



**HM TREASURY**

**Implementation of the E-Commerce Directive in Financial  
Services**

**Consultation Document**

**DECEMBER 2001**

# **Implementation of the e-commerce directive in financial services**

## **Preface**

1. This document sets out how the Government is minded to implement the directive on e-commerce (2000/31/EC) in the area of financial services. In particular, the annex to this document details the main legislative changes the Government is minded to make to the Financial Services and Markets Act 2000, and to the various statutory instruments made under that Act.
2. As the Government intends to implement the directive as quickly as possible, it will not be possible to provide for a normal consultation period of 12 weeks. Instead, comments should be sent no later than 8 February 2002 to:

**Bruce Ridewood**  
**Financial Services Regulation Team**  
**HM Treasury**  
**19, Allington Street**  
**London SW1E 5EB**  
**Email: [ecommerce@hm-treasury.gsi.gov.uk](mailto:ecommerce@hm-treasury.gsi.gov.uk)**

When commenting, respondents should give details of any organisation whose views they represent. Also, it will be assumed, unless indicated to the contrary, that respondents have no objection to their response being made public.

3. This document covers implementation in respect of financial services only; implementation in all other areas of policy has been consulted on

separately by the Department of Trade and Industry. Responses to both consultations will be considered together.

4. The regulations implementing the directive are expected to provide substantial benefits for business, consumers and others. But some provisions may entail compliance costs. There was a draft Regulatory Impact Assessment ("RIA") in the DTI's consultation document ([http://www.dti.gov.uk/cii/ecommerce/europeanpolicy/ecommerce\\_directive.shtm](http://www.dti.gov.uk/cii/ecommerce/europeanpolicy/ecommerce_directive.shtm)]), and a general request for comments. The Government particularly invites further information that would assist in estimating accurately benefits and compliance costs for financial service businesses and their clients (and especially for small businesses). To assist with this, the draft Regulatory Impact Assessment included in the DTI consultation document is reproduced here as well as an initial RIA for implementation in the Financial Services Area.

## **Introduction**

5. The E-commerce Directive (“ecd”) is designed to enhance the functioning of the EC internal market by removing specific legal barriers to the free movement of information society services (“ISS”) between member states, and by improving the level of legal certainty surrounding the provision of such services. It seeks to achieve this by creating a “country of origin” framework for the regulation of ISS, and includes provisions in the following areas:
  - establishment of service providers,
  - commercial communications,
  - electronic contracts,
  - the liability of intermediaries,
  - codes of conduct,
  - court actions, and
  - cooperation between member states.
  
6. The impact of the ecd in the area of financial services is potentially wide-ranging. Many financial services transactions are (and will increasingly be) likely to be conducted by electronic means across borders between member states. The directive will apply in respect of all such services falling within the definition of ISS in article 2(a). As that definition is largely concerned with the medium through which services are provided, rather than their subject-matter, cross-border financial services of all kinds may fall within the scope of the directive.

## **The Scope of the Directive**

### **General**

7. The scope of the internal-market provisions in article 3 of the Directive is determined by the definition of ISS, and the extent of the “coordinated field”. In addition, there are both “fixed” exclusions that remove certain matters from the scope of the directive, and “case-by-case” derogations that allow the application of laws in a manner contrary to the usual “country of origin” approach, but only in certain circumstances, and subject to certain procedures.

### **Information Society Services**

8. The ecd applies to information society services, which it defines (in general terms and with some exceptions) as services normally provided for remuneration, at a distance, by electronic means and at the individual request of the recipient of the service. The full text of the definition is in article 1 of Directive 98/34/EC, as amended by Directive 98/48/EC. A principal example of ISS is services provided over the internet. The implementation of the ecd will therefore be of particular interest to those who intend to provide or purchase financial services products online.

### **The Coordinated Field**

9. The range of member states’ laws affected by the ecd is termed the “coordinated field” (see articles 2(h) and 3(1) and (2) of the Directive). The coordinated field is made up of the legal requirements that apply to ISS or to the providers of ISS, regardless of whether these requirements are of a general nature or are specifically designed for such services or providers.

