

Trade Policies and the Legal Perspective of Electronic Banking Activities in the Single European Market

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Abstract

An undiluted policy of mutual recognition and “home country” control is often regarded as an effective remedy to the dysfunction of the single financial area. This paper intends to support this argument. In particular, it will make the case for genuine “home country” banking supervision over cross-border electronic banking activities via the internet where the progress towards market integration is asymmetrical to the capabilities of network technology. Despite the clear normative value of the proposed model however, its actual success depends on preconditions which are difficult to be fulfilled. No description of actual EU Directives is offered.

Keywords: internet banking, mutual recognition, trade liberalisation, banking supervision, single European market

1. Introduction

It is clear that the provision of banking services via the internet is a fast developing industry in the EU Member States. The progress however towards cross-border electronic banking activities, primarily at the retail level, is slow and anaemic despite the potential capabilities of internet technology and the decent efforts of the EU legislature to eradicate the policy-based barriers which continue to disturb cross-border market openness. The poor contribution of the internet towards “more” cross-border financial services is of course neither surprising nor incidental. It is yet another instance of systemic malfunction of the broader single financial market and symptomatic of the ongoing antagonism between the dyad *local control* versus *cross-border activity* in the era of network technology and advanced telecommunications.

The exercise of supervisory control over banks providing cross-border services is one of the aspects of the creeping tension between the “liberalisation perspective”, ie market openness within the single financial market, and the “regulatory perspective”, ie the diverse national regulatory goals and objectives. This paper purports to examine this tension. In particular, I will argue that, in relation to cross-border electronic banking, a pure model of “home country” supervision is superior to a hybrid model of “home” and “host” country powers. This arrangement presupposes an acceptable level of equivalence in national practices and mutual confidence

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among participating states that the reciprocal covenants are kept and the rules of the game are adhered to.

2. Cross-Border Electronic Banking and the Pathology of Multiple Levels of Supervision

There has never been a shortage of law-based actions precluding or disturbing international banking: discriminatory measures, which treat differently domestic and foreign banks to the disadvantage of the latter (overt discrimination)¹; covertly discriminatory rules which, while non-discriminatory in form, place burdens on foreign banks or subsidise the local industry in effect; and restrictions on capital movements² which render the cross-border provision of capital-related banking services virtually impossible. A more elusive source of trade restrictions is the combination of the plurality of legal systems, the diversity of national views on market control and differences in national laws regulating commercial transactions.

The foregoing list fails to reflect the current complex landscape of the single financial area. And neither has the response of EC law been static and horizontal since the inception of the internal market project forty years ago. The still ongoing process of dismantling barriers to trade has been dynamic and gradual and sources of failure have been addressed in order of significance. This route has never been unproblematic but, despite the persisting dysfunction at the retail level, the single financial market has indeed advanced considerably since the adoption of the Treaty of Rome in 1957.

In implementation of the “1992 generation” of financial services Directives and following the liberalisation of capital movements in 1988, a fully functioning European financial area was hoped to emerge under the concerted effects of a hybrid integration model of centralisation and decentralisation, premised upon three principles, which were set out by the Commission in 1985 as part of its quasi-legendary project to complete the internal market by 1992³: first, the *harmonisation* of national regulatory and supervisory standards⁴; second, the *mutual recognition* by Member States of one another’s regulatory provisions and supervisory practices⁵; and third, the almost exclusive exercise of legislative and enforcement jurisdiction in prudential matters by the *country of origin* of the credit institution, both in respect of

1 P Sauvé ‘Financial Services and the WTO: What Next?’ in P Sauvé (ed) *Trade Rules Behind Borders: Essays on Services, Investment and the New Trade Agenda* (Cameron May London 2003) 134-36.

2 S Mohamed *European Community Law on the Free Movement of Capital and the EMU* (Kluwer London 1999) ch 3.

3 See Commission of the European Communities, *Completing the Internal Market*, White Paper, COM (85) 310 final; See generally G.Zavvos, “Banking Integration and 1992: Legal Issues and Policy Implications” [1990] *Harv.Int’l.L.J.* 463-506.

