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The FSA's proposals

On 7 March, the Treasury published for consultation the draft regulations it is proposing to implement, the E-Commerce Directive (the "Directive"). The proposals of the Financial Services Authority ("FSA") in relation to the Treasury's consultation are considered in detail below. Structurally, the FSA is proposing a new sourcebook to form part of its Handbook of rules and guidance, to be called the E-Commerce Directive Sourcebook, as well as amendments as necessary to other existing parts of the Handbook. Consultation closes on 10 May.

The Directive, and consequently the upcoming FSA regulations, apply to so-called 'information society services.' The Directive defines these as being "any service normally provided for remuneration [though remuneration need not necessarily come from the user of the service], at a distance, by means of electronic equipment for the processing…and storage of data, and at the individual request of the recipient of a service."

Those firms offering unregulated collective investment schemes, derivatives, warrants and broker funds will be particularly affected by the FSA proposals.

The country of origin principle

European Union ('EU') financial services regulation has always included areas reserved to the country of origin of the financial services provider, namely authorisation, prudential oversight, passporting and transaction reporting, and the Directive will not change these responsibilities. However, the Directive's explicit aim is to remove all barriers to cross-border electronic trade by explicitly requiring each EU Member State to impose regulations on electronic service providers established in that jurisdiction, but forbidding imposition of any barrier (including regulation) to incoming business from other Member States. This means that the FSA will no longer be able to require an electronic service provider based in another Member State to comply with conduct of business rules, including financial promotion, unless the area concerned falls within a derogation. This will, then, involve amending both primary and secondary legislation, as well as FSA rules, to make it clear that incoming electronic service providers are excluded from the definition of regulated activities, and that outgoing electronic service providers are subject to UK (i.e., FSA) regulation when operating in other EU Member States.

A key change proposed under this consultation is that, except where a derogation applies, firms providing services into the UK by electronic means will no longer be subject to UK financial

promotion requirements, but will instead have to follow those of the country from where the service is provided. This also means that UK based firms providing services into the EU will have to comply with all UK regulatory requirements (including financial promotion requirements), but will not be subject to the requirements of those states where its products are sold. A key result of this is that those UK based providers promoting unregulated collective investment schemes, derivatives, warrants and broker funds will now be subject to the existing UK restrictions on such promotions when offering these products to customers based in other EU Member States.

The FSA is proposing a direct transition to the country of origin approach for business done electronically between professional or sophisticated counterparties. However, as there is a lack of comparable core standards for consumer protection across the EU, the FSA is proposing that a move to the country of origin approach for retail business should be accompanied by the development of such core consumer protection standards at EU level. A Commission plan to implement measures to foster a single retail market is already in progress.

Exceptions to the country of origin principle

- **Market abuse**: The Treasury's consultation paper has stated that, as market abuse provisions are designed to provide 'a level playing field' for all market participants, they cannot be viewed as a barrier to trade, and therefore, that the Directive should not affect domestic market abuse regimes. The FSA has agreed with this approach.

- Using reasoning analogous to that set out above, the Treasury has similarly concluded that the Directive and the country of origin principle should similarly not affect the provisions at section 397 of the Financial Services and Markets Act 2000 on **communicating criminally misleading investment promotions**. Again, the FSA agrees with this approach.

- **General derogations**: The Directive sets out a number of derogations from the country of origin principle, meaning that member states can impose their domestic regulations. The FSA proposes to use the following derogations:

  - *E-money institutions* who qualify for a waiver from the prudential requirements that apply to other issuers of e-money under the E-Money Directive;

  - *Life and non-life insurers* are subject to a general derogation which means that the FSA is proposing to continue to apply its financial promotions regime and conduct of business requirements to incoming insurance providers, and not to apply its requirements to outgoing providers. However, this derogation does not include reinsurance or insurance intermediaries;

  - *"Contractual obligations in consumer contracts"* Pending implementation of the Distance Marketing Directive, which imposes core disclosure requirements when

financial services are marketed on a non-face to face basis, the FSA is proposing to use this derogation to require providers from other Member States to comply with specified disclosure requirements where their country of origin disclosure obligations do not correspond to those of the FSA. These proposed disclosure requirements concern information about cancellation and withdrawal rights; information about the main features of the product or service; and information about alternative dispute resolution schemes. The FSA is also proposing that outgoing financial services providers would not have to comply with these disclosure obligations, on the basis that other Member States will impose parallel requirements on providers offering services into their jurisdictions. It is also worth noting that the Directive does not govern the jurisdiction or applicable law of an agreement.

Disclosure obligations

The Directive sets out certain disclosure obligations that apply to all those offering electronic services in the EU. These chiefly involve giving the customer basic information, including name and address, contact details, a clear flag that a communication is a commercial or promotional communication, and a clear and unambiguous identification of an unsolicited commercial communication as a commercial communication as soon as it is received by the recipient. In addition, where the recipient is a consumer not acting in a professional capacity, further disclosures must also be made.

There is a particularly notable effect on the FSA's use of the consumer contract derogation on the marketing of particular instruments. The FSA currently restricts the ambit within which certain products, namely derivatives, warrants and broker funds may be marketed. The latter may not be promoted by way of direct offer financial promotions, whilst warrants and derivatives may only if the firm has adequate evidence that they are suitable for the customers concerned. The FSA is therefore proposing that incoming providers offering these higher risk products be required to make specific and prominent disclosures in their promotional material. However, UK providers will still be subject to country of origin rules, and will therefore be restricted in their offerings of these products into other Member States, which could lead to a competitive disadvantage for UK firms operating in Europe.

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