Norges Fondsmeglerforbund

The Association of Norwegian Stockbroking Companies
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Ad: CESR's Advice on possible Level 2 Implementing Measures for the Directive (2004/39/EC) on Markets in Financial Instruments, Consultation Paper

1. The Association of Norwegian Stockbroking Companies (ANSC) represents investment services companies, including the Norwegian banks, operating in the Norwegian market. Our members represent a very dominant market share in providing investment services in Norway, and they provide services both to professional and retail clients.

2. We have participated in preparing a joint response to CESR's June 2004 consultation paper (CESR/04-261b) on advice on possible implementing measures of the Directive 2004/39/EC on Markets in Financial Instruments ("MIFID") together with other Nordic and international associations such as ISDA, ISMA, IPMA, BMA, FOA, LIBA). On the majority of topics covered in CESR`s consultation paper our views are expressed in detail in the joint response. However, since we represent a smaller financial market, we will draw CESR's attention to some important issues by forwarding this additional response.

3. One of the main objectives of the MIFID is to promote effective and real competition within Europe. Therefore it is extremely important that the provisions and advices that are given do not counteract this objective. We fear that too detailed and mandatory regulatory provisions on some of the services provided by investment firms (as competitors with regulated markets on liquidity and trading) can have such an effect. We will try to illustrate this.

4. The Norwegian market is relatively small with only one regulated market – Oslo Stock Exchange – and relatively small securities firms. Despite the fact that the stock exchange regulations in principle are open for competition, the factual situation is that we have only one stock exchange with a de facto monopoly. (This seems to be the situation in the other Nordic countries, with the exception of Sweden.) Since the

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privatisation of the stock exchange we have experienced relatively strong increase in the fees to be paid by members. This seems also to be the situation in other European markets. Thus one of our main concerns related to the Level 2 implementing measures are that, if the regulation of investment firms and MTF's become to prescriptive and rigid, it may seriously hamper the possibility for the only possible competitors to stock exchanges, to compete on liquidity and trading. Less competition will result in increasing fees, and increase that in the end will be borne by investors. In our opinion CESR should have more focus on these possible effects when considering the proportionality of the different advices.

5. The Norwegian market is in our opinion a well regulated market with a relative good balance between statutory laws and rules and regulations given by public authorities as well as relevant trade associations, including ourselves. Trading in listed shares takes place in an automatic trading and matching system and both professionals and retail investors trade in the same order book, basically on the same information. Both retail and professional investors have access to automatic order routing systems through our members and other brokerages. The use web-based solutions for information and trading are very widespread. All Norwegian investors do have at least one account in the Norwegian CSD operated by either banks or securities firms. In these accounts investors register not only positions in equities, but also bonds, UCITS, standardised and OTC derivatives (with clearing on end customer level). Thus the degree of information flow, partly independent of the securities firms, are very high and the level of investor protection must also be considered as very good. The Level 2 implementing measures must recognise these more technological advanced systems and markets. This can only be done by not prescribing in detail how, by whom or by what means information shall be given. This is yet another argument for why a more flexible and principle based approach in the advice is preferred.

6. Trading in financial instruments is not only covered by specific regulations given within the scope of the securities trading act, but also by i.e. the general law of the sale of goods, the general law regulating marketing communication, law regarding consumer purchases and so on. It is our view that the more detailed implementation of MIFID must be done in such a way that it is possible and in harmony with existing regulation as long as the main objectives of MIFID are achieved. With a too detailed and binding EU-regulation we seriously fear that the result may be a development of a kind of common EU securities trading regulation disconnected from the basic private laws in the individual countries. If this will be the result we risk uncertainty and confusion among firms and clients, which again may lead to results other than what we are trying to achieve. In this connection it is important to bear in mind that a lot of legal risk has been transferred from the securities firms and to the clients by implementing the home land regulation approach combined with a higher degree of cross border services. This is yet another argument for why a more flexible and principle based approach in the advice is preferred.