4 See generally M.Gruson, *Convergence of Bank Prudential Supervision Standards and Practices within the European Union*, Institute of International Banking, Finance & Development Law, London, 1999.

5 See generally E.Lomnicka, *The Single European Passport in Financial Services*, pp 181-201, in Barry A.K.Rider et al (Eds.) *Developments in European Company Law*, vol.I, Kluwer Law International, London, 1997; W.Warner, “Mutual Recognition and Cross-Border Financial Services in the European Community” [1992] *Law & Cont.Probs.* 7-27.

activities carried on at home and services provided in other Member States⁶. From the outset, the adopted legal instruments were intended to achieve only the harmonisation, which was necessary and sufficient to secure the mutual recognition of national regulatory standards and supervisory practices, for the purpose of establishing a single banking licence recognised throughout the Community on the basis of “home country” control.

It is only regrettable that despite the genuine expectation, the 1992 programme has not delivered on its promises. Amidst the excitement surrounding the gradual implementation of the relevant Directives in the early and mid-nineties, not much attention was paid to the deficit that they were leaving behind: Mutual recognition has been “imperfect” and a generous dosage of “host country” powers, injected in the interest of the “general good”, appears to have diluted the intended effectiveness of the “single passport”.

Admittedly it would be unfair to dismiss the significance of the 1992 project. On three obvious fronts, including direct discrimination, capital movements and the “single licence” for cross-border services and branches, its contribution shall not be underestimated. It is virtually axiomatic nonetheless that the gradual elimination of the most effective barriers keeps exposing to light more and more deficiencies, previously hidden behind the veil of airtight market partitioning. As Kahler amusingly puts it: “*The decades-long process of lowering trade barriers resembles the draining of a lake that reveals mountain peaks formerly concealed or (more pessimistically) the peeling of an onion that reveals innumerable layers of barriers.*”⁷

This painful reality was brought officially to light in 1998 by the European Commission’s Proposed Framework for Action⁸ and more emphatically by the subsequent Communication on the Financial Services Action Plan.⁹ More systematically, a series of studies including the Lamfalussy Report¹⁰ and the collection of background papers to the 2002 Gyllenhammar Report¹¹ have confirmed that under the persistent model of ‘imperfect’ mutual recognition and the closely linked submission of cross-border services to the law and supervision of more than one jurisdiction, *legal plurality* (the mere fact that the internal market consists of more than one legal system) and *legal diversity* (the fact that those legal systems adopt different rules to deal with the same issues) continue to exert sizeable pressure

6 See E.Lomnicka, “The Home Country Control Principle in the Financial Services Directives and the Case-Law” [2000] *Europ.Bus.L.R.* 324-336.

7 See M.Kahler, *Trade and Domestic Differences*, p.299, in S.Berger and R.Dore (eds.), *National Diversity and Global Capitalism*, Cornell, 1996.

8 Commission of the European Communities *Financial Services: Building a Framework for Action* COM (1998) 625 (28 October 1998).

9 Commission of the European Communities *Financial Services: Implementing the Framework for Financial Markets: Action Plan* COM (1999) 232 (11 May 1999).

10 The Committee of Wise Men *Final Report on the Regulation of European Securities Markets* (15 February 2001) < http://europa.eu.int/comm/internal_market/en/finances/general/lamfalussyen.pdf> (17 November 2003).

11 P Cecchini F Heinemann and M Jopp (eds) *The Incomplete European Market for Financial Services* (Physica-Verlag Heidelberg 2003).

on the single financial area in general¹² and the market for Internet banking in particular.¹³

In the absence of bilateral or multilateral commitments, the scope of spatial application of national law is determined unilaterally by sovereign states. Public international law and the concept of legislative jurisdiction have set the boundaries beyond which national law must not apply but in doing so they have moved beyond the parochial limits of strict territoriality: states may apply national law over activities which while originating abroad may cause harms or other substantial effects within the territory of the jurisdiction.¹⁴

As a result of the departure from the notion of hermetic territorialism, transnational activities may fall within the scope of territorial application of the law and economic regulation of more than one jurisdiction which have nevertheless no obligation to concede priority to others in the event of conflict unless so dictated by the conflict of laws (or private international law).

