



## EUROPEAN CENTRAL BANK

DIRECTORATE GENERAL LEGAL SERVICES

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# E-BANKING, E-TRADING AND THE EU APPROACH

## 1. Introduction

This paper provides an analytical overview of current EU legislative and other related initiatives in the field of electronic commerce<sup>1</sup> for financial services and focuses in particular on **e-banking** and **e-trading**<sup>2</sup>. E-banking is defined as online financial services accessed over the internet or via wireless devices collectively, and based on a business to consumer pattern (i.e., standardised deposit accounts or other investment products). E-trading consists rather in banking services that follow a business to business model, such as brokering services to independent financial intermediaries, or corporate banking. In this regard, inter-dealer systems (EBS, Reuters) are more established in the wholesale foreign exchange market, while dealer to customer systems are less developed.<sup>3</sup>

With this paper we provide an analytical overview for the group to consider whether the legislative approach, which is being adopted at the EU level, and the objectives set, take all interests involved into proper consideration; and whether further legislative intervention is required in certain areas of this new business environment. It should be noted that the EU is focusing primarily on harmonisation of the internal market and consumer protection.

The greatest advantages of using the Internet for the EU are the more efficient product pricing and the cost savings, the greater degree of interactivity between the client and the financial intermediary, and the relevant opportunity given to the client to select the appropriate financial service.

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<sup>1</sup>The OECD defines electronic commerce as follows: “*Electronic Commerce refers generally to all forms of commercial transactions involving both organisations and individuals, that are based upon the electronic processing and transmission of data, including text, sound and visual images. It also refers to the effects that the electronic exchange of commercial information may have on the institutions and processes that support and govern commercial activities*” in OECD, *Electronic Commerce: Opportunities and Challenges for Government (The “Sacher Report”)*, Paris, OECD, 1997, p.11. There is no definition in the e-commerce Directive of the Commission.

<sup>2</sup> It should be noted that there are many terms used for e-commerce in financial services, such as *e-finance*. *E-banking* encompasses retail and small value banking products and services through electronic channels or means, *e-trading* encompasses both inter-dealer and broker-client electronic trading platforms, *e-brokerage* relates to dealer to client electronic schemes usually for equity trading and *e-payments*, that is payments initiated electronically. Often such terms are used as synonyms such as in the case of e-brokerage and e-trading.

<sup>3</sup> There is already the example of Jiway, which has sought registration as an exchange in the UK.

E-trading has a big impact on market structures since it blurs the lines between exchanges and broker-dealers electronic communications systems (ECN), which remain unregulated. It could have repercussions on capital formation and corporate governance as well. The most visible advantage for the investors in Member States is the facilitation of cross-border trading, which poses challenges, as well, since regulation is still national, with some exchange of information among supervisory authorities.

M-commerce and m-payments, transactions conducted via mobile phones<sup>4</sup>, are also expected to play an important role in the future, even for trading purposes, since the technology is already available. The same rules should apply on m-commerce as for e-trading and e-payments, even if the diffusion is not comparable at this stage.

## 2. Initiatives at the European Union level

The initiatives in the field of electronic commerce for financial services at the European Union level<sup>5</sup> pursue the objective of developing a comprehensive legal framework built around the two key elements of the e-commerce Directive<sup>6</sup> and the proposal for a Directive on Distance Marketing of financial services, which is still in the pipeline. After having discussed the main aspects of the aforementioned directives, we shall offer a brief description of the Directive on a Common Framework for Electronic Signatures, the Financial Services Action Plan, the Commission Communication on E-commerce and Financial Services, the FIN-NET network and the Electronic Money Directive.

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<sup>4</sup> M-commerce (mobile commerce) is the buying and selling of goods and services through wireless handheld devices such as a cellular telephone. M-payments are electronic payments for goods or services performed by means of a mobile device.