10. Article 2(h)(i) and (ii) of the ecd give further indications of the scope of the coordinated field. They state that the coordinated field “concerns requirements with which the service provider has to comply in respect of:

- the taking up of the activity of an information society service, such as requirements concerning qualifications, authorisation or notification,
- the pursuit of the activity of an information society service, such as requirements concerning the behaviour of the service provider, requirements regarding the quality or content of the service including those applicable to advertising and contracts, or requirements concerning the liability of the service provider.

The coordinated field does not cover requirements such as:

- requirements applicable to goods as such,
- requirements applicable to the delivery of goods,
- requirements applicable to services not provided by electronic means.”

11. The precise scope of the coordinated field and the “country of origin” framework established by article 3 of the Directive (see paragraph 14 below) are not always straightforward, and the Government has taken the preliminary view that particular provisions in the area of financial services lie outside the scope of the “country of origin” principle. These are explained in detail below.

### **Exclusions and Derogations**

12. Article 3(3) removes certain “fields” from the application of the “country of origin” approach as set out in article 3(1) and (2). These “fields” are listed in the Annex to the Directive. They include the advertising of their units by

UCITS<sup>1</sup> in member states where they are marketed, some requirements in the life and general insurance directives, and contractual obligations concerning consumer contracts.

13. In addition to these “fixed” exclusions, article 3(4) permits member states to take measures contrary to the “country of origin” approach, where they consider that such measures are necessary for specific reasons (including the prevention and prosecution of criminal offences and the protection of consumers (including investors)). This derogation can only be invoked in relation to particular ISS on a “case by case” basis, and (except in cases of urgency) only after a failure by the “country of origin” to address the situation at the request of the “host” state, and the “host” state giving notice to the Commission of its intention to use the derogation.

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<sup>1</sup> Undertakings for Collective Investment in Transferable Securities – see Article 1 of Directive 85/611/EEC).

## **The Country of Origin Approach**

14. The Government is strongly committed to the “home state” or “country of origin” approach to achieving a single market in financial services.<sup>2</sup>
15. The “country of origin” approach to the regulation of ISS is set out in article 3(1) and (2) of the ecd. These provisions specify which member state’s laws apply in relation to the cross-border provision of ISS within the EC. The essence of the approach is that the member state where the service provider is established is the “country of origin”. Generally, it will be this state’s laws that apply in relation to cross-border ISS. This state must ensure that ISS providers established on its territory comply with the local provisions falling within the coordinated field, irrespective of where in the EEA they may be providing ISS (article 3(1)). In addition, member states will not be permitted to restrict the freedom to provide ISS from elsewhere in the EEA (article 3(2)), save in situations falling outside the scope of the “country of origin” provisions (e.g. because the provisions being applied are not within the coordinated field, or are within the article 3(3) exclusions) or in cases where the article 3(4) “case by case” derogations have been invoked.
16. It is worth noting that the prohibition in article 3(2) applies to restrictions on the freedom to provide ISS from other member states. There may be cases where the prohibition does not apply because the provisions in question do not impose such restrictions. Such cases would fall outside the “country of origin” framework irrespective of whether any exclusion or derogation of the kind referred to in paragraphs 12 and 13 applied.

## **Implications for regulation in the UK of the country of origin approach**

17. For ISS providers established in the UK but selling services to other EU member states ("outward providers") the "country of origin" approach will result in an extension of UK regulation to services which had previously benefited from exemptions, particularly in respect of financial promotion, and a reduction in regulation by the recipient member state.
  
18. ISS providers trading from other member states to the UK ("inward providers") will face less UK-based regulation. The "country of origin" approach means that the UK requirements within the co-ordinated field cannot be imposed on incoming ISS providers, except in so far as they are permitted by the article 3 exclusions and derogations.
  
19. The "country of origin" approach also means that there will be potential differences in treatment between services provided via electronic media and services provided via other means. A bank's business conducted over the internet may be regulated differently from business it transacts by post. We recognise the importance of media neutrality (as we have sought to achieve under the Financial Services and Markets Act 2000 (FSMA)) and it should be emphasised that the Government expects any inconsistency in treatment in the financial services area to be transitional, given the target of 2005 for completion of the single market in this area set by the Lisbon European Council in 2000.