Economic regulation and the law governing the 'vertical' relationship between private activities and state authorities does not benefit from the conflicts process.¹⁵ They belong to the hard core of unilateral public policy where mutual concessions, coordination, multilateralism and forbearance of state control are dismissed unless expressly negotiated, agreed and regulated in the context of multilateral agreements, including free trade covenants. Of course, the distinction between private law, where states are prepared to consider multilateral solutions, and public law, which remains at the heart of state sovereignty, is not airtight.

For the banker-customer relationship in particular, mandatory rules or overriding statutes adopted in the interest of financial stability, consumer protection or monetary and economic policy are major sources of law. To accommodate mandatory 'public policy' in a legal process originally intended for multilateral solutions, conflict of laws is often prepared to dilute the parity of eligible options and introduce elements of unilateralism in the form of mandatory rules which override the otherwise applicable law.

In horizontal 'private law' relationships, conflict of laws coordinates the application of national law to transnational phenomena. The function and mechanisms of conflict of laws aim to designate a single applicable law per legal relationship but normally not a single applicable law to all legal relationships associated with a particular person. Hence, contracts by the same person with parties in different states are not necessarily subject to a single set of rules nor do they enjoy a legal environment of certainty as to which law applies.

12 F Heinemann and M Jopp *The Benefits of a Working European Retail Market for Financial Services* (Report to the European Financial Services Round Table EU Verlag Berlin 2002) 45-55.

13 See eg Egg plc (Online Bank) *Electronic Finance in the EU* (Communication to the Secretariat of the OECD Financial Affairs Division Paris) (8 October 2001).

14 *Case Lotus* (1927) PCIJ Rep Series A No 10; Institute of International Law 'Resolution on the Extraterritorial Jurisdiction of States' in M Bos 'The Extraterritorial Jurisdiction of States' (1993) 65 *AIDI* 1; *Compania Naviera* [1938] AC 485,496-7; *BGHZ* 74, 322; *Case C-89/85 Ahlstrom Osakeyhtio* [1988] ECR -5193.

15 J Basedow 'Conflicts of Economic Regulation' (1994) 42 *Am.J.Comp.L.*423.

Hence, a fair summary of the disturbances caused by ‘imperfect’ mutual recognition would include information costs, uncertainty, duplication and lost economies of scale.

Finding out and understanding an unfamiliar applicable law is an expensive exercise and may discourage cross-border ventures. Internationally active banks incur ‘surprise costs’ when new rules are adopted in the country of destination, over which local firms have been consulted.¹⁶ Domestic legal reform is seldom attentive to the needs of non-established entities and legal transparency may be poor. The production of rules which are as close as possible to the structure and operations of local incumbents is not unlikely.¹⁷

‘Imperfect’ mutual recognition leaves scope for unilateral solutions regarding the circumstances which trigger the application of national law and the involvement of supervisory authorities and courts. Services provided on the Internet at a distance depart from the typical market entry by way of local establishment. This upsets the traditional link between national jurisdiction and territorial sovereignty. In the domain of economic regulation, different polities may hold different views on what the subject-matter of regulation and how long the arm of domestic regulation and supervision should be: is the service a regulated activity in the recipient jurisdiction? Is local establishment necessary? Does the Internet content constitute advertising? Is advertising regulated? Will it attract local regulation? When would local authorities be likely to extend the arm of local control? In the absence of coordination, different views in each Member State are likely to cause confusion, uncertainty, perhaps overregulation.

