



**HM TREASURY**

**Implementation of the E-Commerce Directive in Financial  
Services:  
A Second Consultation Document**

**MARCH 2002**

# **IMPLEMENTATION OF THE E-COMMERCE DIRECTIVE IN FINANCIAL SERVICES: A SECOND CONSULTATION DOCUMENT**

## **Preface**

1. This document is a second consultation document on how the Treasury intends to implement the E-Commerce Directive (“ecd”) in the area of financial services. In particular, the Treasury invites comments on the draft statutory instruments contained in Annex C of this document, that will amend the Financial Services and Markets Act 2000 (“FSMA”) and certain statutory instruments made under that Act. Respondents may also find it useful to refer to the separate consultations being undertaken by the DTI and the Financial Services Authority (“FSA”) to see how the various aspects of UK implementation of the Directive interrelate.

## **Previous Consultation**

2. In December 2001, the Government invited comments on its proposed approach to implementing the ecd in the area of financial services. Respondents broadly welcomed this approach, although some raised specific concerns about implementation in a few areas. Part 1 of this document briefly summarises and responds to the comments received and aims to clarify policy where respondents felt it was unclear. We will provide a more detailed response after the second consultation ends on 2 May. Annex A provides a list of those who responded to the first consultation.

### **Current Consultation**

3. Given that the due date for implementing the ecd has passed, the Treasury recognises that a balance now has to be struck between doing so as quickly as possible and giving interested parties sufficient opportunity to comment on its proposals. Having already consulted on its approach to implementation in the area of financial services, the Treasury believes that this balance is best met by an eight-week consultation period on the draft statutory instruments. Comments should therefore be sent to arrive no later than 2 May 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)**

### **Regulatory Impact Assessment**

4. Although the regulations implementing the Directive are expected to provide substantial benefits for business, consumers and others, some provisions may entail compliance costs. We invite information that would assist in estimating accurately the benefits and compliance costs for financial service businesses and their clients (especially for small businesses). To assist with this, an amended version of the draft regulatory impact assessment ("RIA") used in the previous consultation is reproduced in Annex B of this document

for reconsideration by respondents in light of the detailed draft regulations.

Respondents should be aware that the UK is under an obligation deriving from European Community law to implement the ecd into UK law. The RIA is intended to quantify only those costs and benefits which arise from the way in which the ecd is implemented in the area of financial services, and not those that arise from the ecd itself.

## **Part 1**

### **Responses to Previous Consultation**

1.1 Respondents broadly welcomed the Government's approach to implementation of the ecd in the area of financial services, although some raised concerns in the following areas:

- that a different approach to implementation by other EEA states could lead to both UK business and consumer detriment
- that our proposed approach applied "the country of origin" principle either too extensively or too narrowly, (the latter especially in relation to market abuse)
- that implementation of articles 12-14 of the Directive on the liability of intermediaries, especially in relation to Internet service providers ("ISPs"), be implemented by the DTI.

Several respondents also raised specific concerns about how the ecd might have an impact upon them or aspects of their businesses. In general, respondents were keen that we allow sufficient lead-in time for business and consumers to adjust to the new regime for Information Society Services ("ISS") established by the Directive.

**1.2** The responses to the consultation have confirmed the Treasury in its view that both the policy and the legal approach outlined in the December consultation document represent the best way forward in the UK implementation of the ecd in the area of financial services.

### **Implementation by other EEA states**

**1.3** This is the area of greatest concern for respondents. Some are concerned that the Directive does not provide sufficient safeguards to deal with incoming ISS providers established in EEA states with less stringent financial regulation than the UK and that this could lead to incoming ISS providers having a competitive advantage over UK established firms. Others are concerned that ISS providers established in the UK could face dual conduct of business regulation unless the article 3(3) exclusions and the article 3(4) “case-by-case” derogation are interpreted consistently throughout the EEA. Still others are concerned that the Directive fails to provide adequate safeguards for UK consumers purchasing financial services products on-line from firms established in other EEA states with lower standards of consumer protection than the UK.

**1.4** We understand these concerns. We are continuing efforts to ensure that the ecd is fully and properly implemented by other EEA member states so that UK established financial services firms benefit fully from “country of origin” regulation. The draft regulations, in accordance with the Directive, identify

the protection of consumers as one of the grounds on which the FSA can take action against an incoming ISS under the article 3(4) “case by case” derogation. In addition, the approach outlined in the previous consultation on the consumer contract exclusion will help ensure UK consumers are confident about the contractual arrangements that apply to their transactions, and have access to essential pre-contractual information about the financial services products they purchase on-line.

### **The Scope of Country of Origin Regulation**

**1.5** Of those who raised the issue, respondents divide approximately evenly between those who believe our proposals implement the scope of country of origin regulation appropriately, those who are concerned that, in general, our proposals implement country of origin too strictly, and those who believe that greater limits should be placed on the scope for the application of UK laws to incoming ISS providers. The latter respondents focus in particular on the market abuse regime in Part VIII of FSMA.

**1.6** We maintain the view (put forward in the Treasury’s first consultation on the 12th December), that the UK market abuse provisions do not need to be disapplied from incoming ISS providers. The accelerated negotiations on the proposed Parliament and Council Directive on insider dealing and market manipulation (market abuse) have confirmed that the ability of member states to take action to protect the integrity of their markets will be

preserved in the final text. We consider that our proposed approach is consistent with that outcome.