<sup>5</sup> The first attempt by the Commission to address the issues characterizing online financial services and the pertaining distance contracts dates back to 1997. Indeed, the Commission supported the idea that online financial services, and financial services offered from a distance in general (i.e., telebanking), should be comprised in the spectrum covered by the Directive on Distance Selling. Much objection to this proposal arose as the provisions set forth in the Directive proved incompatible with the specificities of the financial sector (namely, the need for specific regulation for consumers' *withdrawal rights* and *reflection period*, in light of constantly changing market prices, and the often speculative nature of financial services) and the financial sector was excluded from the scope of the framework directive on distance selling. Shortly after the adoption of the Distance Selling Directive (1997) the Commission proposed a specific proposal for a directive for the distance marketing of financial services. The proposal focused on the need for specific intervention at a European Union level, so as to attain full harmonization of the Internal Market, and a sheer growth of cross border transactions, particularly in light of the full realization of the EMU.

<sup>6</sup> Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce); Official Journal L 178, 17/07/2000, p. 0001 – 0016. It has to be implemented by the Member States by 16 January 2002. The German government has already presented a draft law for the implementation of the e-commerce directive and the modernisation of data protection in remote services (BR-Dr 136/01).

## The E-commerce Directive

The E-commerce Directive<sup>7</sup> stipulates that the trading rules applied to the cross-border sale and purchase of financial services should be those of the Member State where the service provider is established, meaning pursues an economic activity<sup>8</sup>, i.e., the “country of origin approach”<sup>9</sup>. Indeed, this provision allows providers of financial services to have a thorough access to the entirety of the Internal Market, and to the Euro area, as they will not have to comply with up to fifteen different sets of rules, but only with that of the Member State of establishment (internal market clause)<sup>10</sup>. Derogations from the internal market clause are provided for institutions emitting e-money and UCITS.<sup>11</sup>

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<sup>7</sup> The e-commerce Directive is a horizontal framework directive that applies to all information society services. However, *information society services are defined as those provided at a distance and by electronic means* only (so called on-line services), therefore “off-line” activities are not within the directive’s scope even if thoroughly connected with an “on-line service” Thus, where financial services are provided partly off-line and partly on-line, different legal regimes will be applied to each part (i.e., when a service is promoted on-line but provided off-line, only the on-line promotion will be covered by the e-commerce directive). Furthermore the e-commerce Directive applies solely to service providers that are established within a Member State of the EU: service providers from third countries are not covered by the Directive nor can they benefit from the free movement of information society services (which, as already indicated, comprise on-line financial services too).

<sup>8</sup> An established service provider is defined by the Directive (Art. 2) as a service provider who effectively pursues her activity by means of a fixed establishment for an indeterminate duration. It is worth underlining that the presence and use of technical means and technology required to provide the service do not constitute an establishment of the provider. Following this rationale, the mere fact that a web site offering financial services specifically targets the European Market will not provide sufficient grounds for the Directive to apply. The official place of an established e-business will thus be where its operator is registered for tax or company law, irrespective of where web sites, mail boxes or servers are situated.

<sup>9</sup> It has been argued that the internal market approach could result to excessive regulation (triple regulation) not only from the authorities of the head office but also from the authorities where the branches are located when these branches offer services via the Internet. That could be perceived as a competitive disadvantage vis-à-vis branches of companies whose head office is located in third countries on which the e-commerce directive does not apply. See *Dassesse*, E-commerce, in “Euro Banking Regulation and Prudential Supervision”, Conference, June 2001.

<sup>10</sup> However, on-line providers of financial services will still have to comply with the rules of consumer protection of the Member State where they operate on instances where the provisions of the Brussels and Rome Conventions apply. Pursuant to Art. 13, 1, III of the **Brussels Convention**, which is to be replaced by the Regulation (EC) 44/2001 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters entering into force on 1 March 2001, the competent *Forum* for any matter of dispute that may arise from contracts, between consumers (defined by the ECJ – the European Court of Justice – as a party to a transaction for non professional purposes) and sellers, on the provision of services or on the delivery of movable things (hence, the majority of transactions that are entered electronically too) will be that of the consumer, provided that the seller has deliberately directed any form of advertising or offer to enter the contract to the country of residence of the consumer herself, and that the subsequent steps for its stipulation have also taken place in the consumer’s state of residence. This condition is reinforced in its relevance by the *Giuliano/Lagarde* report on art. 5 of the **Rome Convention** (which, for contracts between consumers and sellers, sets that, as long as there is a strong connection between the contract, which has been entered into, and the consumer’s state of residence, the *lex contractus* chosen by the parties cannot transcend the protection afforded to the consumer in her own country, nor can it deprive her of such protection). The Commission currently works on a possible revision of the Rome Convention.

