CESR

The Committee of European Securities Regulaters

Expert Group on Intermediaries

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FRANCE

Attention: **Mr Callum McCarthy**

Oslo, 16 September 2004

IMPLEMENTING MEASURES IN RESPECT OF THE INCLUSION OF COMMODITY DERIVATIVES UNDER THE FINANCIAL INSTRUMENT DEFINITION OF MIFID - COMMENTS FROM NORD POOL ASA AND NORD POOL CLEARING ASA

Nord Pool ASA and Nord Pool Clearing ASA ("Nord Pool") has with interest examined the opinions vouched in response to CESR's Call for Evidence CESR/04-323 on implementing measures in respect of the financial instruments definitions related to commodity derivatives.

Being the operator of the largest electricity and electricity derivative markets in Europe – the Nordic spot electricity market and financial electricity markets – we wish to give our view on the matters discussed in light of our experiences from the Nordic markets and other European commodity trading markets.

We apologise for not meeting the deadline for the Call for Evidence and we hereby formally give our approval to our comments being made public.

1. The definition of "commodities" in relation to commodity derivatives

In respect of the definition in MiFiD Annex I Section C (5), CESR may wish to take into consideration that cash settled commodity derivative contracts, as other cash settled derivatives, are likely to refer to price indexes for commodities rather than to commodities as such (cf. the parallel definition in Section C (4) where "financial indexes" is named as a possible underlying reference). We presume that commodity index contracts will be deemed

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to “relate to commodities” within the meaning of Section B (5). Alternatively, it should be specified that these contracts are covered under Section C (4) or (10).

2. The definition of “not being for commercial purposes”

Annex I Section C (7) of the MiFiD reads:

> Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognized clearing houses or are subject to regular margin calls;

We assume that the term “<u>not</u>” **(**in “not being for commercial purposes”) cannot be explained as an unintended error nor amended under the procedure for implementing measures as provided for in MiFiD Article 4 (cf. the BaFin-group/Becker Büttner Held opinion for a different view). Accordingly, there are two requirements which both have to be met for physical settled commodity contracts to fall within the scope of MiFiD; that the contracts are (i) “not for commercial purposes” and (ii) have the characteristics of other derivative financial instruments.

<u>The purpose of the individual contract</u>

In respect of the first requirement stated, the text clearly denotes that the relevant matter is *the purpose of the individual contract*. This means that a party typically engaged in trading physically settled forward contracts for commercial purposes will nevertheless fall within the scope of MiFiD if this party enters into contracts with the relevant characteristics for non-commercial purposes.

This would also mean that a contract may be exempted when viewed from the perspective of one party, but included when viewed from the perspective of his counterparty. As the relevant provisions in MiFiD is to be triggered by further definitions of relevant activities related to financial instruments (cf. in particular the definitions of “investment services” and “regulated markets” services) such an individualistic approach seems however not unwarranted.

In our opinion, this conclusion holds true also when taking into account the triggering effects of the MiFiD definitions in relation to other EC legislation, most notable the implications of the Market Abuse Directive (MAD). MAD Article 9 limits the scope to financial instruments listed or admitted to trading in a regulated market, cf. the definition in MiFiD Annex 1 Section B (6) where the purpose of the counterparties is of no relevance for listed contracts.

<u>Different motives for physical forward commodities trading</u>

Futures-, option- or other derivative contracts may be entered into for various purposes. With a strict linguistic interpretation the term “commercial purposes” may be read as “profit purposes” and contrasted to non-commercial or non-profit purposes (cf. for illustration the Prospectus Directive Article 1 where the for-profit/non-profit distinction is applied). However, taking the background of this text into consideration, such an interpretation seems unfounded, leaving a too wide scope of application for MiFiD.

However, we disagree with the narrow interpretation offered by the BaFin-group in their position paper, where the phrase “not being for commercial purpose” is suggested to include only the contracts entered into by a non-commercial enterprise as further defined. This is clearly not what the Annex calls for - what is suggested here by BaFin Group is a further

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qualification with no support in the directive's text but with the unintended consequence that MiFiD's scope would be limited to contracts entered into by financial institutions, investment firms and similar, where (we quote the BaFin-group letter)

> "the provision of (financial) services takes priority in the enterprise's business activities. An enterprise e.g., which delivers electricity to third parties and at this opportunity sells or buys a small number of derivative contracts relating to the base value electricity from its portfolios, in order to ensure an optimal portfolio management, does not act on a commercial basis with regard to these derivatives and therefore not for commercial purposes. The enterprise's primary motivation to act is the delivery with electricity. Consequently, the differentiation of the characteristic "for commercial purposes" depends on the composition of the portfolio of the enterprise dealing with base values of derivative financial instruments.

