



REPORT ON THE USE OF THE INTERNET

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1. MANAGEMENT SUMMARY

The increasingly confusing regulatory environment for e-commerce activities with respect to their business to consumers' transactions, esp. in respect of funds' promotion over the Internet prompted FEFSI to prepare a report on the use of the Internet. The report sets out an number of key elements that investment funds may be able to use to place themselves in a "safe harbour" with respect to sanction from third country regulators.

First and foremost the report should **provide guidance to investment funds and management companies** that are considering the use of the Internet for promotional or transactional purposes. It must be noted, though, that FEFSI has heeded not to recommend a standardised or uniform model so as not to encroach on the commercial prerogatives of individual companies, which will need to complement the basic model disclaimer that FEFSI provides in function of the specificities of their own marketing strategies.

In addition, but of subservient importance the report equally purports to:

- **Serve national associations** in their dialogue with the public authorities and regulators on the best use of websites by the investment funds industry. The report highlights the approaches / stances which may placate national regulators feeling their statutory scrutiny is under threat by the marketing of funds via the Internet.
- **Serve FEFSI in its dialogue with the Community institutions** and other international governmental bodies to illustrate the investment funds industry's agreed use of the Internet.

2. GENERAL INTRODUCTION

The Internet is recognised as a powerful driving force behind the current changes in the field of financial services, and in the investment funds industry in particular. Most fund providers across the world now use the Internet in one form or another. Some are very active in the use the Internet not only for marketing, advertising and communication purposes, but also for the process of buying and selling.

The opportunities presented to fund providers by the Internet are extensive and varied. They include:

Increased globalisation – where one Internet site can be accessed across the world, the geographical location of an investment firm is becoming much less important. Marketing can be carried out from any jurisdiction.

Distribution – the ability to deal on line could reduce the need for distribution outlets, particularly in the context of cross-border sales.

Increased investor sophistication - access to greater information about investment funds, markets and other investments will help investors become more sophisticated. Fund providers can use Internet sites to provide more extensive information and education about their own products to existing and potential clients. More sophisticated investors will look beyond the providers to whom they have traditionally looked in the past in search of funds which offer better services and performance.

Intermediaries - The Internet is especially attractive for self-service clients. Many investors will, however, continue to seek professional financial advice and with increasing investor sophistication the demand for advice will also increase. Financial intermediaries are themselves marketing their own services on the Internet as well as providing information on a wide range of products available through them. This activity will potentially contribute to increasing the profile of fund providers' products, again offer the potential for increased trading volumes. Fund providers can use the Internet to market to and service financial intermediaries, particularly by adding value by, for example, the provision on-line of research and analysis that previously had to be paid for.

FEFSI regards the Internet as presenting substantial opportunities to increase the profile of the fund management industry generally with the investing public, as well increase the profile of individual fund providers. It represents an opportunity for increased competition within the fund management industry itself and as against other types of product provider.

The Internet does, however, present significant challenges for both the industry and the regulators to confront.

3. THE PROBLEMS

3.1 National differences in Europe

The 1985 **UCITS directive** [85/611/EEC] led to the harmonisation of product regulation, however, this has not meant that investment funds can be distributed freely across Europe:

- UCITS still need to register for distribution in another market and non-UCITS cannot be marketed without the agreement of the host country.
- There are no pan-European standards with regard to content or presentation of Internet sites. Different national legislation, prevailing national preferences and peculiarities and different levels of investor knowledge pose specific problems, causing questions relating to cross-border distribution to become predominant.
- Distribution and business models widely diverge, mainly reflecting the different structures and traditions of the securities industry in the various countries.

The **E-commerce directive** (2000/031/EC of 8 June 2000) might appear to provide a solution to some of these problems in focusing on creating clarity in the new rules that regulate financial services and E-commerce. Unfortunately, it does not provide solutions for investment funds. Whilst for most financial services, the directive takes a country of origin approach (“home country control”) there is a derogation for Article 44 (2) of the UCITS directive, preserving the application of host state advertising rules. In theory, this means that cross-border marketing of UCITS on the Internet is subject to home country control, whilst advertising remains subject to host country control. In terms of the Internet, though, it is unclear how advertising can be distinguished from marketing.

