

# Norges Fondsmeglerforbund

The Association of Norwegian Stockbroking Companies  
Stiftet 5. oktober 1915



Kredittilsynet  
Postboks 100 Bryn  
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27 April 2001

Re: FESCO Proposal for harmonisation of core conduct of business rules for investor protection.

We refer to your letter 31<sup>st</sup> of March 2001.

In our remarks we will concentrate our focus on general views on the initiative from FESCO to obtain harmonised rules and practice for good business conduct throughout an integrated European securities market. When it comes to more specific comments on the individual principles we will need some more time to compare the proposed principles and rules with already existing Norwegian regulation (law, government regulations, general business terms and conditions and ethical norms). We are also aware of the fact that Den norske Bank (DnB) has presented their comments in a separate paper given to representatives of Kredittilsynet and in the main we support the views of DnB.

In the introduction FESCO states the following:

*"The ISD establishes some basic conduct of business requirements for EU investment firms. FESCO members believe, however, that the present diversity of conduct of business regimes may hinder not only the freedom which investment firms have to provide services throughout Europe but also the provision of an adequate level of protection to European investors. It is therefore necessary to undertake a process of convergence in this field, both to ensure a level playing field for investment firms and to foster public confidence in the operation of the single market in financial services. FESCO members are aware that in this respect a green paper on the ISD has been published as part of the process to update the ISD."*

It seems that FESCO from this basis has drawn the conclusion that a detailed regulation is necessary for all member states, without considering the actual regulation in each country, i.e the specific regulation on securities trading, the general contract law, regulation on consumer

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protection in general and so forth. From the consultative paper it is impossible to see which countries that are not providing an adequate level of protection and the reason for such a conclusion. The draft code of conduct does not state reasons for the introduction of its various principles and rules, nor does it explain what specific shortcomings (if any) of the markets the new rules are supposed to remedy. It is therefore more or less impossible to assess the actual basis for the proposed regulation.

According to the letter from Kredittilsynet it seems that Kredittilsynet are of the opinion that the requirements resulting from the proposed principles and rules follow more or less directly from article 11 of the ISD. Kredittilsynet will therefore apply the FESCO norms as such as mandatory rules under an interpretation of the present standard of “good business practice” in section 9-2 of the Norwegian Securities Trading Act. No reference is made to any need to have the FESCO standards implemented into the Norwegian regulatory framework through a formal legislative procedure, i.e. law enacted by Parliament, or regulation.

We are of the opinion that a major part of the proposed principles and rules, according to the fundamental principle of legality in the Norwegian legal system, needs to be implemented by law in order to obtain mandatory effect on private subjects in Norway. In this connection it is important also to take into account that breaches “good business practice”, ref section 9-2 of the Norwegian Securities Trading Act, in principle will be subject to criminal sanctions according to section 14-3 of the Securities Trading Act.

It is also our opinion that the burden of comprehensive new obligations of this character on private subjects cannot be implemented under national law without proceeding by way of a formal legislative procedure, or by way of regulation (presupposing the existence of a sufficient legal basis for such regulation).

The total regulation on securities trading in the Nordic countries also taking into account the general regulation of contracts and purchasing of goods and the regulation of consumer protection, already implies a very high level of investor protection. The FESCO standards for investor protection will, if adopted, represent an additional source of law in an already thoroughly complicated legal framework, represented by the Norwegian Securities Trading Act, the different investment firms’ general terms of business, exchange and clearing house regulations, as well as the Ethical Norms and the decisions of the Ethics Council of our Association. The predictability of the investors’ legal position after an eventual adoption of the standards will probably be weakened, and the investors’ position difficult to assess, without consulting legal expertise. A formal implementation of the FESCO proposals, i.e. by law or government regulation, will therefore – in our opinion – entail an unnecessary, bureaucratic and inflexible regime without improving investor protection significantly.

The code of conduct regulates investment firms’ provision of investment services in general. The content of the draft seems however only to reflect the way equities brokerage business functions in order-driven markets, where equities are traded on exchanges. Trading in other financial instruments is operated in an entirely different way (price-driven markets), where the investment firm acts as principal in the transactions. Many of the proposed principles and rules seems to be in conflict with the way industry and markets for these instruments function, and seems to be based upon a theoretical and inefficient view on how these markets functions. Alterations, or substantial qualifications, of the proposed code of conduct should be

made in order to take in to account how markets function for a majority of the traded instruments. For further comments see DnB's paper.