<sup>11</sup> There are significant derogations in the e-commerce Directive from the “Internal Market” approach. Such derogations fall into the two categories of *general* and *specific case* derogations. General Derogations are listed in the annex to the e-commerce Directive. These comprise, *inter alia*, the freedom of the parties to choose the law applicable to their contracts, the law applicable to contractual obligations in consumer contracts, and the formal validity of contracts creating or transferring rights in real estate. In these cases the rules set in the Rome Convention will determine which Member State’s law applies to cross-border contracts. The second category of derogation permits a Member State on a case by case basis to apply restrictions to an information society service from another Member State under the conditions outlined in Article 3(4) and (6) of the e-commerce Directive which allows Member States to take measures to protect general interest objectives and, more specifically, to protect consumers and investors. The Commission shall always be involved for examination of any decision by a Member State in this regard.

### **The Directive on Distance Marketing for Financial Services**

The main purpose of the proposal for a Directive on Distance Marketing for Financial Services<sup>12</sup> is to harmonise key marketing rules: *inter alia*, an obligation on behalf of the supplier of financial services to provide a comprehensive set of information elements prior to the conclusion of the contract, and the introduction of a right of withdrawal.<sup>13</sup>

### **The Directive on a common framework for electronic signatures (1999/93/EC)**

The Directive on a common framework for electronic signatures has entered into force on 19 January 2001 and has to be implemented by 19 July 2001 by the Member States. This directive facilitates the use of e-signatures and their legal recognition in all Member States, the rationale being that divergent rules regarding the recognition constitute barriers for all aspects of e-commerce and e-finance.

### **The Financial Services Action Plan**

All further legislative initiatives unfold in accordance with the Financial Services Action Plan<sup>14</sup> and the conclusions of the Lisbon European Council Meeting of Spring 2000, which aims at the creation of an integrated European Market in financial services by the year 2004.

### **The Commission Communication on E-commerce and Financial Services**

The Commission Communication on E-commerce and Financial Services<sup>15</sup> in February 2001 has defined three policy areas where further action will be needed: 1) full convergence in core marketing rules and at the service or sector specific level; 2) the establishment of a Community wide network of financial services complaints bodies to provide effective and rapid out of court redress on a cross-border basis; and 3) a stringent monitoring of cross-border on-line financial services (notably in terms of prudential supervision). Furthermore, the Communication underlines that the “country of origin approach” has to be extended to other remote communication channels to avoid that the applicable law to offers or advertising of regulated activities depends on the use of technological means. One of the main purposes of the Communication was to identify areas where a better coordination should be ensured between the different on-going EU initiatives in the field of e-commerce and financial services and the texts recently adopted such as the e-commerce Directive, especially where international private law issues are at stake. Lastly, it

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<sup>12</sup> The Commission original proposal has been adopted on 14 October 1998. Following the first reading in the European Parliament, an amended proposal has been adopted by the European Commission on 23 July 1999. Since then, the Council has continuously failed to reach a political agreement, and notably at the last Internal Market Council of 30-31 May 2001. One of the main obstacles to a quick adoption of this initiative has been, ever since the start of the negotiations, the level of harmonisation, which would be acceptable by Member States at the EU level. Whilst the European Commission and the European Parliament (at least in the first reading) favour a maximum harmonisation approach, a majority of Member States favoured the choice of a “minimal clause”, such as the one provided in the Directive 97/7/EC of 20 May 1997 on the protection of consumers in respect of distance contracts (Article 14). In order to reconcile these diverging views, the Swedish Presidency has opted for a “high level harmonisation” approach. This compromise proposal was however also rejected at the last internal Market Council.