This means that a UCITS provider will still have to design an Internet site selling UCITS funds to ensure that the site complies with the national legislation of each country that is targeted by the site.

3.2 Defining jurisdiction

Further problems exist even where an Internet Site is not targeted at the nationals of a particular country.

Unlike the traditional means of marketing securities, investors worldwide can access an Internet site even though, under traditional ways of thinking, an offer is directed only to investors in a particular jurisdiction. The question of which national regulator has jurisdiction in relation to an investment advertised on the Internet is very unclear and leaves fund providers with the question of how to deal with the possibility that a number of regulators may seek to assert jurisdiction in respect of a site advertising a particular fund. Fund providers have to consider how to design an Internet site that satisfies the concerns of all national regulators who may possibly take an interest in it. Tests such as the language in which the site is written do not necessarily help since the use of certain languages is not confined to national borders. Where a site uses a language that

is commonly used across Europe (or world-wide) there is the danger that more than one national regulator will deem that Internet site to be aimed at its nationals.

3.3 Financial Crime

The ability to carry out transactions in a context, which does not involve meetings face to face with an investor, raises the issue of how proper identification is to take place to avoid the possibility of crime including money laundering. The issue is not exclusive to fund providers but the reputation of the fund management industry depends on the identification of a proper resolution of the problem in the context of fund management business.

4. SOLUTIONS - IOSCO RECOMMENDATION

The Technical Committee of IOSCO adopted in September 1998 five key principles and 24 recommendations that might be applied at worldwide level.

Concerning the principles, two are of particular importance to the investment funds industry:

- *“The fundamental principles of securities regulation do not change based on the medium”* (1st principle).
- *“Regulators should strive for transparency and consistency regarding how their regulations apply in an Internet environment”* (3rd principle).

Among the 24 recommendations, section B “Exercise of regulatory authority over cross-border securities activities on the Internet” with recommendations 14, 15 and 16 is essential for the investment funds industry. Recommendation 16 describes circumstances in which regulatory authorities should exercise action over Internet offers:

- Information is targeted to regulator’s jurisdiction.
- Service provider accepts purchases from or provides services to residents from regulator’s jurisdiction.
- Service provider uses e-mails and/or other media to push information to residents of regulator’s jurisdiction.

The report also describes factors that would support a regulator's decision not to assert jurisdiction. These include whether:

- The issuer or financial service provider clearly states to whom the Internet offer is directed, rather than appearing to extend the offer into any jurisdiction.
- The Web site contains a statement listing the jurisdictions in which the issuer or financial service provider has been (or has not been) authorised to offer or sell its securities or services.

- The issuer or financial service provider takes precautions that are reasonably designed to prevent sales to residents in the regulator's jurisdiction. For example, the issuer or financial service provider could screen the address and other residency information provided by persons responding to the Internet offer. A significant amount of unauthorised sales would indicate the absence of reasonable precautions.

Approaches of most national regulators are consistent with the IOSCO recommendations. Experience of FEFSI's Members indicates that they take a similar approach in their Internet policies, the crucial question for regulators taking action being whether the Internet offer is targeted at their jurisdiction.

However, policies generally do not articulate a definite set of circumstances, in which an offer would be deemed to be targeting the residents of a jurisdiction. So far, only a handful of jurisdictions have articulated their Internet policies in a formal and transparent manner.

"The ideal world"

Against the background of the current legal environment and the approach taken by supervisors, the investment funds industry is not able to benefit fully from the opportunities presented by the Internet to fund providers.

FEFSI believes that in an ideal world the free sale of EU-based and regulated investment funds in all countries of the EU should be possible ("as easy as buying books via Amazon.com").

