the personnel / employees who received the information;
- periodic/systematic inspections;
- information barriers for traders and mechanisms to stop trading in case the trader gained access to insider information.

If MNE market participant uses a trading algorithm:

- it must be possible to stop any trading activity immediately using an algorithm. This must be achieved through the kill functionality. The responsibility for running the kill functionality must be clearly defined to avoid a lengthy negotiation process during which the algorithm may continue to contribute to chaotic trading conditions;
- structured and formalized testing of the algorithm for possible market manipulation should be carried out. Test results should be documented;
- the possibility of deploying an algorithm with a limited trading mandate in a limited period may be additionally considered, for example rule 100-10: in the first 100 hours of deployment the algorithm may open positions only within 10% of the expected trading mandate.

8. Conclusions

Fundamental trends in recent decades have focused on the integration of Europe's sovereign economies, including the integration of energy markets, and create a powerful determinant for the risk management strategies of multinational enterprises of the energy sector (MNE). As part of the formation of the relevant regulatory field, the European Parliament and the Council of the EU adopted in 2011 EU Regulation 1227/2011 on Wholesale Energy Market Integrity and Transparency, REMIT. In accordance with the requirements of the REMIT Regulation, MNE participants in the energy markets must establish

an appropriate REMIT compliance regime, which should ensure risk management taking into account the nature, size and complexity of MNE business and the nature and range of wholesale energy products. This requires a strong REMIT compliance culture, adequate and clear policies and procedures aimed at building effective MNE strategies to manage the risks associated with market manipulation and insider information.

Ukraine has committed itself to the Energy Community in implementing the REMIT Regulation in its regulatory field, which increases the relevance of developing appropriate MNE risk management strategies within the country.

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