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<sup>2</sup> See *Completing a Dynamic Single European Financial Services Market: A Catalyst for Economic Prosperity for Citizens and Business Across the EU*, HM Treasury, July 2000

## **Other directive provisions**

20. Paragraphs 21 to 30 contain a summary of other directive provisions with potential impact in the area of financial services.

## **Exclusion of prior authorisation**

21. The Directive prohibits member states imposing authorisation requirements as conditions for the taking up and pursuit of the activities of ISS providers (article 4). This does not apply to authorisation schemes that are not specifically and exclusively targeted at ISS (which in our view would include the FSMA authorisation regime), or certain licences in the field of telecommunications.

## **Information requirements**

22. Member states are required to ensure that ISS providers furnish certain minimum information, in a form accessible both to service recipients and authorities. The information includes the name, place of establishment, and contact details of the ISS provider, and any applicable authorisation schemes (article 5).
23. There are also information requirements in relation to “commercial communications” (mainly commercial advertising) that take the form of ISS. These include the identification of the commercial communication as such, and the identity of the person on whose behalf they are made (article 6).
24. Further information requirements are imposed in connection with electronic contracts (article 10). These include the technical steps required to conclude the contract, and the languages in which the contract may be concluded (article 10).

### **Commercial Communications**

25. Member states are required to ensure that unsolicited commercial emails are clearly and unambiguously identifiable (article 7). The Directive also requires member states to ensure that senders consult and respect opt-out registers through which individuals can indicate that they do not want to receive them (article 8).
  
26. Member states are required to allow members of regulated professions to use commercial communications that are part of, or constitute, an ISS so long as these communications comply with professional rules (article 8).

### **Electronic Contracts**

27. Member states must ensure that their legal systems allow contracts to be concluded by electronic means and that they do not create obstacles to the use of electronic contracts (article 9).

### **Requirements in relation to the placing of an order**

28. Article 11 provides for certain principles (concerning acknowledgement of receipt of orders for ISS and the correction of errors in such orders) to apply when recipients of a service place an order with an ISS provider through technological means.

### **Liability of Intermediaries**

29. Member states are required to ensure that intermediary service providers are not liable for the information transmitted or stored by them on behalf of ISS providers and their customers except under specific conditions (article 12, article 13, and article 14). Member states cannot impose a general obligation on intermediary service providers to monitor the information that they transmit or store (article 15).

## **Dispute Settlement**

30. Member states must ensure that their legislation does not hamper the use of out-of-court schemes for dispute settlement in the event of a disagreement between an ISS provider and a recipient of the service (article 17), including appropriate electronic means. Article 18 requires member states to ensure that court action can be taken against alleged infringements in relation to ISS quickly and effectively.

## **Implementation in Financial Services**

### **General**

31. This section sets out in general terms the Government's proposed approach to the implementation of the ecd in the area of financial services. There follows (paragraphs 34-49) discussion of specific issues that seem to us to give rise to problems of interpretation, or which otherwise may be controversial. The Annex to this document contains a description of the legislative changes the Government is minded to make, based on the discussion in this section.
  
32. As indicated in paragraphs 7-13 above, we think that the scope of the ecd is wide-ranging in the context of financial services, although there are two particular cases of provisions we consider to be outside that scope. The following general remarks are intended as an outline of the legal arguments upon which these conclusions are based.
  
33. We think that it is important to bear in mind the distinction between the scope of the coordinated field and the scope of the country of origin principle. These will usually, but not necessarily, coincide (see paragraphs 11 and 16 above).
  
34. There are a number of indications in the text of the directive of what the scope of the coordinated field is intended to be, but no single, comprehensive description of its contents. It is clear from article 2(h) (see paragraph 10 above) that the field consists of requirements in member states' legal systems which apply to ISS, or ISS providers. It is also clear from that article that requirements will not fall outside the coordinated field merely because they are general in nature, or because they are not specifically designed for ISS or ISS providers.