Bearing in mind that MiFiD Article 2 introduces other exemptions for (i.e.) energy companies who engage in commodity derivative contracts as an ancillary business, the intent with the definition in Annex 1 Section C) can not be to introduce even further exemptions for commodity companies and similar commercial enterprises when entering into financial contracts. The purpose of the "financial instruments" definition is to designate financial contracts and consequently not whether "financial services takes priority" in any business or whether any party enters into a forward contract for commercial or other purposes.

We presume that the BaFin conclusion may be caused by their reading of the "<u>not</u> being for commercial purpose" as a lapse or error. Also the principle of equal treatment suggests that what should be relevant for the definition is the purpose related to each derivative contract, irrespective of any other business matter of the participants involved.

Most derivative contracts will have commercial motives in the meaning "profit motive". However, the key point is, as we understand the legislative background, to distinguish between different types of commercial motives, namely (i) "financial motives" where market risk and market expectations are motives for entering into a contract, and (ii) other commercial motives not related to market price development and the risk and profit opportunities related thereto, most notably to procure delivery or off-take of commodities.

In the following we will distinguish between "financial motives" and "non-financial motives" in this respect. CESR may wish to introduce this distinction and a further explanation in the implementing measures to be issued upon CESR's advice, cf. our proposal below.

To illustrate the complexity in the motive situation we will start with an example from the emerging wholesale gas markets in Europe where physical spot and forward contracts still dominate. Here, there are basically two types of forward gas contracts utilised by market participants, in addition to their spot gas trading; (i) fixed price contracts and (ii) floating price contracts where the delivery price is a reference to a market price at delivery or a basket of market prices or a more advanced formula.

When applying "strict" floating price contracts, the market price risk – the profit and loss opportunities in respect of a fall or increase in market price – is *not shifted or re-allocated* between the counterparties. Such a contract will thus merely be a tool for procurement of delivery/distribution/consumption of gas, with no financial motive related to market price development. Similarly, this applies to most spot contracts traded at a fixed price.

On the other hand, a fixed price forward contract will have a *financial* motive, which is precisely why the delivery price is fixed in advance. The contract may also be a tool for delivery if the parties expect it to mature before or on delivery. The significance of the latter

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motive depends on to which extent the party expects to make or take delivery or alternatively close the contract prior to delivery, or effect further delivery by entering into new forward or spot contracts for the relevant quanta of gas. However, there is still a financial motive at hand, and this is what triggers the utilisation of a fixed price contract.

In the European wholesale electricity markets, fixed price forward contracts are common. In our opinion these contracts are primarily or exclusively financially motivated, even though the financial motives may differ in orientation and strength for the parties involved:

A producer of electricity may have a *financial hedging motive* as the fixed price forward contract provides him with hedging of market price exposure/market price risk. Whether this is the dominant motive for disposing expected production of electricity on a forward basis also depends on the relevant contract and market. In a volatile commodity market the price hedging aspect will normally be more important than in a less volatile commodity market. Similarly, a long-term contract period (a long supply period or long interim prior to delivery period) will indicate a stronger financial motive compared to a shorter term contract.

A (fixed or floating price) forward contract calling for mandatory physical settlement of electricity will also be a tool for disposal of the participant's electricity production. The significance of this purpose will depend on the availability of an alternative sales and delivery channel, including the existence of a spot wholesale electricity market or a retail or wholesale consumption market where the producer otherwise could have disposed of his future production.

Similar motive considerations apply to major consumers and distributors active in the electricity wholesale markets. A physical forward contract may both serve financial investment needs (market risk taking or market price hedging) and secure electricity for consumption or distribution to customers. What motive is dominant may depend on the market and the contract at hand. In markets with well-functioning wholesale spot purchase facilities – as is the case for the Nordic market and some European electricity markets - we are strongly inclined to conclude that fixed price physical forward contracts are dominantly financ ially motivated.

<u>Nord Pool's views on the financial/commercial purpose distinction</u>

On this background we will maintain that certain opinions vouched in the Call for Evidence offer a too narrow interpretation of the financial/commercial distinction in respect of the term "not for commercial purposes", not recognising that a price hedging motive clearly is a financial motive/financial investment motive, and that this is precisely why fixed price forward contracts are utilised (being settled physically or in cash) instead of floating price contracts.