7. On this background, and despite the fact that most of what CESR prescribes is sound and sensible, we will voice a general criticism against CESR's advice, namely that it is <u>too detailed to be suitable for inclusion in legislation or regulations</u> issued by public authorities, as must be the case where Level 2 is concerned. Most of what is stated in the different boxes is more suitable for Level 3 or as explanatory texts. CESR should focus more on creating its advice in such a manner that the EU-regulation comes out so flexible, but at the same time precise, that it is possible to implement such

regulations within the frame of existing national laws and regulation. In our opinion it is therefore important that CESR in its final advice is clear on what issues that need to be dealt with at level 2 and what parts of the advice that are more examples and illustration on how the different goals can be achieved.

8. To illustrate this, and without accepting the detailed content of the individual advice, ref our joint response, we can give the following examples on how we think CESR should approach this task.'

Example 1:
In Box 1 the general provision under point 2 a to d (with the amendments suggested later in this paper) may be the level 2 advice. The same goes for point 3, but under this point litra a to e should be moved to the explanatory texts. The same applies for the rest of point 3 and 4 with the exception of the requirement for direct reporting. The reason for this is that what is stated in these paragraphs are only examples or descriptions of some of the compliance functions and responsibilities and therefore not suitable as legal texts. Point 3 and 4 can therefore be compressed as follows:

> *3. An investment firm must ensure that its senior management is responsible for compliance. Where the head of compliance function is not a member of senior management, he must have direct reporting line to senior management.*

Example 2:
In Box 6 under conflicts policy and with reference to art 19 nr 3 the advice may be compressed as follows:

> *4. An investment firm must establish, maintain and enforce a written policy that sets out details of its organisational and administrative arrangements for identifying, preventing and managing conflicts of interest in order to prevent damage to the interests of its clients.*
>
> *The investment firm's conflicts policy must be appropriate to the nature, scale and complexity of its business, in particular:*
>
> > *(a) its organisational structure and business model;*
> > *(b) the investment and ancillary services it provides to its clients, and the type of financial instruments involved; and*
> > *(c) the business it conducts on its own account.*
>
> *Where the investment firm is a member of a group the firm shall take account of the size, structure and business of the other members of the group.*

The rest (point 6 to 8) can moved to the explanatory texts.

Example 3:
In Box 7 under general obligations paragraph 2, and probably paragraph 4, are suitable as advice, while the contents of paragraph 3, 5, 6 and 7 are more of the nature of explanatory text.

9. It is our general impression that, where there are disagreements within CESR on how to regulate an issue, the members that argue for a more principle based and flexible approach have justified their position with relevant arguments and examples. On the other hand, those of CESR's members, that are in favour of more detailed and binding rules – and even in favour of reversed burden of proof – to very little degree come up with other arguments than what they "feel" or "are of the opinion of".

10. In our opinion detailed and binding rules within a sector can only be justified if there are legitimate reasons for such rules, and this has to be based on facts or analysis of the relevant issues. A reversed burden of proof is a very radical step to take and should only, if ever, be introduced if one can demonstrate that there is a general lack of compliance throughout Europe. In our opinion there is no evidence for such lack of compliance, nor are we familiar with any research or analysis that can support such an assertion. Another aspect with such a rule is that they may lead to a lot of unnecessary and unfounded conflicts and litigation, not at least because it very often can be very difficult to demonstrate or prove in every detail sufficient compliance.

11. Since the securities market is international, international co-ordination of the regulatory system regarding the market is important in order to render the securities market more efficient. We co-operates with other trade associations and SROs in Europe concerning international co-ordination. Irrespective of whether it occurs upon the initiative of the players on the market or the initiative of the European authorities, this co-ordination must take place on a level which is adapted to market conditions. There must not be any tendency to assess the quality based on the quantity of regulations. CESR's proposal is too far-reaching in this respect, bearing in mind that it relates to Level 2 and, therefore, requires local, centrally formulated statutory rules or regulations issued by public authorities.

