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European Commission

Public Consultation on

Measures to ensure transparency and integrity of wholesale markets in electricity and gas

Reply from NASDAQ OMX

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NASDAQ OMX *Commodities* provides access to the world's largest power derivatives exchange and one of Europe's largest carbon markets. NASDAQ OMX acquired Nord Pool ASA end of May 2010. All commodities trading is cleared through NASDAQ OMX clearing house. In partnership with Nord Pool Spot, NASDAQ OMX Commodities also offers a cleared physical UK power market, N2EX. The ambition is to launch power derivatives in the UK in the fall of 2010. NASDAQ OMX Commodities, including the subsidiary Nord Pool ASA, has more than 390 members from 22 countries across a wide range of energy producers and consumers as well as financial institutions.

NASDAQ OMX appreciates the opportunity to comment in the process of taking measures to ensure transparency and integrity of wholesale markets in electricity and gas. Please find below answers and comments to the questions in the consultation document.

1. Are there particular developments in relation to oversight of energy markets at a national, European or global level that we have not properly considered?

We generally agree with the Commission. Possibly to be added to the otherwise comprehensive list of developments, are two items:

- The European Commission's considerations to propose a standalone legislation dealing with potential risks arising from *short selling*.¹ The consultation on the proposals closed 10 July 2010. As the Commission seems to be considering a regime which at least in part may cover all types of financial instruments, thus including derivatives that have commodities as underlying, that development also seems relevant to consider.
- The European Commission's Communication on a *better food supply chain*.² This work stream includes aims to address concerns on excessive price volatility on commodities markets. It seems that this work stream may include considerations to impose position limits and/or position reporting on commodities, to be included in the review of the MiFID.

These work streams also needs to be taken into account for appropriate coordination as necessary.

We generally emphasise that market integrity and transparency is achieved not only through the measures developed in the consultation paper, but also through a transparency regime. This part does not seem to be properly addressed in the consultation paper. We encourage the Commission to move forward also with measures ensuring a uniform transparency regime for energy markets across Europe. We believe that the transparency regime that has for some time been in place in the Nordics is one of the success factors of the Nordic power market.³

Furthermore, from our experience of operating markets, in the power sector as well as in the financial sector, we want to underline the importance of ensuring that the enforcement and sanctioning of the rules are also part of the regime to be established. As market operators, our surveillance function is one of the crucial parts of our operations in order to ensure the well functioning of markets. In the markets that we operate we conduct both issuer surveillance, ensuring that transparency obligations are properly complied with, as well as market surveillance, which entails monitoring the market and reporting to the competent authorities as soon as anything suspicious is detected. Omitting clear rules enforcement will leave a serious gap in the future regime for energy markets.

The above comments illustrate the necessity of sufficiently coordinating the development of transparency and integrity of energy markets with other regimes governing the operation of

¹ http://ec.europa.eu/internal_market/consultations/docs/2010/short_selling/consultation_paper_en.pdf.

² http://ec.europa.eu/economy_finance/publications/publication16061_en.pdf.

³ http://www.nordpool.com/digitalAssets/67/67025_tradingappendix6.pdf. The disclosure requirements are in Section 4 of these Market Conduct Rules, which are an appendix to both our Trading Rules and our Clearing Rules. The same text is also a part of the Rule book for Nord Pool Spot.

markets, such as specifically the Market Abuse Directive (MAD) and the Market in Financial Instruments Directive (MiFID). Equally necessary is to recognize that MAD or MiFID cannot be extended one-to-one, but needs to be properly adjusted to fit the energy sector. The main specificity to be taken into account for the application of MAD principles in the energy sector relates to the definition of insider information and its related scope, type and timing of disclosure requirements: market features specific to the energy markets (non-storability of some commodities, use of day-ahead auctions for the setting of the reference prices, trading of participants holding information impacting price formation).

2. Do you agree that the current Regulatory Framework should be updated to include clear rules governing energy market oversight? Please justify your reply.

We welcome a tailor-made regime for energy markets. All markets should operate under the same regime, thus creating opportunities for a level playing field among market participants. It is important that the same products are subject to the same regulation, irrespective of where they are traded (regulated market, MTF, OTC). It is also necessary to appropriately recognize the link between various types of products, such as spot and various types of derivatives.

In order to support the level playing field, the organisation of markets as well as the oversight of markets need to be harmonized across Europe.

3. Do you agree that this update should ensure integrated/coordinated oversight between financial and commodity markets and across borders?

Yes. Commodity markets and financial markets are integrated to an extent that motivates coordination of oversight of the two types of markets. In addition, markets are integrated across borders. This makes it crucial that there is a system set up with built-in cooperation. Oversight needs to be as integrated as the markets to be supervised. Cooperation is needed between energy authorities and financial supervisory authorities both on national and international level and there needs to be a strong centralised European authority to ensure the harmonized application and enforcement of the rules in place. This is a prerequisite for a level playing field within the European internal market.

4. Do you agree that the overlap of physical, and financial (derivative) markets, and the cross border nature of the market currently lead to sub-optimal oversight of energy markets?