To limit the financial/non-commercial motive definition to "speculative" motives or arbitrage motives relevant to non-hedging participants offers no satisfactory definition of the financial motives relevant and fails to identify *the single most important financial motive in the fixed price forward markets*, namely *price hedging* of production or consumption and distribution portfolios. The effect of this exclusion would be that one group of financially motivated participants – the hedging producers - is totally exempted from MiFiD.

We also note that the phrasing of "unhedged" positions as "speculative" risk-taking (though being rather common in some markets) may be misleading. From the point of view of a forward contract party – the point of view that in our opinion is relevant under the MiFiD

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definition – the price-hedger is no less a market risk taker than the non-hedging party. Both accept a certain market risk while being protected from another market risk (the seller accepts the price increase risk while he is protected against price fall and vice versa).

A fixed price forward contract is in this sense a financial investment in respect of both parties; the parties are *buying and selling financial risk.*

This financial investment contract may balance or not balance market risk in a larger portfolio of business contracts and properties, but this is another matter that is not relevant to the motive for the forward contract as such, as the motive of the forward contract is still financial. The "hedger" takes on one financial market risk exposure against buying protection from the opposite market price development, and thus makes a financial investment in a forward contract in order to limit or "close" a market price risk in his underlying commercial portfolio.

(From a market risk perspective of the relevant forward contract, the difference in risk is rather between the forward seller taking an unlimited risk and the purchaser whose risk is limited to the fixed price. This goes however only to the maximum of the financial risk exposure accepted and not the financial/non-financial motive distinction).

If applying the further qualification to the "main business purpose" as suggested by the BaFin Group, the situation would be even worse. A key group of participants in the forward markets could then have *all kinds of financial motives* for their engagement in the forward markets but still be exempted because of the significance of their remaining (commercial/energy) business.

This is in particular important as the motives of a participant may change and develop over time. A distributor of electricity or gas may i.e. initially be engaged in forward trading to manage a customer portfolio, and then enter into forward fixed price contracts to hedge price risk and be able to offer long term fixed prices to his customers (a financial motive). However, in order not to be to "visible" in the market, he may also wish to engage in sales contracts, or make additional profits on arbitrage or speculative trading in a smaller or lesser scale. It is in our opinion rather obvious that such trading is financial trading even if the participant would not have been in the fixed price forward market at all if not for his underlying commercial delivery needs.

Any participant, being commercial or financial, may also wish to adjust his hedging and risk taking positions on a continuous basis based on market price development or other factors. In this respect it is important to recognise the mechanics of these markets and in particular how the financial motives may have *decisive impact on the contractual instruments applied*: When a participant chooses to secure a "commercial" delivery need by entering into a forward contract at a fixed price, the financial motives are clear, cf. our comments above.

What we here have in mind is the typical motivation for trading in standardised contracts in a more or less liquid wholesale OTC-market, namely to have the later option to unwind or strengthen his hedge or risk-taking by further market operations if market and business development makes this favourable. A tailor-made, non-standardised, forward contract (with a floating price) would suffice to secure delivery needs. When a participant chooses to enter into a *tradable, standardized fixed price contract,* his motive is plainly financial; he wishes to take the risk to loose and to have the opportunity to profit on the contracts depending on the future market price development. The choice of (a standardised and thus financial) contractual instrument thus strongly indicates a financial investment motive.

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What the above illustrates is that an intentional approach to the commodity derivatives definition may give rise to complications and uncertainties, unless a more standardised and objective approach is chosen.

Nord Pool's recommendations on implementing measures

Our proposal in this respect is threefold:

1. The distinction between financial motive and non-financial motive is introduced in the implementing measures to explain the term "not being for commercial purposes".

2. The term "financial motive" is defined wide enough to include price hedging, price speculation and arbitrage. From a forward market perspective these distinctions are irrelevant – all are financial investments in price fall or price increase.

3. More objective indications should be introduced to qualify the individual motives, most notably the following matters related to the contract at hand:

   - whether the relevant contract fixes the delivery price and thus reallocates market price risk rather than procures for physical commodity delivery only (fixed price versus floating price contracts);

   - the length of the contract (spot or forward terms);

   - the volatility of the market at hand and the availability of other delivery channels for physical production, consumption and distribution of the relevant commodity;

   - whether the contract is standardised, including if the contract "mirrors" any listed contract series of a regulated market.