In fact, the potential of the www can only be fully utilised to the benefit of investors and fund providers under the following conditions:

- **A unified European regulatory regime for marketing/advertising that means that a site that advertises a particular fund authorised in the fund provider's home state, and which allows a transaction in the fund to take place on line, would satisfy all European national regulators without any specific adaptation. A fund provider would be able to advertise authorised funds on the Internet without the need to comply with individual national regulatory regimes and, in particular, would not need to register a fund locally.**
- **Harmonised redress procedures, which mean that investors know that complaints and compensation mechanisms are available even though the fund in which they were invested is located in a different country.**
- Identification of clients on the net through an electronic signature on a European basis.

5. FEFSI POSITION

5.1 General

As long as this “ideal world” does not exist, we must live with the reality. As mentioned above, on the European level this reality is mainly defined by the UCITS Directive and the IOSCO principles and recommendations.

FEFSI acknowledged in February 1999 the IOSCO principles and recommendations, underlining, however, “that more precision is required regarding the three factors mentioned in the Recommendation as the more precise the rules, the safer the harbours”.

To allow the industry and investors to make efficient use of the Internet, a reasonable level of legal certainty and some clarification are necessary. Safe harbour rules must be more precise and harmonised. In particular, regulators should clearly disclose the conditions under which they refrain from taking action.

5.2 The first step towards more safety

In FEFSI's view, an offer should not be regarded as targeted (and regulators will refrain from taking actions) if it includes:

- A clear statement of intended recipients.
- A prominently placed and easily understandable disclaimer indicating:
 - the countries where the fund is registered;
 - that the offer (and website) is not directed to residents of any other jurisdiction.
- Appropriate arrangements:

Such arrangements should be reasonably designed to identify the location of the purchaser, thus making sure that the potential purchaser is fully aware that the offer was not targeted at him and that he might not be as effectively protected as he would be if the regulations of his own country would have been applied.

6. ISSUES IN THE INTEREST OF INVESTORS

FEFSI is of the view that the following matters also add to the integrity and quality of fund providers' websites generally.

6.1. Information

- Full consistency between information and documents released on a site and corresponding information and documents published in paper form.
- Use of the simplified prospectus as the fundamental marketing tool.
- Clear indications of downloading facilities of required information.
- Use of educational information.

6.2. Privacy

- Enforcement of all appropriate safety measures in order to protect the confidentiality of the data, which the users avail themselves or for information purposes.
- The use of the collected data should be stated.

6.3. Marketing services

- *The use of systems which can verify that the investor has had access to all information documents in downloadable form usually disclosed prior to any sale.*
- *The maintenance of adequate records on all information, transmissions of orders, dealing and transactions.*
- Sites should be designed to ensure a high degree of safety against intrusion. The identification of investors and all personal data concerning them should be encrypted when transmitted.

6.4. Hyperlinks

- If hyperlinks are provided, clear information should be added when the site of the fund provider is left.

USE OF THE INTERNET BY FUND PROVIDERS: CHECKLIST FOR A DISCLAIMER

General Remarks

- Prominent / clearly visible position
 - on first page, preceding pages with information about funds, or
 - a clearly visible pointer drawing attention to the disclaimer
 - may not be by-passed when entering into a site through a hyper-link
- Unambiguous content
- Plain language
 - wording easily understandable by average investor
 - no specialist terms
- Same language as used in web-site

Contents

- List of countries, in which the fund(s) are registered
- Statement, that information is directed only to citizens / residents of countries, where fund(s) are registered
- Explicit statement, that funds are not sold or offered in certain countries, e.g. the U.S.

Importance / advantages of registration for investors (restrictively disadvantages if fund is not registered)

- Statement, that web-sites contain only general information, which may not be considered as a solicitation of offer, or recommendation, to acquire units/shares of funds
- Reference to the prospectus, simplified prospectus and other material forming the legal basis for all investments in a fund
- Statement that web-sites may be subject to changes without previous notice
- General risk clause

Baumann/Matthias