Yes. Please see the answer to Q 3 above.

5. Do you agree that definitions of market misconduct for gas and electricity markets should be consistent across EU? If not, why not?

Yes, they should be consistent across EU. To ensure a level playing field and the availability of efficient price signals, all market platforms (either regulated or OTC) should be subject to a uniform legal framework across Europe.

6. Do you agree that market misconduct should follow the MAD definitions? If not, why not?

We believe that there is a need for a market abuse framework for both physical and financial markets in order to detect market misconduct. A market abuse framework should at least comprise physical products that serve as underlying products for derivatives products regulated by MAD and standardized physical contracts that may serve as close substitutes to commodities derivatives regulated by MAD. Having a market abuse framework comprising these products will be important for securing that market abuse in the physical markets does not spill over into the derivatives market.

The Market Abuse Directive (MAD) may serve as a good starting point when tailoring a market abuse framework for the physical markets. The physical and financial commodity markets for electricity and gas are closely related, and it will therefore be beneficial if the rules are harmonized where possible. However, the specificities of the physical markets require some adjustments to the regulation set out in MAD.

One example to illustrate this is the case of day-ahead auctions. Large market participants cannot be excluded from the auction even if they possess inside information, as their withdrawal from the auction may have a major impact on the auction price which is not desirable. In Nord Pool Spot's market this has been handled by allowing the participant to place orders, but being prohibited from taking the inside information into account when placing their bids unless this information is made public to the market. Similar, the need for regulation of insider trading in electricity balancing markets differs from trading in other physical products with a different purpose and time horizon.

MAD definitions can give orientation and provide a good basis for further definition work. It is however crucial to take into account the interactions between tradable physical and financial contracts since the former usually represents the underlying for the latter and the choice for market players to use physical or financial contracts should only depend on economic or investment reasons and not be driven by differences in the way various contracts are regulated or monitored.

We support the alignment of the inside information definition for commodity derivatives with the general definition of the MAD directive. The general definition focuses on what we see as the essence, namely whether the information would be likely to have a significant effect on the price of a product. This is what determines whether the information may be used in trading or not, and should therefore be one of the criteria when establishing if the information is inside information for commodities as well. It is however important to note that the definition used in MAD for commodities has to be further developed to the

peculiarities of the electricity markets. The terms “issuer” and “price sensitive information” have to be developed. One solution may be to clarify the understanding of these terms in relation to commodities in guidance from the relevant European authorities.

7. Do you agree that specificities of the physical energy markets should be taken into account through guidance rather than in legislation? If not, why not?

It is crucial that the regime is applied in a harmonized manner across Europe. This will be more likely in the case of binding rules. However, there are also benefits in avoiding a too fragmented regime with too many specific rules, as this may unnecessarily complicate the application of the rules. One way to address this may be to mandate the relevant European authorities to produce guidance on the interpretation and application of the rules specifically for the energy markets. This also allows certain flexibility so that future developments of the markets can be taken into accounts. Possibly, a combination of legislative adjustments on the one hand and guidance on the other hand may be the best solution.

8. Do you agree that regular market monitoring is an essential function to detect market misconduct?

Yes, as timely as possible. For an effective market monitoring the desire should be to develop harmonized, clear and complete rules and obligations, and as far as possible to align surveillance of other financial markets with that of the commodities markets in order to detect market misconduct (e.g. duty to disclose information). This is also related to transparency requirements.

Implemented internet based platforms by power exchanges already today ensure pre-trade transparency of fundamentals that can influence the price formation and power balance in the short and longer time frame (for ex. via planned/unplanned outages for production, consumption and grid (interconnector) per individual unit and/or aggregated) as well as post-trade transparency (e.g. publication of information as close to real-time) and provide market surveillance. These existing solutions like exchanges' surveillance bodies or transparency platforms shall be taken into consideration though it doesn't seem to be efficient to merely duplicate existing practices.

Market monitoring also needs to extend to OTC markets. Regulations should cover all trading venues (MTFs, regulated markets, OTC) spot and derivatives products. In order to effectively hinder market abuse it is important that the regulation applies to as much of the market as possible regardless of execution venue. This will reduce incentives to circumvent the market abuse regulations.

9. If yes, given the characteristics of wholesale energy markets, do you agree that market monitoring is best organised on EU level?

Monitoring and enforcement are essential and need to be interrelated. As ACER focuses on the coordination of and between the energy regulatory bodies in the MS, monitoring and enforcement should be done on a national level, ideally by one national regulator for energy markets (spot-and derivatives markets) together with the market surveillances of the exchanges. Regulators should be entitled to share information with each other in accordance with existing standards.

National regulators together with the surveillance bodies in place are best placed to perform supervisory tasks as *market monitoring* as well as *enforcement* for several reasons:

- a. They have in depth knowledge of the local markets, electricity systems and legislation and
- b. They have long experience with detecting breaches of market abuse
- c. They have already access to the relevant data from each regulated market

There shall be close cooperation between regulatory and surveillance bodies on national levels as already practiced today. In the upcoming legislation process existing (often voluntarily) and market based exchange rules should be included.

