QUARTERLY NEWSLETTER
from Nord Pool Market Surveillance

Q1 2020

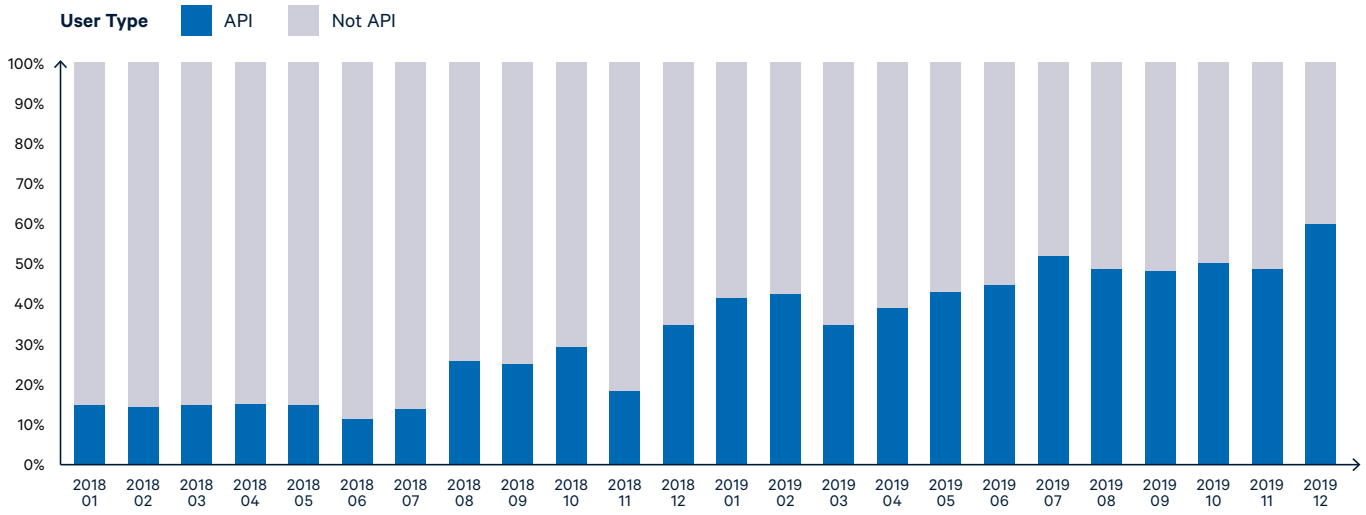
Welcome to the latest quarterly newsletter from Nord Pool's Market Surveillance team. We are delighted to share this new update on surveillance, regulations and other topics we have been working on. In this edition you will find an overview of the update to the REMIT Best Practice Report published in January 2020. We will also share our thoughts on a recent REMIT case from Hungary published on ACER's overview of sanction decisions.

Update to the REMIT Best Practice Report

In August 2017, we published the first edition of the REMIT Best Practice Report[1]. This Report was based on expertise from market participants, NAET (Nordic Association of Electricity Traders) and Nord Pool. It provides a guide to best practice on how market participants may ensure that they have implemented the right measures to comply with REMIT and hence limit their risk of misconduct.

In recent years, we have observed that more and more market participants have started to use algorithmic trading. This trend is indicated in the amount of volume that is traded by API-users and highlights the importance of establishing special compliance measures when using algorithm trading.

[1] https://www.nordpoolgroup.com/globalassets/download-center/remit/remit-best-practice_first-edition.pdf



Percentage share of total intraday volume on Nord Pool's platform per month traded through API-users, compared to non-API users

With the aim of recommending a compliance regime when deploying algorithmic trading for wholesale electricity products, we have collected input from market participants and NAET to extend the REMIT Best Practice report[2]. We used relevant financial regulation as a starting point and assessed which measures are a good fit for the current state of the wholesale electricity market.

In the new chapter on algorithmic trading, we review best practices for developing an algorithm in-house and consider the most relevant steps in that process: design, testing, approval, post-deployment management, monitoring and record keeping. Additionally, the new chapter includes recommendations when purchasing an algorithm from third-party vendors. It is important to be aware that in such situations, market participants remain fully responsible for the trading activity of those algorithms. Market participants also need to have sufficient knowledge of the third-party algorithm to be able to challenge its compliance with applicable law, most notably REMIT's market manipulation and inside trading prohibitions.

We recommend everyone who is working with algorithmic trading should read through the new chapter and would highlight three key points from a Market Surveillance perspective:

- **Identification of trading done by algorithms:** When we are able to clearly identify orders and transactions generated by algorithms we can get a better understanding of the trading activity, without asking questions about it to the market participant. At Nord Pool, this can, for example, be done by assigning one API-user[3] per algorithm and giving them clearly comprehensible names such as "IDAPI_Algo_Powertrading_01".

- **Impact on the market:** Market participants should consider how the algorithm's trading strategy will affect the market. Could it send false or misleading signals? Is there a real desire to trade behind each order?

- **Interaction with other algorithms:** Market participants should consider how the algorithm interacts with other algorithms. How will the algorithm act if it meets another algorithm with a similar or opposing trading strategy? How does it interact with other algorithms of the same market participant? Could this send false or misleading signals?