<sup>13</sup> It is recognised that the proposal will apply only to consumers. Nevertheless, for greater legal certainty an exemption should be introduced in Article 4 1a (a) which lists all the areas where the right of withdrawal does not apply in order to encompass the finality of payments and settlement via payment and securities settlement systems for participants.

<sup>14</sup> COM 1999/232.

<sup>15</sup> COM 2001/0066

was announced that the Commission intended to develop a legislative framework for refunds in order to enhance consumer confidence.

### **FIN-NET**

Pursuant to the aforementioned objectives, FIN-NET<sup>16</sup> has been designed as an out-of-court complaint network to facilitate the out-of-court resolution of consumer disputes on instances where the financial service provider is established in an EU Member state other than that where the consumer lives. The FIN-NET rests upon the wide range of ADR<sup>17</sup> procedures for financial services that already exist at a national level<sup>18</sup> and brings the national redress schemes together, so as to create a network and ensure full cross border co-operation in case of consumer complaints<sup>19</sup>.

### **The Electronic Money Directive**

The Electronic Money Directive<sup>20</sup> aims at fostering the Single Market in financial services by introducing a minimum set of harmonised prudential rules for electronic money issuance and by applying the arrangements for the mutual recognition of home supervision provided for in the Consolidated Banking Directive<sup>21</sup> to electronic money institutions (ELMIs). This includes the safeguarding of the financial integrity and the operations of ELMIs by, on the one hand, ensuring the stability and soundness of ELMIs and, on the other, ensuring that the failure of any one individual ELMI does not result in loss of confidence in this new means of payment. The Directive further creates a level playing field for the issuance of electronic money by both traditional credit institutions and ELMIs, thus ensuring that all issuers of electronic money are subject to an appropriate form of prudential supervision. The amendment, introduced by Directive 2000/28/EC of 18 September 2000, to the definition of credit institution in Article 1, point 1, first subparagraph, of the Consolidated Banking Directive, obliges institutions that do not intend to enter into the full range of banking operations to issue electronic money in accordance with the fundamental rules governing all credit institutions. Such an amendment promotes the harmonious development of the issuance of electronic money throughout the Community and avoids any distortion of

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<sup>16</sup> The FIN-NET network was set up on the basis of the Commission Recommendation 98/257 of 30/03/1998.

<sup>17</sup> ADR is the acronym for Alternative Dispute Resolution, a term which refers to any procedure for settling a dispute by means other than litigation, such as in the case of, i.e., arbitration and mediation.

<sup>18</sup> For a full list of the out of court complaints bodies for financial services see [www.europa.eu.int/comm/internal\\_market/en/finances/consumer/intro.htm](http://www.europa.eu.int/comm/internal_market/en/finances/consumer/intro.htm).

<sup>19</sup> The consumer will contact her national ADR system for financial services, which will put her in touch with the ADR scheme in the supplier's country of operation and ensure full redress. This notwithstanding, the consumer will not have to waive her right to file a suit in court, in the event where she should not be satisfied with the outcome.

<sup>20</sup> Directive (EC) 2000/46 of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit and prudential supervision of the business of electronic money institutions, OJ L 275 27.10.2000 p. 39-43.

<sup>21</sup> Directive (EC) 2000/12 of the European Parliament and the of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, OJ L 126, 26.5.00, pp. 1-59.

competition between electronic money issuers, even as regards the application of monetary policy measures<sup>22</sup>.

### 3. Conclusions

In light of the initiatives currently unfolding it is noted that the Commission focuses on e-banking services, that is on Business-to-Consumer transactions. The rationale is that only by doing away with the legal disparities which may characterise the approaches of the various Member States, and only by fully harmonising the market, will it be possible to increase consumer confidence, and, as a result of that, attain stringent competition between online providers of financial services, and, thus, a sheer growth in cross-border transactions. The Commission is adopting a strategy which aims at ensuring an electronic market without barriers based on full competition, by removing all obstacles to an unrestricted, harmonized access to the market. Such strategy is a two-pronged one based on consumer protection properly balanced with the interests of the banking industry and on a relevant role for self-regulation.

There may be a number of issues, that could be addressed, and it would be useful to gather the views of the group on these matters.