Further comments

Our suggested has similarities with (but there is no complete match) the close-out test suggested by EEX, in particular when applied to the standardised fixed price forward contracts. An advantage of our proposal is that it relates directly to the qualifying terms of MiFiD (the commercial/non-commercial purpose), as it may be unwarranted to assume a financial motive of a contract simply because it in principle may be used to off-set cash settled contracts or contracts admitted to trading in a regulated market.

What is needed is more precise advice as to what will constitute a financial motive in respect of the contracts (in the form of implementing measures). We will also maintain that a tailor-made fixed price forward contract may have a financial motive (price hedging) even if less useful to offset a regulated market contract portfolio. On the other hand, a floating price OTC contract would not constitute a financial investment even if it may be used to close-out a regulated market listed floating price contract.

Our analysis is "technical" in the sense that we explore the standard motives of participants involved in physical commodity forward trading and suggest more precise definitions in the implementing measures of MiFiD on this basis. However, when issuing implementing measures general policy concerns of MiFiD should also be taken into consideration, most notable (i) the aim to protect investors in the relevant markets and in particular retail investors and (ii) the effort to improve equal and fair competition in the relevant markets.

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Here we agree with EEX that a third element is the need to avoid regulatory arbitrage. MiFiD introduces well-advised additional requirements on regulated markets and investment services related to financial instruments in the European markets. It is, however, of importance that the scope of definitions does not leave an "open door" for OTC-markets where financially motivated trading takes place, but where market operators and key participants are unregulated due to the physical delivery needs/commercial purpose relevant to possibly only a small part of the trades they enter into.

So far the retail energy markets of Europe are primarily spot markets/off-take markets with a limited extend of forward price fixing for private consumers. However, a fixed price physical forward market is the most likely retail/consumer derivatives market to be developed both in the electricity sector and gas sector. If physical forward contracts are excluded from the scope of MiFiD, this directive will to a very limited extent be a regulatory tool for handling further development of the financial retail markets in commodity derivatives.

A third policy consideration must be to introduce a common regulatory approach all over Europe, minimising the differences in traditional regulatory practices and approaches. A too intentional and purposive approach will, irrespective of being related to the intention of the single counterparties or the "general purpose" of the business of the participants, create openings for different interpretations by the regulatory bodies of Europe.

What one may then experience is (as a matter of illustration only) that German market participants will place pressure on their regulators to maintain the traditional German "light" approaches to the physical forward markets while the English participants will prefer their intentional approach, the Dutch will champion their own traditional practice and so forth. The outcome of this may very well be that the EC or EEA member states with the most lenient approach to physical forward trading will be favoured by market operators and key participants, and become centre for the emerging commodity derivatives trading in Europe.

In our opinion, CESR and the Commission should address this problem by introducing precisely defined implementing measures where the *contracts and markets as such* are the key factors of assessment: What shows a financial motive/financial investment motive in respect of a counterparty to a forward contract is the fact that this party chooses to enter into a long-term contract that allocates market price risks, or is designed for regular trading, or both. In this respect there is a connection between the first and the second condition of the definition in Annex 1 Section C (7): *What indicates a financial motive is precisely the fact that a party enters into a contract with the characteristics of (other) derivative financial instruments.*

Finally, we maintain that the MiFiD definition must include all contracts with financial or non-commercial purposes ("not being for commercial purposes") irrespective of whether this is the <u>only</u> motive or there are also other motives relevant. A physical forward contract may as shown serve more than one purpose. Here any contract with a financial motive must be included, even if other motives are also relevant.

3. Definition of the characteristics "other derivative financial instruments" for derivative contracts within the meaning of Section C (7)

We agree with EEX that the conditions relating to clearing and regular margin calls do not identify the "core" of what characterises a derivative financial instrument. These are credit risk mitigants which are important for the derivatives markets but not specific of these

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contract markets. What defines a derivative financial instrument is the *market risk allocation* provided for in the contracts.

A possible starting point may be the definition provided by the Ba-Fin Group:

> Derivatives are outright forward transactions or option contracts whose price depends directly or indirectly on the stock exchange or market price of a reference value (here: commodities). An outright forward transaction is a transaction pending between conclusion and maturity, and which has not been settled by both parties. One characteristic of buying forward e.g. is the fact that the object of purchase is to be delivered and paid at a deferred point of time. An option contract in its typical form is a contract which entitles a party, the buyer of options, against premium payment to conclude a transaction on the basis of predetermined conditions by issuing a unilateral declaration of intent at or up to a specific future date. Until exercising the option right the buyer of options is only entitled, but not obliged to conclude such a transaction.