Moving to ‘private law’ relationships, conflict of laws does not necessarily restore harmony in international business. Member States may apply different connecting factors for similar conflicts, whereas harmonized connecting factors may be poorly drafted or inherently incapable of producing predictable solutions. Conflict of laws has been described by its own experts as ‘one of the most baffling subjects of legal science’¹⁸, a ‘dismal swamp’¹⁹ and a ‘veritable jungle that leads to a reign of chaos’²⁰. Voiced between 1928 and 1975 in a comparatively orderly world, the quotations indicate the poor certainty afforded by private international law. The position is likely to be worse in the increasingly untidy legal landscape of e-commerce over transnational computer networks. The historical anchor of conflict of laws has been the location of firms, persons, ‘things’ and transactions.²¹ With the exception of the place where the firm is established, the remainder of territorial elements raise ambiguity in transactions performed via the cross-border flow of digital data. Uncertainty in the question of applicable law increases the cost of

16 Eg A Sykes ‘The (Limited) Role of Regulatory Harmonization in International Goods and Services Markets [1999] JIEL 49.

17 A Sykes ‘Regulatory Protectionism and the Law of International Trade’ (1999) 66 U.Ch. L. Rev.

18 B Cardozo *The Paradoxes of Legal Science* (Columbia University Press New York 1928) 167.

19 W Posner ‘Interstate Publication’ (1953) 51 Mich.L.Rev.959,971.

20 *Re Paris Air Crash* 399 F Supp 732, 739.

21 H Yntema ‘The Historic Bases of Private International Law’ (1953) 2 Am.J.Comp.L.297.

transactions and may potentially discourage cross-border services, particularly online services.²²

Derogations from one-stop supervision do not necessarily cause uncertainty. When two or more supervisory authorities claim competence over the same case of international banking, the disturbance is caused by the need to comply with many sets of rules. Having met that obligation, the bank is subject to the equally disturbing process of proving so to each one of the seized authorities, through duplicate reports, audits and similar mechanisms. In the less frequent case of national regulations which are irreconcilable in substance, the accumulation of competences operates as an access barrier.

The 'home country' may have no interest in regulating *outgoing activities* which may therefore be adapted to the law of the country of destination. In this case, the bank is only subject to a single set of rules and the competitive parity vis-à-vis domestic competitors in the target market is restored. The problem here is the need to adapt the services, corporate literature, market conduct, trading practices or advertising information to the requirements of each national market which the bank intends to enter. Imperfect mutual recognition destroys the economies of scale that integrated markets and the properties of network technology promise to deliver. The disturbance is particularly annoying if the underlying differences are the by-product of pure chance or lack of information, particularly in the 'pointillist' detail of regulation. If practicable, one solution could be the compliance with the most stringent regime as a 'passport' to enter all other markets. But this suggestion implausibly assumes that the cost of conversion is low and market access is not impeded by the remainder of law-based obstacles. It also presupposes that cross-border trade matters more than purely domestic trade, in relation to which the bank will be placed at a position of competitive disadvantage vis-à-vis local competitors, inactive in the international arena, which decline to follow suit.

Financial services are products of law. Their economic value is to a great extent defined by the contractual obligations of the parties. The undertaken obligations are discharged when legal rights and claims come into existence and are subsequently settled, in contrast with other services, in which legally undertaken but non-juridical tasks must be performed. A medical examination or a car repair are services performed in discharge of contractual obligations but the law does not strictly dictate how the service is to be performed and what the end value is likely to be.

In contrast, financial services are often subject to mandatory rules which define what the obligations of the parties must or must not be. The so-called 'product rules' determine essentially the end value of the service which is packaged in the form of a bundle of rights and obligations relating to the structure and performance of financial particulars. The mandatory application of different 'product' rules in each national market precludes 'products' structured in accordance with the law of the home country from circulating in the single market. Hence, economies of scale

22 Strong empirical data in International Chamber of Commerce *Survey Regarding Business Practices on Jurisdictional Issues* (International Chamber of Commerce Paris 2003) <<http://www.iccwbo.org/law/jurisdiction/index.asp>> (17 December 2003).

are lost and the level of competition is impaired to the extent that customers are more likely to choose local banks when foreign banks are precluded by law to offer something different. Customers also lose choice and start questioning the advertised value of the single financial market.²³