- The development of e-commerce in financial services and of e-money in particular may reduce the importance of banks as the primary lending institutions and take the functions of payments/settlements outside the banking system.
- Legal risks normally derive from the legal uncertainty surrounding the provision of banking services due to the global nature of the Internet. It is recognised that the financial institution holds the ultimate risk on positions delivered via electronic channels. In this regard, credit institutions may find themselves exposed to an operational risk, which, in general, is not easy to assess or quantify in advance. Such operational risks could stem from computer or other technological failures within the institution or within its providers or from the uncertainty regarding the laws applying in countries where their banking services are accessed. The FSA in the UK has recently identified 17 risks related to e-commerce<sup>23</sup>, among which feature a number of legal risks related to fraud and data protection. Money laundering aspects, albeit their importance, do not fall within the scope of this paper.
- The traditional banking regulation should be extended to the e-banking/e-trading so that banking services may not be offered by non-regulated entities. Therefore, any disparity of investor protection in the 15 EU Member States should also be abolished to ensure equal treatment of investors EU wide. In this regard, the establishment of banking service providers in off-shore centres should be brought under internationally recognised standards via international agreements.

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<sup>22</sup> The Directive on Electronic Money will be further complemented by a legislative framework on the issue of payment refund by the issuer of the electronic payment instrument if a problem occurs at the time of a transaction - which should lead to the proposal for a future directive on the electronic funds transfer transactions, - yet as this will focus solely on the retail sector we deem best not to include the pertaining discussion in this paper.

<sup>23</sup> Financial Services Authority, *The FSA's approach to the regulation of e-commerce*, June 2001.

**The Members of the EFMLG are kindly invited to report which aspects are important to the banking community and which matters raise concern to the EFMLG Members.**

**In particular, it would be appreciated if Members could suggest any other issues for future consideration, in particular with a view to ensuring legal robustness of e-banking and e-trading and indicate whether, in their view, cross-border activities are properly addressed by the existing framework.**

## **ANNEX: International initiatives in the area of e-finance**

A number of initiatives and studies concerning e-banking and e-trading are unfolding at an international level and are worth being taken into account:

- The *Electronic Banking Group* of the *Basel Committee on Banking Supervision* is currently working on a framework for cross-border issues arising from e-banking, and is developing supervisory training materials and surveying licensing procedures. Another important issue the Group is dealing with is that of IT operations of back office functions, where they are trying to assess how it would be possible to ensure that the bank remains effectively responsible for such operations.
- The *Committee on the Global Financial System* has established a working group to examine the impact of electronic trading on the structure of financial markets, price dynamics and financial stability.
- The *Financial Action Task Force on Money Laundering* (FATF), an inter-governmental body, which develops and promotes policies, both nationally and internationally, to combat money laundering is reviewing its forty recommendations in light of e-finance development where the virtual world with less physical interaction between a bank and the client, including straight-through processing techniques, could make customer identification and hence money laundering combating more difficult.
- The *OECD Committee on Financial Markets* is to undertake a study on the implementation of e-finance for cross-border financial services.
- The *1996 UNCITRAL Model Law on Electronic Commerce*, one of the most comprehensive proposals for the unification of legislation on electronic commerce. The model law focuses, more specifically, on the formation and validity of electronic contracts and on the legal recognition of data messages (original documents, signatures).
- The *TBMA, The Bond Market Association* has reviewed 75 electronic trading systems for fixed income markets (70 in the US and 5 in Europe). The Report can be viewed on [www.bondmarkets.com/research/ecommerce/ecommercedraft.shtml](http://www.bondmarkets.com/research/ecommerce/ecommercedraft.shtml)
- The *IOSCO* made 24 recommendations through its Internet Task Force.
- The *FSA* intends to continue to undertake surveillance of the Internet to identify market abuse, breaches of the Listing Rules requirements, and perimeter offences and to adopt e-regulation.
- The *SEC* has published a report in 1999 “On- Line Brokerage: Keeping Apace of Cyberspace” [www.sec.gov](http://www.sec.gov).
- SEC Report on the impact of recent technological advances on the securities markets.