We would like to add futures contracts (day-by-day cash settled contracts) and swaps and contracts for difference (CfD) as variations of forward transactions.

<u>Derivative financial instruments are financial risk investments</u>

Further, we would like to highlight the fact that the "dependence" of a derivative contract to the underlying reference value has a specific nature: What derivatives actually do is to create a contractual profit for a party (and loss to the other) upon the development of the underlying reference value relative to a fixed value (the agreed forward price or option strike price) or relative to another variable (as for i.e. a plain vanilla currency swap or a CfD with two variable commodity values). *The derivative contracts are thus investments in a certain combination of market price risk/profit opportunities; the parties buy and sell a certain market risk protection from/to each other.* (This is why we emphasize that the key characteristic of a forwards contract that is a derivative financial instrument is the forward price fixing contrary to a floating price reference).

This financial investment element in the contracts is most visible in markets with a robust underlying value reference (a liquid commodity market) and a liquid forward market, as in the Nordic electricity area. These markets make it easy to realise profit or loss on the forward contract alone, either by re-purchasing or re-selling the forward contract, or by market operations in the underlying commodity upon delivery.

However, even without a liquid underlying market or liquid secondary forward contract market, a fixed price forward contract will serve financial motives by securing the price of a commodity. The lack of a well functioning secondary forward contract market or underlying commodity market for re-balancing of positions simply means that this market is less suitable for financial investment purposes (speculation or hedging) for participants not being physical producers, distributors or consumers while the fixed price contract would still represent a financial hedge of the market price for the latter participants.

In this respect the typology suggested by the BaFin Group in line with traditional German practice fails to acknowledge the characteristics of derivative financial instruments, but merely serves to identify *one particular use of derivative financial instruments*, namely the trading strategy called "hedging" as contrasted to a so-called "speculative" approach to market price risks. A reference to the (quite overwhelming) finance theory on derivatives should suffice to explain that this is a too narrow approach to what is characteristic of derivatives. What characterises derivatives is that the same type of contract (being physical or

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cash settled) can be used for *different financial purposes* where price hedging where financial derivatives are combined with other contractual or property positions is but one financial motive.

We fail to see the support for the argument that energy markets have their own “special situation” due to the fact that on the one hand electricity cannot be stored and gas is only storable to a certain extent and the necessity of security of supply on the other hand. It is not our experience from the Nordic markets that this creates a higher economic demand of physical forward transactions, as the BAFin Group claims. The need for electricity delivery at a deferred date may be served by spot market trading as in the Nordic region, while financial or physical forward contracts hedges or increases market price exposures. Please recall that in the Nordics the initial physical forward marked early turned into a market structure with a liquid physical spot market and cash settled futures, forwards and options markets with lesser and lesser physical forward trading. The different development in the German market has primarily historical reasons, probably also related to regulatory arbitrage.

The fact that fixed price forward transactions stipulate physical settlement and thus leave the parties under an obligation to perform and accept delivery of a commodity does not imply that these transactions are not financial investments/derivative financial instruments as the BaFin Group claims. It simply means that the derivative financial instrument at hand is a physically settled derivative financial instrument, as compared to a cash settled derivative financial instrument.

The distinction between these *two types of derivative financial instruments* is well known from the securities derivative markets, where physical call options were the first instruments introduced in the US stock markets in the 1970ies and in a number of European markets in the 1980ies, to be followed by put options (also mainly physical) and the cash settled index products. No one has to our knowledge ever claimed that the physically settled derivative instruments in these markets are in fact not derivative financial instruments at all but something else.

Thus, to distinguish between “derivatives” and “deferred delivery contracts” and to designate cash settlement as a key characteristic of derivate financial instruments misses the point, in particular in light of the context of the MiFiD definition, where the crucial legislative point is that the implementing measures shall identify *the common characteristics* of all derivate financial instruments irrespective of settlement form.

<u>Nord Pool’s recommendations</u>

The single most important factor characterising a derivative financial instrument is in our opinion that the contract re-allocates market price risk, and thus serves a financial insurance (hedging or risk reducing) or risk increasing purpose.

Here, a fixed price forward contract has all the relevant derivative characteristics while a spot contract at fixed price or a floating price forward contract merely will be a tool for delivery.