35. Whilst the precise scope of the coordinated field must be determined principally by reference to article 2(h), we are minded to think that in some cases the ambit and character of particular national laws, and their relationship to the subject-matter of the directive, need to be taken into account when considering whether or not they fall within its proper scope. We also think that account must be taken of the specific wording of articles 1(4) and 3(2), both of which indicate that the directive is intended to operate so as to remove restrictions on the freedom to provide ISS within the Community.
36. We recognise that the scope of the directive is problematic in a number of respects, and that it is difficult to formulate clear-cut legal arguments that can be applied consistently to the whole of the directive text. For the purposes of this consultation we have suggested what appear to us to be sound arguments about the scope of the directive in specific contexts. They will be considered further in light of responses to this document and to the DTI's consultation document and may also need to reflect any guidance that may be produced by the Commission.
37. With these considerations in mind we are inclined to conclude that almost all of the regulatory apparatus for financial services in the United Kingdom falls within the ambit of the coordinated field, and must therefore be applied on a "country of origin" basis in connection with ISS. This would include authorisation requirements<sup>3</sup>, and requirements relating to them such as permissions, prudential supervision requirements, conduct of business rules and disciplinary measures. It would also include financial

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<sup>3</sup> We are of the view that these would not contravene article 4 of the directive, because they are not specifically and exclusively targeted at ISS – see paragraph 18 above. However, there is no equivalent to article 4(2) in the definition of the coordinated field – on the contrary, article 2(h) clearly states that requirements fall within the coordinated field regardless of whether they are specifically designed for ISS. It therefore seems clear that the "national provisions" referred to in article 3(1) would include any

promotion restrictions, and requirements imposed on the basis of the single market directives. However, we are also inclined to the view that the market abuse provisions in Part VIII of FSMA, and the general criminal offences in Part XXVII are not properly to be considered within the scope of the directive. These arguments, as well as others that are specific to the financial services area, are explained further below.

## **Specific issues**

### **The single market directives**

38. We think that provisions implementing the single market directives<sup>4</sup> (smds) are within the coordinated field, although in the case of insurance, certain provisions also fall within the derogations in article 3(3), and the Annex to the Directive. In practice, this means that the ecd will have to be considered first in the context of ISS that fall within the scope of the smds. However, smd provisions in member states (including those allocating responsibility for prudential and conduct of business regulation) will continue to operate, in so far as the particular member state's law is applicable in accordance with the ecd.
39. In other words, where the place of establishment of a provider of ISS that falls within the smds is also the head or registered office of the provider within the meaning of those directives, the "country of origin" in ecd terms will be the same as the "home state" in smd terms. In this scenario the law applicable (subject to any applicable ecd exclusions and derogations) will be that of the state from which the services are provided. The smd implementing provisions of that state will be within the ecd's coordinated field, and it will be responsible for applying these (and any other applicable domestic provisions) for both prudential and conduct of business

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authorisation provisions not caught by article 4. Similarly, such provisions would be within the scope of article 3(2) if their effect was to restrict the freedom to provide ISS from another member state.

<sup>4</sup> The directives referred to in paragraphs 1-4 of Schedule 3 to FSMA.

regulation of the head/registered office on its territory. There would be no question of any division of regulatory responsibility in smd terms, because the services would not be being provided through an smd branch. The state in which the service recipient is located will only have a role if an ecd exclusion or derogation is applicable.

40. Where services are provided from a branch as defined in the smds into another member state, the “country of origin” in ecd terms will be the state in which the branch is located. The law of that state will include the smd-implementing provisions, which will assign regulatory responsibility for the branch in accordance with the smds. Generally, this will mean that conduct of business regulation will be a matter for the state where the branch is established, and prudential regulation will be a matter for the state where the head or registered office is situated, as required by the smds. A third state into which services are provided will only have a role if an ecd exclusion or derogation is applicable.
  
41. The smds, including the “passporting” requirements will therefore continue to operate in the same way as they do now, although the E-Commerce Directive will require an extra level of analysis in cases where the services in question are ISS. In order for a parent firm in EEA state ‘A’ to establish and conduct business falling within the smds through a branch in EEA state ‘B’, the parent must comply with the “passporting” obligations in the smds, and, in accordance with those directives the prudential supervision of the branch will be the responsibility of state A. State A would also be responsible for the prudential supervision of the parent firm. Supervision of the conduct of business by the branch would be a matter for state B. This situation would continue to prevail in cases where the branch or the parent provided ISS into other EEA states. In both cases the combined effect of the ecd and the smds would be to locate the seat of prudential supervision in state A, and conduct of business supervision in state B. Other (“third”)

states into which ISS were provided (either by the parent or the branch) would have no role, either in prudential or conduct of business supervision, except in areas outside the scope of the ecd (e.g. areas such as the provisions of the insurance directives referred to in the article 3(3)/Annex exclusions), or in so far as those states may be able to invoke derogations from the country of origin approach by virtue of article 3(4).