If you have any questions or suggestions related to this topic, please send them to us, using the contact details on the last page.

This update to the Report would not be possible without the unique expertise provided by market participants, therefore, we would also like to thank everyone who has contributed with their knowledge and experiences to the second edition of the REMIT Best Practice Report.

Incorrect information regarding available transmission capacity as a REMIT breach

According to the Annual Monitoring Report by ACER/CEER[4], efficiency in the use of interconnectors in the day-ahead time-frame has greatly increased from 2010 to 2018.

Market coupling – the possibility to trade power across borders – has rendered a benefit of approximately 1 billion Euros per year to European consumers. This benefit depends on the volume of transmission capacity provided to the market by Transmission System Operators (TSOs). Therefore, TSOs' actions are crucial in creating a well-functioning electricity market.

In September 2019, the Hungarian Energy Regulatory Authority (MEKH) issued a decision[5] fining the Hungarian TSO (MAVIR) for a REMIT breach. This is the first case[6] where a TSO was found to be violating the prohibition of market manipulation in Article 5. Described in the decision was the fact that MAVIR had submitted incorrect information to the day-ahead auction for delivery on 18th March 2019, regarding the transmission capacities on the Slovak-Hungarian interconnector in hours 0 – 18. Instead of 1300 MW only 700 MW net capacity was submitted.

[2] https://www.nordpoolgroup.com/globalassets/download-center/remit/remit-best-practice_second-edition.pdf
[3] Contact our customer service colleagues via support@nordpoolgroup.com to set-up API-users.
[4] ACER/CEER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets in 2018: Electricity Wholesale Markets Volume, published November 2019 (available on-line)
[5] Decision is available online in Hungarian, the article is based on an unofficial translation from Hungarian
[6] Overview of sanctions decisions, published by ACER (available on-line)

The Hungarian NRA had to assess whether the conduct of MAVIR affected a wholesale product, and, if so, if it also constituted a breach of REMIT Article 5. The below key points are formulated based on our understanding of the assessment by the Hungarian NRA:

- **Implicitly allocated transmission capacity in the day-ahead market is a wholesale energy product.**
  According to Article 2(4)(c) of REMIT explicitly allocated transmission capacities are wholesale energy products. In the day-ahead timeframe transmission capacity is allocated implicitly (meaning it is allocated at the same time as cross-border trade takes place). It can, therefore, be seen as an integral part of an electricity supply contract and, thereby, a wholesale energy product, according to Article 2(4)(a) of REMIT.

- **Providing cross-border capacity to the day-ahead market is a transaction, since the TSO is receiving congestion revenue in return.**
  Therefore, it may fall under the definition of market manipulation in Article 2(2)(a) if it sends false or misleading signals or secures the price at an artificial level.

- **Disclosure of incorrect capacity can qualify as dissemination of false information and, therefore, as market manipulation.**
  Article 2(2)(b) defines market manipulation as "disseminating information [...], which gives, or is likely to give false or misleading signals as to the supply of, demand for, or price of wholesale energy products [...], where the disseminating person knew, or ought to have known, that the information was false or misleading". It is considered that publishing incorrect capacity, including through ENTSO-E's Transparency Platform, can constitute disseminating false information, which influenced the market. TSOs are considered as the primary owners of the information related to transmission capacities, according to Article 11(1) of Transparency Regulation[7].

According to MAVIR the "incorrect value" was taken into account when calculating the available capacity due to an "administrative error". The actual capacity was later made available to the intraday market. According to the Hungarian NRA, an "administrative error" was not acceptable as an excuse in this case, since it should have been detected before the information was transmitted. It was estimated that the reduced transmission capacity raised next day's day-ahead prices by 1.5 – 2%, or about 0.5 – 0.7 EUR/MWh. Certain TSO information (e.g. available transmission capacity) is likely to have a significant impact on price formation. That is one of the reasons why administrative, unintentional errors may also qualify as market manipulation under REMIT.

Taking into account these considerations, the Hungarian NRA concluded that publishing incorrect capacities fulfils the definitions of market manipulation in Article 2(2)(a) and (b) of REMIT. The fine issued to MAVIR constituted HUF 1 000 000 (or approximately 3000 EUR).

This case highlights the importance of TSOs' actions and inactions for price formation in power markets. For market surveillance teams and market participants the case represents an example of REMIT interpretation applied to TSOs and is, therefore, an important reference. Market Surveillance at Nord Pool supports the Hungarian NRA's interpretation of REMIT in this case – we follow a similar approach in our monitoring. As TSOs often have unilateral access to information of crucial importance, we encourage them to be extra diligent in ensuring the market receives correct and timely information. However, the exact assessment of similar events may differ under varying circumstances.

[7] Commission Regulation (EU) No 543/2013 on submission and publication of data in electricity markets

HOW TO CONTACT MARKET SURVEILLANCE

We hope that you have enjoyed reading our latest quarterly newsletter. Please let us know if you have any comments on the subjects covered here, or if there are any issues you would like us to examine in future editions: market.surveillance@nordpoolgroup.com