12. Level 2 measures need to help to alleviate the practical problems caused by the timescale for implementing the Directive. Measures should be at a general enough level of detail, consistent with the Level 1 text, to minimise the need for extensive changes in market participants' existing systems and procedure. Transitional, phased implementation, grandfathering, and other means should be used to take account of the practical impossibility of making certain changes to systems and procedures by the implementation date. For smaller firms and smaller markets the possibility of phased implementation or grandfathering is extremely important due to the simple fact that the necessary resources to develop, buy and alter advanced IT-systems are limited.

13. We would also like to highlight the importance that CESR make its advice adaptable to future developments in electronic communication in recognition of the global uptake of the internet. It should be sufficient for the firms to provide the information required available either through the WEB or e-mail or provide the information on paper only by request from the client. In Norway, most of the transactions are done over the internet and therefore most likely the majority of clients, including retail clients, will have access to the information published on the WEB. CESR should take in consideration that internet already is and will be even more an efficient and well functioning communication of information between clients and firms. Adding additional cost to the investment firm without adding any benefit for the customer but rather costs is not a desirable situation. The whole draft must be reviewed so that electronic alternatives to paper communications with clients are recognized. There must be alternate options for more or less every rule in this context.

14. Therefore, when the phrase ”in writing” is used in the consultation paper (for example under Article 19(3) regarding information to clients), we would like to highlight the importance of including electronically distribution of information through e-mail and the firm’s website etc. In addition, when a signature is required by the clients (in connection with client agreement) we would stress the importance to equalise written signature with electronic signature.

15. If the method proposed by CESR is applied in regulation by the European authorities, there is much that indicates that this would counteract the goal of harmonised European regulation, namely to create a legal platform which provides a level playing field for investors, issuers, and intermediaries to work throughout Europe. The experience from the implementation of the Market Abuse directive, with three proposals present (Norway, Sweden and Denmark), clearly shows different approaches and interpretations, i.e. to the implementation of the definition of “inside information”.

16. If a large number of courts and supervisory authorities in various European countries are charged with the duty of interpreting the harmonised rules, there is a very great risk of divergent interpretations, if CESR's all too vague, but detailed, proposals are carried out. In addition, legal traditions differ throughout Europe and will continue to do so for a long time in the future. Apart from the deficiencies relating to the clarity of CESR's Advice, we are also critical of the quantity of proposed regulations and the detailed level of the regulations. If a method is selected that goes as deeply into details as CESR has done, it will be necessary to create a large quantity of rules in order to cover the entire area. It will establish the need for repeated amendments and supplements in order to adapt to the changing reality that is regulated. If amendments are not made, this may hamper development possibilities to the disadvantage of the fundamental goal of the European Financial Action Plan, which is to create the conditions for a globally competitive European financial market. The crucial factor must be to attain the goal intended with the regulation, and to do so in a manner that is adapted to the inherent power of the European market. The goal must not be to achieve a regulatory regime in it self.

17. Secondly, there is in fact a large risk that too many, overly detailed regulations create a tendency among the players to comply with every individual detail in the regulations at any price, with the risk that the real goal of achieving a fair and orderly European market will come second.

18. The main role of the compliance function is both to monitor the employees and deal with pre-emptive actions. We would advise CESR to focus more on the importance of dealing with the pre-emptive actions since pre-emptive actions are just as important as surveillance.

19. A focus on remuneration as the most important issue is wrong. We have to stress that independence has a broader perspective, i.e. compliance must have direct access to the Managing Director as well as the different heads of business units and as well as all other employees. Officers within the compliance function shall also have access, in pursuit of their duties, to all business units within the firm and to all archives, records, documents and meetings. All officers charged with compliance must be sufficiently independent to be able to perform their duties objectively. Furthermore they should have the status, expertise, authority and personality that make them able to follow up their duties.

20. The degree of independence should be dependent on the complexity of the investment firm's business. For smaller investment firms the compliance officer might have other and more administrative tasks and responsibilities. As a consequence, in smaller investment firms, it may not be possible for the compliance function to comply with the requirement for independence from the business. In practice, the compliance function is often carried out by one of the business-line employees and requiring an independent compliance function may undermine the ability of small firms to enter the market. The degree of independence set out in CESR's proposals should only be required where it is proportionate in view of the nature, scale and complexity of the business.