The content of the proposed principles and rules represents a shift in the investment firms' obligations and introduces extremely comprehensive advisory duties on the firms towards their customers. With the exception of the situation when investment firms provide the investment service of discretionary portfolio management, the responsibility for the investment decisions remains, and should remain, with the customer himself. Norwegian investment firms providing broker/dealer services do generally not take on extensive advisory responsibilities. The role of the investment firm providing brokerage services is clearly stated in the firms general terms of business. Advisory duties may presently to some extent result from the obligation on the firms to respect "good business practice". More comprehensive and detailed, general, investment advisory duties on the investment firms do however need specific agreement with the customer.

The proposed code of conduct reflects a totally different attitude to this question, in its detailed requirements concerning risk warnings, monitoring of the customers' trading restrictions, investment advice according to the customers "needs" (as opposed to e.g. the customers "requirements") etc. These obligations are way more extensive than the services which are presently being provided by investment firms acting as broker/dealers, and will represent a level of service provision, regulatory burden as well as legal risk, which the present modest (minimum) brokerage fee does not cover. It is therefore our opinion that the proposed extensive advisory duties only should apply where the investment firm agrees to act as the customer's investment advisor.

We also do believe that such a regulation rather will make it more difficult and expensive to trade – and several of the proposed principles and rules will hinder the development of an effective electronic trading platform for retail investors based on information and advice from the service provider.

The FESCO paper seems to draw a distinct line between advisory-based trading and so called execution only trading, where the latter is characterised by the non-existence of advice from the investment services company. We are of the opinion that such a distinction will be a disadvantage for the investors and the service providers. The reason for this is that you, as an investor or as a service provider have to choose between a very strict regime with burdensome responsibilities and a regime with none advice at all, not at any point taking into account the actual investors real need for advisory services. Taking into account also the proposed definitions of professionals and non-professionals this will lead to an even worse result for Norwegian investors.

The draft rules for investor protection will in our opinion, if adopted and applied, lead to an unnecessary detailed and rigid regime allowing little room for industry to develop business practices between the customer and the firm, and thereby also hamper efficient development of the financial markets. The whole idea of regulating the investment firms' relation with their customers in such detail does moreover seem contrary to fundamental, explicit, assumptions of the preparatory works to the Norwegian Securities Act.

By significantly increasing retail customer servicing costs, the proposed principles and rules will guarantee the customers more expensive, and in many cases unwanted, services, and make it much more difficult and expensive to establish a customer relationship. The detailed rules of

the draft code of conduct will by experience give investors able, but unwilling to, pay or deliver at settlement day an unexpected incentive to raise disputes, i.e. when market prices fall. This can again, in the more extreme scenarios, contribute to deals failing in the national securities settlements systems, and thus indirectly contribute to less orderly markets and financial instability. The extensive regulatory burden, the increase of costs as well as the evident importance of new legal risks will probably make investment firms react either by significantly increasing prices to retail customers, or, worse, by refusing to deal with retail customers, because of the costs and risks involved. Neither of the alternatives will in our opinion be to the best of the customers.

Bearing in mind the above mentioned it is important to underline that a lot of the principles and rules proposed by FESCO already are implemented in Norwegian regulation often on a more general basis. It is therefore important to clarify to what extent an implementation of the principles and rules towards the customers, can be done on a more general basis, i.e. in connection with the initial establishing of a business relationship. The FESCO paper does not give any answer to this problem.

It is our opinion that the different problems that are discussed above, and to a more detailed degree in DnB's paper, should be subject to more thoroughly discussions between the market participants and Kredittilsynet. It should also be considered to extend such discussions to also cover our Nordic colleagues so that we could develop a common Nordic standpoint on these important issues. It is not acceptable to adopt a regulatory regime that is unnecessary, bureaucratic, inflexible and also in great contrast to the present regulatory regime as a whole. When we look at investor protection it is obviously not enough to have a formal and detailed regulation, it is also important to have a regime that works in such a way that the investors relatively easy and to a reasonable cost can enforce their rights.

In our opinion the total regulation in Norway on securities trading combined with our effective public supervision and the relatively easy access to grievance procedures, i.e. our Ethics Council, The Complaints Board for Consumers in Banking and Finance Matters (Bankklagenmda) and the County Courts, implies a more than satisfactory regime for investor protection.

Best regards

**The Association of Norwegian Stockbroking Companies**

Frede Aas Rognlien