### **The UCITS Directive**

42. We think that the analysis is broadly similar in the case of the UCITS directive (85/611/EC). Provisions implementing the UCITS directive would be within the scope of the coordinated field. Therefore, where a UCITS situated in one member state (state 'A') provides ISS into another member state ('B'), in a case where that activity also fell within the scope of the UCITS directive, the "country of origin" in ecd terms will be state A, which will also be the state which is required to apply the requirements of the UCITS directive to UCITS situated within its territory. The provisions of Section VIII of the UCITS directive (which concern cross-border marketing of units in UCITS) do, however, pose certain problems of interpretation. Only article 44(2) of the directive is referred to in the Annex to the ecd as being outside the scope of the "country of origin" approach. It would therefore seem that that approach would have to prevail over the other provisions of Section VIII to the extent they were inconsistent with it, or at least to the extent that they imposed restrictions on the freedom to provide services within the meaning of the ecd.

### **Financial promotion**

43. Subject to the provisions in the Directive on unsolicited commercial electronic mail, the financial promotion regime established by the Financial Services and Markets Act 2000 ('FSMA') is within the coordinated field. The balance between "country of origin" and host state regulation of

financial promotions currently specified in secondary legislation will be changed by implementation of the Directive. Ministers recognised the need for change during FSMA's parliamentary passage.

44. We expect for outward providers to remove the exemption available to all but unsolicited real time promotions; for inward providers we expect to widen the exemption currently available only to promotions not directed at persons in the UK. More specific details of the proposed changes are outlined in the Annex to this document.

### **Market Abuse**

45. Part VIII of FSMA defines appropriate standards of conduct for traders in investments on particular markets. Its purpose is confined to securing the proper functioning of such markets by putting in place a "level playing field" designed to maximise confidence in their integrity and fairness. It operates without reference to the provision of services in the sense contemplated in the directive. We therefore consider that it should not be construed as imposing restrictions on the freedom to provide information society services. As a result, we are minded to conclude that the provisions of Part VIII do not fall within the scope of the "country of origin" principle, and will not require any amendment in order to implement it.

### **Section 397**

46. Although the market abuse provisions do not create criminal sanctions, we think that arguments by analogy with those outlined above suggest that the offences created by section 397 of FSMA are likewise outside the scope of the "country of origin" principle. The purpose of the section is to set general standards for conduct irrespective of the provision of services in the sense contemplated in the Directive and as such we are minded to

conclude that it should not be construed as imposing restrictions on the freedom to provide information society services.

### **The Scope of the Consumer Contract Exclusion**

47. Widespread use of e-commerce in the financial services sector depends upon consumers being both confident about the contractual arrangements that apply to their transactions, and having access to information that may aid them in their purchasing decisions, for example: whether the ISS provider is regulated and by whom; if there are cancellation or withdrawal arrangements and what they are; and whether provision exists for complaints and compensation in the case of a dispute between a consumer and an ISS provider.
48. Article 5 of the ecd requires member states to ensure the provision of certain information that will be useful to consumers of ISS. This includes the name and location of the ISS provider, and, if the activity is subject to an authorisation scheme, the particulars of the relevant supervisory authority.
49. Besides the information required of ISS providers by article 5, the Directive also retains the level of protection offered to consumers by other EU directives and, in article 3(3) and the Annex, provides for the exclusion from the requirements of articles 3(1) and 3(2) of “contractual obligations concerning consumer contracts.”
50. Recital 56 of the Directive states that the contractual obligations should be interpreted to include “information on the essential elements of the content of the contract, including consumer rights, which have a determining influence on the decision to contract.” The exclusion would therefore allow host states to require incoming ISS providers to provide consumers

with certain information but only in relation to the “essential” features of a contract which may govern the outcome of a consumer’s decision whether to enter into it.