21. Under the advice related to personal transactions, paragraph 7e) (i), it is stated that an investment firm must, where a relevant person is prohibited from entering into a personal transaction, take reasonable steps to ensure that the person does not counsel or procure any other person to enter into such transaction, unless such advice is given in the normal course of his duties. In Norway, we have very strict rules for employees trading on own account. We take it that the abovementioned suggestions does not prohibit an employee from giving advice to clients on a regular basis on specific instruments, even though that employee is not allowed to trade on own account in the same instruments.

22. Neither the directive nor the consultation paper seems to voice any strong opinion on what parts of a business that can be outsourced. In principle every part of the business can be outsourced as long as all legal responsibilities towards clients and authorities rest with the licensed firm. Thus the rules and regulations must be flexible enough in order to base the "outsourcing decision" on business evaluations only. The competent authority should concentrate on ensuring that outsourcing decisions.

23. When it comes to the annex on minimum list of records we understand that the request for records on categorisation of each client this must refer to whether the client is professional, eligible or retail. Some members has raised question about this and this should therefore be clarified. Regarding periodic statements we would like to underline hat such statements are relevant for providers of custody and discretionary asset management services, but not for brokers/dealers in general. Clients receive contract notes, transaction statements from CSDs, periodic statements from the CSDs and can view their securities holdings through internet solutions at any time. Thus there is no need for introducing (additional) periodic statements which are also not customary in Norway today. Again the advice must be so flexible that it is possible to take into account the most effective electronic solutions as long as the clients receive the relevant information irrespective of who the provider is.

24. Regarding records of marketing communications and investment research; it is excessively onerous to keep records of every item of such communications, and we can see no reason for a mandatory requirement for filing and keeping all kinds of faxes and more or less informal recommendations for 5 years. If the requirement is kept the requirement to keep them "in writing" should be deleted, because it should be sufficient in the web-enabled age to publish and keep the communications electronically.

25. Question 4.1 propose the reversed burden of proof where the investment firms are forced to provide proof that they have acted according to the rules and regulations in regards to every potential conflict. This reversed burden of proof goes against the

European Parliament's and the European Council's decision at Level 1, and also runs against constitutional requirements of some Member States. It is a fundamental principle of law that the burden to prove a case rests with the "accuser". If no evidence is brought, then the case has not been established. In addition, this rule will introduce an untenable situation for investment firms taking into consideration the enormous amount of transactions and client relationship the investment firms are involved in.

26. In relation to question 4.2 we take it for granted that all firms will keep records of all legal documents in original and signed by entities involved in the actual assignment/ transaction, (i.e. assignment agreements, agreement among underwriters, reports, waivers, disclaimers etc), correspondence with concessions from authorities (including stock exchanges), prospectus if any and for IPO's and similar transactions book-building data, subscription /allotment list, dependant upon the actual type of assignment. A mandatory requirement is not necessary and such a requirement has an element of unnecessary micro management in it.

27. Even though custodian service in Norway is an ancillary service that do not require a license according to the securities trading act, the normal situation will be that custodians that are being used do have a license as a credit institution or an investment firm. This factual situation should not lead to the conclusion that license should be mandatory wherever in the world clients assets are held. There may be jurisdictions where no licensed firms exist. Therefore the advice should have an exit option for such circumstances.

28. Regarding question 5.1 the individual custodian should be subject to national legislation and therefore should have an independent responsibility/liability to fulfil the governmental obligation in regards to security etc. The investment firm that appoints such a firm should not bear any responsibility for this firms actions unless the investment firm has not done the necessary due diligence before appointing the custodian.

29. Regarding conflicts policy we will underline that concrete organisational standards should be stated at a general level in Level 2. Then firms should be allowed to adapt or develop their conflicts policy appropriately. We support a conflicts policy in principle as a way to retain managerial responsibility, but stress that the detail of this should not be prescribed by European law. Further examples are therefore unnecessary. It is preferable to require firms to take sufficient steps to manage their conflicts rather than providing such detailed recommendations as to amount to a mandated course of action.