### **Liability of Intermediaries**

**1.7** We agree with respondents that there is no need for separate implementation of articles 12-14 of the Directive in the area of financial services. The effect of the amended Financial Promotion order is that whenever a person is exempt from civil liability under the DTI's general implementing regulations, they will be exempt under the Financial Promotion regime.

**Annex A: List of Responses to Previous Consultation**

Abbey National Group  
ABN AMRO Bank N.V.  
Advertising Association  
Association of British Insurers  
Association of Unit Trusts and Investment Funds  
Barclays  
Bloomberg  
Building Society Association  
Cable & Wireless plc  
Consignia  
Consumers' Association  
Council of Mortgage Lenders  
Faculty of Advocates  
Financial Services Consumer Panel  
Financial Services (Europe) Ltd  
HBOS plc  
ILAG  
Internet Services Providers Association  
Legal And General Assurance Society Ltd  
London Investment Banking Association  
National Computing Centre Ltd  
National Consumer Council  
Reuters  
Shepherd & Wedderburn  
Thus plc  
Yahoo! Europe

## **Annex B: Initial Regulatory Impact Assessment**

B1. 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**

B2. 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.

B3. 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.

B4. 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**

B5. The Government believes that the ecd should bring substantial benefits to ISS service providers established in the UK. Under the ecd, they will be subject to regulation by the Financial Services Authority ("FSA") if they are established in the UK, irrespective of where in the EEA they provide financial ISS. In return, the provision of those financial ISS, again irrespective of where in the EEA service providers do business, cannot be restricted unless they are conducting business in an area specifically excluded 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 such “country of origin” regulation.**

## **Costs**

### **Financial Promotion Regime**

B6. 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 does not restrict the provision of financial ISS into the UK from other EEA member states. This will bring additional costs for firms established in the UK launching promotions into EEA member states.

B7. 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.

B8. 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.

B9. 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.**

## **Annex C: Draft Regulations and Explanatory Notes**

C1. The draft regulations contained in this annex implement the ecd in the area of financial services, in line with the legal reasoning described in the previous consultation document.

C2. The proposed Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (Electronic Commerce Directive) Order 2002 will create a general exclusion from the definition of “regulated activity” for activities consisting of the provision of information society services from places of establishment in other member states. The exclusion does not extend to the effecting or carrying out of a contract of insurance as principal where the activity falls within the scope of any of the insurance directives. This is in accordance with Article 3.3 of the Directive, which excludes the subject matter of the insurance directives.

C3. The proposed Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) (Electronic Commerce Directive) Order will realign exemptions to the FSMA Financial Promotion restriction so that they are consistent, and can be applied in conformity with, the ecd. This is done by the creation of a new category of communication for the purposes of the Order – an “electronic commerce communication”, which is defined to mean a communication, the making of which constitutes the provision of an ISS. The category is sub-divided into “outgoing” and “incoming” electronic commerce

communications. The former are removed from the ambit of the exemption in article 12 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (S.I. 2001/1335) (“the principal Order”), with the result that the financial promotion restriction *will* apply to such communications, unless one of the other exemptions applies (in effect, they will be treated in the same way as purely domestic communications, despite the fact that they are received by persons in other EEA States).

C4. The order also makes adjustments to certain of the exemptions in the principal Order, to enable them to be applied to outgoing electronic commerce communications (e.g. references to amounts in pounds sterling in the net assets tests in articles 48 and 49 are expanded to include equivalent amounts in foreign currencies).

C5. We have also aligned the “mere conduit” exemption with the proposed DTI Regulations, with the effect that immunity from civil liability under those Regulations will also mean that the FSMA Financial Promotion restriction does not apply. Although the Financial Promotion regime is not civil in character, we consider that it is more in keeping with the structure of the exemptions for there to be a prima facie exclusion, rather than a defence to criminal proceedings, as contemplated elsewhere in the DTI draft regulations.

C6. The proposed Electronic Commerce (Financial Services and Markets) Regulations 2002 provide for the modifications of certain powers of the FSA, in order to give effect to the ecd. Part 2 of the proposed regulations will modify section 138 of FSMA, to enable the FSA to apply rules to incoming ISS providers in accordance with the exclusions in article 3.3 of the Directive. Part 3 will give effect to the “case-by-case” derogation in article 3.4 of the Directive, by enabling the FSA to take measures against individual incoming ISS providers, where the criteria in article 3.4 are met. Part 4 will clarify the scope of the FSA’s enforcement powers with respect to incoming ISS providers.

C7. Part 5 of the proposed regulations makes amendments to sections 417 and 418 of FSMA, in order to give effect to article 3.1 of the ecd. The effect of the amendments will be that a UK-established ISS provider providing ISS to persons in other EEA States will be regarded as providing those services in the UK.

C8. Part 6 of the proposed regulations will make provision with respect to information and notices, for the purposes of the FSA’s functions under the regulations.

C9. Part 7 of the proposed regulations will restrict the operation of the Electronic Commerce (EC Directive) Regulations 2002 in relation to FSMA, and enforcement action taken under it. The purpose of this provision is to ensure that the Treasury’s implementation of Article 3 of the Directive does not overlap with

the general implementing provisions to be made in the DTI regulations. For the purposes of draft regulation 17(1), we have taken the view that UK-established persons who are not subject to enforcement action under FSMA (e.g. exempt persons, recognised exchanges) will not themselves have functions "in relation to" FSMA (or any legal requirement resulting from it), and hence the DTI Regulations will apply to the performance of their functions.