51. The scope of the consumer contract exclusion is open to interpretation and depends upon the position taken as to what are considered “essential” features of a consumer contract, and potentially determinative of a consumer’s decision to contract. In the area of financial services, (and with reference to Recitals 27 and 11), the Government is minded to interpret the scope of the exclusion in the context of policy underlying the draft Directive on the Distance Marketing of Financial Services (“DMD”).
  
52. In view of the arguments outlined above, we believe that the consumer contract exclusion allows for some limited regulation of pre-contractual information in the financial services area. This interpretation would permit limited measures to be applied to incoming ISS service providers requiring them to provide certain information to consumers in addition to the information requirements already contained in the ecd. In our view, any such measures as could be justified on this ground should operate only on a contingent basis (ie: if this information is not already required by the country of origin). We also believe that the scope for the application of the consumer contract exclusion is narrow and its maximum range should be limited to the information requirements currently covered by the draft of the DMD.
  
53. For information, as the draft DMD currently stands, the main information requirements which are additional to those in the ecd are:
  - Notice when the financial service is related to instruments involving special risks or whose price depends on fluctuations in the financial markets

- The existence or absence of a right to withdraw from the transaction
  - Information on whether the transaction falls within a dispute resolution and/or compensation scheme and, if so, its contact details
54. In accordance with the Government's proposed legislative approach to the implementation of the Directive as a whole (see Annex), these requirements will be applied, where necessary, to incoming ISS services providers via relevant FSA rules. The FSA will be consulting separately on the application of their rules in this area.
55. The Government fully intends that the application of FSA rules to incoming ISS service providers in the area of consumer contracts should be temporary. The DMD provides for core standards of consumer protection to be applied on a "country of origin" basis in relation to the distance marketing of financial services. This will mean that, once the DMD is made and implemented, consumer protection in relation to the distance marketing of financial services from providers in other member states will become a matter for the "country of origin" of the services, and not for the UK. Once the core standards come into effect, following the transitional arrangements provided by the DMD, member states will cease to be able to impose consumer protection requirements on incoming ISS financial service providers and the FSA's powers will be adjusted accordingly.

## **Annex**

### **Amendments to financial services legislation**

A1. The legal reasoning outlined above suggests to us that amendments need to be made, both to the Financial Services and Markets Act 2000 (“FSMA”), and to certain statutory instruments made under it. Our preferred approach is to use existing FSMA powers where they are available, and to rely on regulations made under section 2(2) of the European Communities Act 1972 to amend the primary Act only where those powers are insufficient. At this stage it appears to us that at least some amendments to the primary Act will be needed.

A2. It is also clear that the Financial Services Authority’s (FSA’s) powers to impose requirements on ISS providers established in other member states will need to be limited to cases falling within the exclusions and derogations in the Directive. One of the amendments we propose is a change to the concept of “regulated activity” to exclude ISS provision by persons established in other member states. A consequence of this would be that those providers would not need to be authorised under FSMA if they did not carry on any other kind of regulated activity in the United Kingdom. As explained further below, the FSA’s existing powers in relation to such persons will need to be re-defined by reference to the relevant provisions of the Directive, to ensure that they only operate where the exclusions and derogations allow. We think that in general it would be desirable to make the necessary modifications with reference to the relevant provisions of the Directive, in order to preserve flexibility to take account of future developments at Community level (e.g. decisions of the European Court of Justice). This approach would also be consistent with the approach taken in

other areas (e.g. the application of single market directive requirements by FSA rules).

A3. Set out in this Annex an outline of the legislative changes we envisage will be needed to implement the ecd in the area of financial services, in line with the legal reasoning described in this document. This outline must be regarded as provisional, and may require adjustment in light of the outcome of this consultation, as well as the consultation undertaken by the Department of Trade and Industry.

## **Outline of main legislative changes proposed**

The amendments will be likely to fall into six main categories.