30. In relation to question 6.2 we strongly prefer option (a) and oppose (b) which is unreasonably rigid. It is sufficient to give examples of methods for securing objectives, and prescription is neither necessary nor desirable. Since investment firms differ in size and services offered there should be no requirements to describe arrangements to prevent conflicts of interest in a policy. Hence, there should not be a presumption that personnel should not be engaged in multiple activities. Instead the emphasis should be on conflict management, for which one of the tools may be limiting the ability of one person to engage in conflicting activities. Requiring firms to include certain pre-defined measures in their conflict policy is a recipe for the conflict policy to be too rigid, and become out of date. The onus should be put on senior management to manage conflicts of interest, as conflicts will differ between

firms, and, even within a firm, will change over time. It will not be possible helpfully to mandate the appropriate policies or steps that must be taken by all firms all of the time. The way to resolve disagreements between CESR members is to adopt a principled approach that all parties can agree on, leaving Member States to put this into practice as they see fit.

31. Given that firm policies are regularly updated, being required to issue static paper based policy, is not workable. We suggest that disclosures, in general, should be available on the investment firm's WEB-site, and that reference to this WEB-site is made known to the clients. Such statements should then be regarded as complying with the actual provisions.

32. In regards to the different provisions related to information to clients, and the requirement to inform “in writing” we will like to stress the importance that CESR make this a WEB-enabled advice in recognition of the global uptake of the internet. Hence, the requirement that information is provided “in writing” should be deleted here and throughout, unless the definition of “in writing” is altered to include posting on a website or by other electronically means. Written information on paper to clients is just adding unnecessary cost on the firms which again will increase the cost for the clients. This will certainly be the case for smaller firms and in smaller markets. Therefore, there should be allowance for distributing information via the investment firm's WEB-site. Electronically distribution also enables continuous and simultaneously updating of information to clients. If a client requests, the firm can provide information in the traditional way.

33. The requirement that retail clients shall be provided in writing "in good time", may not be practicable as far as "good time" is concerned. Retail customers should not be prevented from participating in IPOs, new issues and other securities offerings, where such a requirement is not possible. Some of our members have addressed the need to delete the phrase "in good time" and necessary flexibility introduced by adding "in general" or similar. Alternatively, one should rephrase "in good time" by adding "dependent on the situation or the instrument/service in question

34. Whereas we support the idea of introducing clients to risk areas/levels, one should recognize that, in the end, it’s the client’s responsibility to make the final investment decision. The investment firm duties to ”advise against”, seem to take away this investor risk.

35. Information of the investment firm, methods of redress, conflicts policy etc should be given to potential or new clients when establishing a new client relationship. Most of existing clients have already received similar information in accordance with existing laws and regulations. It is therefore not necessary to replicate this, even if there may be some smaller discrepancies between the old and the new requirements regarding the content of such information. We do not support the idea of repeating this kind of general information each time an existing client uses new services, as the wording in paragraph 1 b) ii) implies. Also, the proposed requirement that information must be provided in writing before an existing customer enters into new types of financial instruments might not be very practicable. It opens for a discussion of how to define a new instrument (Completely new, variations of an existing instrument, and so on).

36. Most of the information that is required to give to the clients before they put an order must be sufficient to include in the common business terms. In accordance with Norwegian contract law and practice clients giving orders after having received the

general business terms and conditions are deemed to have read and accepted the terms and conditions.

37. There is a lot of scepticism among our members regarding the term “illiquid” in relation to paragraph 7 a (page 57). Liquidity is a dynamic term and the definition must be relative to the market and/or shares in question. The term is likely to raise major interpretation difficulties within different EEA countries. In contrast to other financial markets, stock-exchange listing in Norway will not necessarily indicate that the security is liquid. Thus, a lot of securities traded in the Norwegian financial market might be covered by the term “illiquid”. Compared to i.e. the majority of stocks traded on the London Stock Exchange, most of the stocks traded on Oslo Stock Exchange will be referred to as “illiquid”. As a consequence, the information that has to be given to the clients by the Norwegian investment firms will be extremely comprehensive, extremely costly and most likely unnecessarily, unless it is clear that the alternatives given in paragraph 7a are alternatives.