In order to guarantee harmonization and consistency between countries and markets while respecting differences in national and sectoral legislation the following criteria should be addressed at European level.

- a. Criteria for market surveillance
- b. Management of market surveillance related to cross border issues
- c. Management of second level analysis related to supranational cases

MiFID and MAD already specify these topics for financial markets and there are cooperation systems in place in the form of for instance CESR-Pol. A similar framework should be considered for energy markets as well. It is extremely important for the level playing field that the criteria for surveillance are the same everywhere.

10. If yes, do you believe that ACER should be given the role of an EU level monitoring body for wholesale energy markets?

No. See Q 8 above.

11. Do you agree that the EU level monitoring body for energy markets should have a coordinating role to ensure effective application of EU level rules for energy markets? If not, why not?

Yes. The coordination needs to focus on ensuring a harmonized application of EU rules in order to ensure a level playing field.

In general, a framework of market supervision cooperation at the European level should also be adapted to the cases where the nature of the Home State supervisory bodies differs from country to country - e.g., in the case a financial authority is in charge of the

national supervision of the energy market in a given country, while in another country this mandate has been given to the national energy regulator. A legal framework should enable both regulatory bodies to cooperate for their tasks of energy markets supervision, irrespective of their nature. Such a general cooperation framework should be part of a tailor-made regime for the energy markets supervision.

12. In your view, would enforcement of market misconduct rules be best organised on national level or EU level?

It is essential that rules governing enforcement are harmonised on EU-level in order to avoid that trading member's shift trading venues to safe harbors. The performance of enforcements together with monitoring should be organized on a national level, with European authorities having a role to ensure the harmonized application of the rules and ensuring proper cooperation.

a. If on national level, would national energy regulators or national financial regulators be better placed to enforce compliance?

Ideally, there should be only one central regulator in each Member State responsible for enforcing compliance and monitoring in energy markets. Which authority/regulator is best placed to fulfill this task needs to be left to a decision in each Member States. Should more than one Home-State supervisory body be designated, a legal framework should at least enable full coordination between these national bodies in charge of markets oversight, irrespective of their nature (e.g. financial or sectoral). Such a general cooperation framework could be part of the tailor-made regime for the energy markets supervision.

b. If on European level, which institution would be best placed to enforce compliance?

Enforcing compliance as well as monitoring shall be done on a national level. National authorities in the different Member States should closely work together, according to a legal framework with the help of European bodies such as ACER.

13. Do you agree that the market monitoring body for energy markets should also be able to monitor EUA transaction?

Compared to electricity and gas markets, the EUA market is not restricted by physical constraints. This would make EUAs better placed for European monitoring. This is also in conformity with what is envisaged in the Auctioning Regulation.

It is also relevant however to underline that exchanges already perform market surveillance of all trade that takes place on its markets. For EUAs as for all other products, it is crucial to ensure a proper cooperation in order to capture all trading that takes place in the same type of instruments on different markets. It is necessary for the authorities to take an overall view.

14. Would monitoring of traded carbon markets be best organised on national or on EU level?

See the answer to Q 13 above.

15. If on EU level, do you believe that ACER could be an appropriate monitoring body?

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16. Do you agree that it is not appropriate, at least at present, to consider coal, oil and other commodities along with wholesale gas and electricity markets? If not, why not?

From our perspective it is important to move forward with a regime to improve transparency and integrity of gas and electricity markets. Coal, oil and other commodities should not be taken into the scope of this legislative initiative as there is a clear risk for time delays for the gas and electricity markets. We prefer to move forward swiftly with the gas and electricity markets.

As we do not conduct business in the coal or oil sector, we will not go into further details of those markets, other than to say that it would seem appropriate to address also those markets in due time and taking due account of the specificities of those markets.

17. Do you agree that it is appropriate to apply exemptions and *de minimis* levels? If not, why not?

We agree with the Commission that rules shall apply equally to all entities within the scope of the regime. Should there be exemptions, these need to be explained further. Any exemptions must apply equally.

18. Do you agree that market data relating to energy market transactions should be reported centrally? If not, why not?

Authorities should have access to all the data necessary to perform their tasks. Exchange of data also needs to be ensured. It must also be ensured that all sensitive, i.e. individual party, information is kept strictly confidential and also that this data only can be used for purposes specified in advance and linked to market monitoring/surveillance.

Data reporting at European level should not lead to an additional layer of reporting. Generally, data reporting should be driven by the principle of efficiency. An immense amount of data is processed every day in energy markets, starting from market orders till fundamental information. Although all these data can potentially be used for market supervision, regular reporting of all market data may not be useful and should therefore be limited to what is absolutely necessary. Additional data must however be available on

request when required for an in-depth investigation. The goal should be to find a balance between record-keeping measures and reporting obligations to avoid unnecessary burdens both for market participants as well as for regulatory bodies.

19. Do you agree the body with an oversight role requires full access to fundamental data relating to carbon?

Yes.