(1) An amendment to extend the territorial application of the concept of “regulated activity” in the Financial Services and Markets Act, so as to include the provision of financial ISS by persons established in the United Kingdom, regardless of where in the EEA the services are actually provided. Although section 418(5) already comes close to achieving this result, we think a slight adjustment would be necessary to ensure proper implementation of the Directive. We consider that the best way of achieving this would be to use regulations under section 2(2) of the European Communities Act to amend section 418 of FSMA so that a UK-established person providing financial ISS anywhere in the EC would be regarded, for the purposes of FSMA, as carrying on a regulated activity in the United Kingdom. We think that this will be the principal amendment required to implement article 3(1) of the Directive in the area of financial services. The notion of “financial ISS” would need to be defined by reference to the scope of the FSMA regulatory regime as it applies to activities carried out in the UK.

(2) Amendment of the concept of “regulated activity” to exclude the provision of ISS by persons established in other member states. Our preferred method of achieving this would be to amend the Financial Services and Markets Act (Regulated Activities) Order 2001 (S.I. 2001/544) to create a general exclusion for the provision of financial ISS by such persons. This could be achieved by the

making of a negative resolution statutory instrument in accordance with the power in section 22 of FSMA. This would be the main amendment required to implement article 3(2) of the Directive. As indicated above, one consequence of this approach would be that ISS providers in other member states would not need to be authorised persons in order to provide ISS in the UK. They would, of course, need to be authorised in order to carry out any other activity in the UK that amounted to a regulated activity.

(3) The adjustment of the FSA's powers as necessary to ensure that it may take measures in accordance with the exclusions and derogations in the Directive. The FSA's powers based on the exclusions in article 3(3) and the Annex will of course need to be different in nature from those based on the case-by-case derogations in article 3(4). In relation to ISS providers established in other member states who happen to be authorised persons (e.g. because they are performing other activities in the UK which are regulated activities), the FSA already has the power to make rules with respect to their carrying on activities which are not regulated activities (FSMA section 138(1)(b)). We consider that this may already provide the FSA with adequate powers in relation to authorised persons performing non-regulated activities. However, we may need to ensure, using regulations under section 2(2) of the European Communities Act, that the FSA has the power to take measures pursuant to the article 3(3) exclusions and the article 3(4) derogation in relation to ISS providers who are not authorised

persons. The precise form this re-definition of powers will take is still under consideration.

(4) Amendment of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (S.I. 2001/1335). Currently, article 12(1) of the Order disapplies the financial promotion restriction in section 21 of FSMA from communications received outside the United Kingdom, or directed only at persons outside the United Kingdom. As part of the implementation of article 3(1) of the Directive, we consider that this provision will need to be amended to ensure that the financial promotion restriction does apply to communications by UK-established ISS providers to persons in the EC, where those communications comprise, or form part of, the provision of an ISS. There will also need to be a separate amendment to the Order to ensure that the financial promotion restriction does not apply to communications from ISS providers established in other member states, where those communications comprise, or form part of, the provision of an ISS. The first of these amendments will require an affirmative resolution statutory instrument, due to the effect of section 429(3) of FSMA. The second would normally require a negative resolution instrument (by reference to section 429(8) of FSMA), but could we think be incorporated into the affirmative instrument with the first amendment. We also consider that parallel amendments will be required to the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) Order 2001 (S.I. 2001/1060). These amendments will be required to be made by negative resolution procedure.

(5) Ensuring that the FSA has powers to make rules implementing the articles of the Directive referred to in paragraphs 20-30 above. We consider that the maintenance, so far as possible, of FSA rules as a “single rule book” is very important from the point of view of financial services practitioners and consumers. We are also strongly in favour of implementing the Directive for the financial services sector in a way that is as well tailored to that specific environment as possible. Accordingly, we take the view that provisions in the Directive which are likely to have a significant impact on financial services, and which it would not be inappropriate or unnecessary to implement in that way, should be implemented in the financial services area by means of FSA rules. It seems to us that the power in section 138(1)(b) already offers some scope for this to be done. The precise extent (if any) to which separate implementation in this area will be necessary cannot be determined with any certainty as yet, and will depend in part upon the form that the Department of Trade and Industry’s more general implementing provisions take.

(6) We think that the above amendments would be likely to cover most of the ground of implementing the ecd in the area of financial services. However, additional (and most likely minor) amendments (e.g. amendments consequential to those outlined above) may prove to be necessary upon further consideration.