38. Furthermore, in accordance with paragraph 12 an investment firm must provide appropriate guidance on, and warnings of, relevant risks when providing investment services according to paragraph a)- f) including illiquid financial instruments. There are strong concerns among Norwegian investment firms that the requirement in paragraph 7a) together with paragraph 12 will be extremely difficult to handle in practice. As already stated, most of the Norwegians retail clients trade electronically and do not necessarily speak to a broker before trading. The question will be; how can the investment firms in these situations provide the necessary information?

39. The level of prescription related to client agreements is inappropriate for Level 2. There is nothing in Level 1 that indicates that Level 2 should set out the complete text of the model client agreement.

40. For trading in derivatives and portfolio management written agreements are OK. However, for basic services, the Conduct of Business Rules or similar document should be sufficient. There should not be necessary to sign a written basic agreement, which by today, neither is required by contract law, nor required by market practice in Norway. If a general requirement to sign a written agreement will be mandatory, which will be inefficient, costly and contrary to the objective of promoting and developing a European financial markets, there must be an opening to permit i.e. electronic signing.

41. There should be flexibility for clients to be allowed to waive rights to receive certain or any reports. Some clients may not want to receive trade confirmations.

42. In regards to paragraph 3 on contract notes, orders are, in Norway, accepted on a day-to-day basis, unless otherwise agreed. This is according to Norwegian market practice. Thus, the customer will either receive a confirmation of trades executed or will have to repeat his/her order on the following business day. The proposal for mandatory confirmation of orders that are not executed is therefore unnecessary, impracticable, old-fashioned and very costly. Most of securities transactions done by retail clients are carried out over the Internet. The systems made for such trading allows the customers to monitor the status of their orders real time. We suggest that paragraph 3 in Box 10 is removed, or alternatively modified, removing the first two sentences.

43. CESR should appreciate and support the use of internet as a very efficient information and communication tool between firms and clients. Even though Norwegian firms might be ahead other countries within EU when it comes to providing internet

facilities and solutions for the clients, less developed countries on this issue will very soon follow this "WEB-approach". Once again we stress the importance of making rules that are flexible enough to innovation and future developments.

44. As an alternative to provide information required in Box 10 in writing, we suggest that most of the information shall be made available for the client on the internet. This might be desirable for a lot of the retail clients since they, at any time, can monitor the status of their orders through the Internet. The client should have the opportunity to choose whether information shall be provided in writing or through Internet.

45. Unlike other countries in Europe, the Norwegian CSD, is providing retail clients with a lot of information that in other countries is provided directly by the investment firms. This relates to i.e. annual reports and accounts statements and real time information of any changes made in the individual accounts. Therefore, the rules must be made flexible enough so that, if the client has received information from the Norwegian CSD, the investment firms should not need to provide the client with the same information.

46. CESR propose that when orders have been executed in several tranches, firms must inform the retail client of the price for each tranche. This is impractical. In Norway, as may be the situation in many other countries, trading is done through an automatic matching system on the different market places. Information on each trade is available, but to inform the client of a potentially huge amount of trades does nothing more than confusing the client. CESR should therefore take the opposite approach, namely that retail client is given the average price unless the client asks for the details of each tranche.

47. Regarding the arrangements to disclose post trade information we suggest that the second sentence, *"This should in any case not happen later than one minute after the transaction took place"* should be changed to 5 minutes which is in accordance with the NOREX member rules (covering all Nordic markets in equities). The text states that post trade information should be made public as close to real time as possible and no later than one minute after the transaction took place. Today, in Norway there is a 5 minute limit to publicize off-market trades. A one minute limit would be too narrow and impracticable for these trades. The requirement to make public post trade information as close to real time as possible allows for later publication of off-market trades.

48. Deferred publication for blocks trades (larger trades) can be an important tool for firms in managing their risk, when trading on their own account as i.e. a liquidity provider (market maker) or when taking larger blocks as a service to their clients. Deferred publication can therefore be justified only where the firm takes a real risk.

Best regards
The Association of Norwegian Stockbroking Companies

Per Broch Mathisen