Law is not the only parameter to affect the success of the project. On the demand side, differences in language, the poor understanding of overseas financial services and products, an embedded trust in domestic suppliers, inertia and disinclination to change, distance and the desire for personal contact, remaining differences in national currencies, lack of information and the poor understanding of and distrust towards overseas consumer protection, redress and enforcement procedures may have significant dissuasive effects. Further, the residual lack of customer confidence in the security of transactions over computer networks and a diminishing but still sizeable deficit of IT skills among the general population, which hold back the full acceptance of Internet banking in the domestic arena,²⁴ are likely to be even more dissuasive where trust is reduced by physical distance.²⁵

On the supply side, firms may be discouraged by information costs and a handicap in understanding local preferences, which are caused by cultural, linguistic and social differences; the small unappealing size of certain national markets, which does not justify the required entry costs; and remaining privileges of domestic competitors in Member States where state-owned banks dominate the market. A further source of friction originates in the high cost required for adapting domestic network relationships relating to clearing, settlement and straight-through flow of information between reference agencies and commercial lenders to the requirements of cross-border banking.

In principle, the distinction between law-based and non-legal obstacles is not strict. The underperformance of Internet banking as a stimulator of further integration seems to reflect the joint dynamics of the foregoing discouraging realities. On the demand side for example, were the lack of consumers' confidence in cross-border redress to be reduced, it is expected that a more confident approach towards the security concerns would follow.²⁶ On the supply side, the commercially questionable size of certain national markets would probably not discourage cross-border ventures, were law-based obstacles to be addressed.

3. A Perspective of Electronic Commerce and Financial Integration

It is argued that on certain conditions the impact of information and network technology on market integration may be profound and even rival the effects of even the most dramatic policy-induced deregulation²⁷. Although the point is often missed, the archenemy of market integration is geography, not law. Historically, the primary cause of partition of national markets was distance, poor transports and poor communications. Law-based obstacles became apparent, only after cross-border

23 Eg C Duflos *Public Opinion in Europe: Views on Financial Services* (European Research Group Brussels 2001) (Eurobarometer 56.0)

24 Z Liao and MT Cheung 'Internet-Based E-Banking and Consumer Attitudes: An Empirical Study' [2002] *Information and Management* 283.

25 B Suh and I Han 'Effect of Trust on Customer Acceptance of Internet Banking' [2002] *ECRA* 247.

26 C Duflos (n23) 17-31.

27 See, e.g., C.Buch, *Financial Market Integration in the US: Lessons for Europe?*, Kiel University, 2000.

trade had become a realistic prospect. Under the effects of network technology and modern telecommunications this prospect is now more than realistic, particularly in commercial activities which, consisting essentially of movements of data and information, do not require packages, storage facilities, docks, motorways or air carriers to circulate. Hence, it is rightly observed that that internal market could have been invented for electronic commerce and vice-versa:

The internet and the internal market have a common point: they both bring down boundaries, physical the former, legal the latter²⁸.

Particularly within the single financial area, the provision of services across national borders from within a single location, without displacement and movement, on a full scale, both at retail and wholesale level, is probably feasible for the first time since the inception of the internal market project. The slow, almost excruciating, process of dismantling legal barriers has been irreversibly exposed to painful comparisons with the tidal redefinition of the concepts of market access and market integration in the light of internet technology. The opportunities afforded to firms and customers to come together and enjoy real market access and choice beyond national borders have no doubt rendered persistent law-based obstacles more obvious, more disturbing and less justifiable.

Despite the initial euphoria however, it soon became apparent that rather than uprooting outdated concepts of internal market governance, e-commerce was subordinated to the full might of poorly equipped national regulatory policies. In sharp contrast with the romantic views of internet modernists, which used various metaphors to describe cyberspace as an unregulated area beyond the reach of national governments²⁹, the collision between the dyad “local control versus global business” has never been more vicious. The magnitude of the collision has been commensurate to the scale of cross-border contacts and the number of states with a rightful claim of international jurisdiction over online activities. Ironically, the inherently transnational character of online information has been both a blessing and a curse, exposing internet ventures to unprecedented legal risks and elevating the question of jurisdiction into a major theme of controversy for academics and policy makers³⁰.