Indications of lesser importance is (i) whether the forward contracts are tradable in a secondary market, (ii) whether the forward contracts may be subject to close-out (novation) prior to delivery bilaterally or multilaterally through a clearing house, and (iii) whether the underlying commodity is tradable in a liquid market.

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Items (i) and (ii) makes it possible for the counterparties to realise profit and loss on the contracts without ever being involved in any commodity delivery or commodity trading. If only item (i) but not (ii) apply, the counterparty must be party to the commodity settlement system to effect these settlements. If a functioning spot market exists, he may also take net positions to settlement and realise his profit and loss in spot market transactions.

A key challenge for the development of the European gas markets is the development of well functioning transmission systems, where lack of transmission capacity may limit settlement system availability for trading market participants. In the European electricity markets these problems are not material, with the exemption of certain cross border bottlenecks.

When taking into consideration the development of the electricity spot markets, we conclude that the continental European electricity markets are functioning markets to such an extent that fixed price forward contracts not only serve a financial hedging motive in relation to securing prices for a underlying commercial need for commodities but also represents *financial investments* as such, as contract values may be realised by participants with no commercial interest in production, delivery or consumption of the relevant commodity.

Still, these markets need further development and new participants to create more liquidity and better functioning markets. To achieve this goal we believe in creating an equal playing field for all market participants to the largest extent possible, where regulated markets are introduced when the markets mature. An implementation of the MiFiD definitions whereby energy companies are exempted from all regulations to the extent they trade in OTC physical forwards would jeopardize such a development of the continental electricity markets. It would represent a continued discrimination of the financial market participants trading in the same markets and may prevent regulated markets from establishing the liquidity pools required, as the MiFiD definition will apply to any listed contracts (cash or physically settled).

4. Definition of emission allowances

"Emission allowances" should in our opinion be defined in accordance with Directive 2003/87/EC on establishing a scheme for greenhouse gas emission allowance trading within the Community. However, one should – in line with IETA Master Agreement – also include definitions of Alternative Allowances and CER's:

Alternative Allowance means a unit of account, representing a right to emit 1 tonne of carbon dioxide equivalent, either issued by a Member State in return for a similar unit from an emissions trading scheme in a non-Member State pursuant to Article 25 of the Directive or an allowance from an emissions trading scheme in a non-Member State recognised by the EU Commission pursuant to the Directive, that may be used for determining compliance with emissions limitation commitments as prescribed by the Scheme Rules.

Certified Emissions Reduction or **CER** means a unit of account on a Government or Intergovernmental registry representing 1 tonne of carbon dioxide equivalent issued by the CDM Executive Board in accordance with Decision 17 (17/CP.7) of the Conference of the Parties to the UNFCCC.

Emission allowances can not be regarded as financial instruments, but derivative transactions (including physical forward transactions) in such instruments should be included under the definitions of financial instruments on the same basis as commodity derivatives by applying the definition in Section C (10) cf below.

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5. **Whether there are, at this time, other categories of assets, rights, obligations, indices and measures not otherwise mentioned in Section C, where contracts relating thereto should be determined to fall within Section C10. CESR should explicitly detail those categories.**

We are of the opinion that at least two categories of derivatives should be included:

- Any derivative financial instrument relating to greenhouse allowances when cash settled, and also when physically settled to the extent the terms under Section C (7) applies, ref. above.

- Any derivative financial instrument relating to green certificates, on the same terms.

Nord Pool is presently organising the exchange trading and clearing in green certificates issued by the Swedish state, and expects to further develop its certificate market.

Nord Pool is also planning for exchange trading and clearing of all-European allowances to be launched in early 2005.

We do not expect these new European trading markets to develop to a size comparable to the existing and future European gas and electricity markets. These markets will at the same time be "ancillary markets" to the gas and electricity markets as many of the participants will be active in all these markets.

Both from a regulatory and cost- and market efficiency viewpoint it is thus important that these markets to the largest extent possible becomes subject to the same regulatory framework as the electricity and gas markets. From a derivative financial market perspective, where the key element is whether the contracts serve financial investment needs (including price hedging and other investments in market risk), it does not matter what is the underlying reference – be it electricity, gas, green certificates or allowances – the contracts that provides financial investment opportunities should fall within the scope of MiFiD whether the contracts are admitted to trading in a regulated market or not.

We are looking forward to further participation in the joint efforts to reach a good regulatory framework and appropriate MiFiD implementation for the existing and emerging European energy markets.

Yours sincerely
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