## **Initial Regulatory Impact Assessment in the Financial Services Area**

1. The Department of Trade and Industry produced a draft partial regulatory impact assessment in its consultation document earlier this year. It covers the implementation of the E-Commerce Directive in the UK as a whole and has been reproduced here for the benefit of respondents. This initial regulatory impact assessment only covers the Government's plans for implementation in the area of financial services.

### **Purpose and Intended Effect in the Financial Services Area**

2. This consultation document and the accompanying annex provide an outline of how the Government is minded to implement the E-Commerce Directive in the financial services area.

3. The E-commerce Directive ("ecd") is designed to enhance the functioning of the EC internal market by removing specific legal barriers to the free movement of information society services ("ISS") between member states, and by improving the level of legal certainty surrounding the provision of such services. It seeks to achieve this by creating a "country of origin" framework for the regulation of ISS, and includes provisions in the following areas:

- establishment of service providers,
- commercial communications,
- electronic contracts,
- the liability of intermediaries,

- codes of conduct,
- court actions, and
- cooperation between member states.

4. The impact of the ecd in the area of financial services is potentially wide-ranging. Many financial services transactions are (and will increasingly be) likely to be conducted by electronic means across borders between member states. The directive will apply in respect of all such services falling within the definition of ISS contained in article 2(a) of the ecd. As that definition is largely concerned with the medium through which services are provided, rather than their subject-matter, cross-border financial services of all kinds may fall within the scope of the directive.

5. In implementing the E-Commerce Directive in Financial Services, the Government aims to bring the full benefits of country of origin regulation to businesses that provide information society services while ensuring that UK consumers retain core European standards of protection.

### **Benefits**

6. The Government believes that country of origin regulation should bring substantial benefits to ISS service providers established in the UK. Under the ecd, their regulation by the Financial Services Authority ("FSA") will allow them to conduct business throughout the EEA. They will only need to follow the

regulatory regime in other EEA member states if they are conducting business in an area specifically excluded from the scope of the ecd under article 3(3) or if the relevant member state into which they are providing services has completed the “case by case” derogation process outlined in article 3(4). The potential benefit of country of origin regulation is large: instead of having to meet the costs associated with meeting the regulatory requirements of all the EEA member states into which they provide services, ISS providers established in the UK will only need to meet the costs of being regulated by the FSA. The specific cost benefits will depend on the amount and nature of the business being conducted by the ISS provider with the EEA.

**The Government would welcome more specific details of the cost benefits to ISS providers established in the UK in the financial services area of “country of origin” regulation.**

## **Costs**

### **Financial Promotion Regime**

7. Under the ecd, the government is required to alter the Financial Promotion regime established under the Financial Services and Markets Act 2000 for ISS providers so that it conforms with the “country of origin” principle. This will bring additional costs for firms established in the UK launching promotions into EEA member states.

8. We believe that the additional cost burden will be small. Most firms established in the UK engaged in financial promotion into other EEA member states will already be authorised by the FSA; the additional cost for them as a result of implementation of the ecd will be the extension of FSA rules to promotions to which they previously did not apply.

9. There will also be an impact on unauthorised firms seeking to do one-off financial services transactions such as raise capital or undertake takeovers. Implementation will increase costs for UK established firms engaged in these outward financial promotions to EEA member states through the provision of an ISS service (primarily, over the internet) who are not already authorised by the FSA. Estimates of the cost of approval of a promotion range from a minimum of £25,000 for a small firm undertaking a basic promotion up to £500,000+ for a large firm engaged in a complex promotion.

10. In both cases the additional costs will be offset by the reduction in host-state regulation in the state/states into which the promotion is entering. Whether the net result will be a cost or a saving will depend, amongst other factors, on the number of countries to which a promotion is made: the greater the number of EEA countries to which a promotion is made, the greater the saving from having to comply only with UK requirements.

**We would welcome evidence from respondents as to the extent of the burden that will be imposed on firms by implementation of the ecd in the financial promotion area.**

**Impact on small and medium sized businesses**

**The Government would welcome evidence of whether implementation of the ecd in the financial services area will impose significant additional costs on small or medium sized businesses.**