Instinctively and in the initial absence of international coordination, the regulatory claims of national authorities paid particular attention to the unprecedented notion of global availability of online information, which while stored on a single location may be retrieved by Internet users worldwide. On that basis, the legitimate concern to secure domestic regulatory preferences has been translated into regulatory policies

28 “L’Internet et le Marché Intérieur ont pour point commun de supprimer les frontières, physiques pour le premier, juridiques pour le second”. E.Crabit, “La Directive sur le Commerce Electronique. Le Projet “Méditerranée” [2000] Rev.Dr.Un.Europ.749-833, p.753.

29 See, e.g., W.Osthaus, *Local Values, Global Networks and the Return of Private Law*, pp 209-235, in K.Keller & C.Engel (Eds.), *Governance of Global Networks in the Light of Differing Local Values*, Baden-Baden 2000; D.Johnson & D.Post, “Law and Borders: The Rise of Law in Cyberspace” 48 *Stan. L. Rev.* 1367 (1996); A.Yen, “Western Frontier or Feudal Society: Metaphors and Perceptions of Cyberspace” 17 *BerkeleyTech.L.J.*1207 (2002).

30 See P.Berman, “The Globalization of Jurisdiction” 151 *U. Pa. L. Rev.* 311 (2002); H.Perritt, “Jurisdiction in Cyberspace” 41 *Vill. L. Rev.* 1 (1996).

which have tried to emulate the globalisation of information and the global accessibility of local networks.

Two general approaches have emerged. First, there have been extreme cases of what may be termed as global unilateralism, whereby the mere fact that online information was publicly available within the jurisdiction triggered the application of national law³¹. Although not widely adopted, this approach severs the connection between state control and the territory in which any sort of meaningful activity is carried on and thereby creates an unprecedented risk of global liability. It also raises awkward questions regarding the global export of domestic standards of behaviour:

[I]t may even justify jurisdiction over the editor of the Sport Illustrated Online Swimsuit Edition in the courts of any Islamic country with strict decency rules...”³²

The second approach requires a closer connection than mere availability of information. It is based on the concerted use of the concepts of “targeting” and “effects” and shall probably be regarded as the established regulatory policy among commercially orientated nations³³. Essentially, national law will apply in cases where online information and services are explicitly or tacitly directed at local residents or in cases where local interests may be objectively affected³⁴. The “effects test” has much in common with targeting but they are not identical. The concept of “targeting” connotes a specific effort to reach persons in the jurisdiction, whereas effects may be produced in relation to local interests by acts that, at least on their surface, are not aimed there³⁵.

The place where activities are carried on as the connecting factor between banking services and national economic regulation does not pose particular problems in cross-border trade by way of permanent establishment in or temporary physical movement towards another jurisdiction. But it was not designed to deal with Internet services provided at a distance, let alone simultaneously addressing customers in different jurisdictions. But neither were national authorities in their capacity as recipients of services prepared to revisit traditional principles of state control in the light of the new technology and open up markets in the absence of specific multilateral commitments.

In March 1998, the US Securities and Exchange Commission confirmed that securities activities in the US or with US persons via the Internet were within the

31 See generally J.Henn, “Targeting Transnational Internet Content Regulation” 21 *B.U.Int’l L.J.*157-177(2003); R.August, “*International Cyber-Jurisdiction: A Comparative Analysis*”, [2002] *Am.Bus.L.J.* 531-573; U.Kohl, “Eggs, Jurisdiction and the Internet” 51 *ICLQ* (2002) 555-582; P.Hugot & N.Dalton, “The Universal Jurisdiction of French Courts in Civil and Criminal Cases: The Road to Digital Purgatory” 13 *Ent.L.Rev.*49-55 (2002).

32 See *Zippo Mfg.* 925 F. Supp. At1127.

33 See C.Reed, *Internet Law: Texts and Materials*, ch.7, Butterworths, London, 2000.

34 See generally C.Kessedjian, *Jurisdiction in Global Networks*, Conference Proceedings, pp 88-111, Internet Law & Policy Forum, San Francisco, 11.09.2000.

35 See A.Manolopoulos, “Raising Cyber-Borders: The Interaction Between Law and Technology” 11 *Int’l.L.Inf.Tech.*40-58 (2003); C.Murphy, pp 413-416, *supra* note 31; R.August, *supra* note 31; U.Kohl, *supra* note 31.

scope of its jurisdiction regardless of the location of the regulated entity.³⁶ The Commission sent a strong signal that its concerns were best addressed through the implementation by issuers and financial service providers of precautionary measures reasonably designed to ensure that offshore Internet offers are not targeted to persons in the United States. It reserved the right to have regard to the overall circumstances of the case but recommended the use of prominent disclaimers coupled with technical measures capable of identifying US persons prior to the conclusion of the contract.

In September 1998, the Technical Committee of IOSCO reviewed and summarized the positions taken by its members and recommended a common denominator of good practice regarding the exercise of regulatory authority over cross-border securities activities on the Internet.³⁷ If an offer or service occurs within the jurisdiction or has a significant effect upon residents or markets, a regulator may impose its regulatory requirements on such activities. Factors that may support assertion of regulatory authority include indications of targeting residents such as local advertising, prices denominated in local currency or the use of local language or indications of offers being 'pushed' to local residents. Factors supporting the opposite conclusion include listing the countries at which the website is addressed or the countries in which the provider is regulated and technical measures taken to preclude providing services to unwanted customers. In June 2001, the second IOSCO Report reiterated the position³⁸ and confirmed that virtually all key national authorities have taken a similar effects-based approach,³⁹ including the Australian Securities and Investments Commission⁴⁰ and the Canadian federal authorities⁴¹.

Regarding banking supervision proper, the Basel Committee released its position in October 2000.⁴² The Committee stressed the importance of placing e-banking activities against the backdrop of the general institutional framework, including the Committee's key recommendations regarding cross-border activities.⁴³ It did however refer to the ambiguity caused by the new medium, particularly the potential ease and speed with which banks located anywhere in the world can conduct activities with customers in countries where a bank is not licensed or supervised and the practical difficulties faced by national authorities

36 Securities and Exchange Commission *Use of Internet Web Sites To Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore* (23 March 1998) Release No.1125 at <<http://www.sec.gov/rules/interp/34-42728.htm>> (03 December 2003).

37 IOSCO *First Report on Securities Activity on the Internet* (IOSCO Madrid 1998) 34-36.

38 IOSCO *Second Report on Securities Activity on the Internet* (IOSCO Public Document 120 Madrid 2001) 5.

39 Ibid Annex I.

40 Australian Securities and Investments Commission *Offers of Securities on the Internet* (10 February 1999) Policy Statement 141 at <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps141.pdf/\\$file/ps141.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ps141.pdf/$file/ps141.pdf)> (03 December).

41 Canadian Securities Administrators *Trading in Securities Using the Internet and other Electronic Means* (15 December 1999) National Policy 47-201 at <http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Policies/47-201_19991217.html> (03 December 2003).

42 Basel Committee 'Cross-Border Electronic Banking Issues for Bank Supervisors' in *Electronic Banking Group Initiatives and White Papers* (Basel Committee Basel 2000).

43 Ibid 3-5.

wishing to monitor or control local access to e-banking sites originating in other jurisdictions without the cooperation of home country authorities.⁴⁴

The Committee analysed the responsibilities of national authorities depending on whether local banks offer services abroad (*the in-out scenario*) or banks based outside the jurisdiction provide services to parties within the jurisdiction (*the out-in scenario*)⁴⁵. In the latter case, the Committee declined to suggest connecting criteria. It stressed however the need to minimize ‘jurisdictional ambiguities’ and ensure adequate supervision of cross-border services with clearly defined responsibilities and recommended that a number of issues pertaining to the nature and scope of the activities had to be determined when deciding whether the local regulatory apparatus must be involved.⁴⁶

In July 2003 the Committee published its final position.⁴⁷ The Committee emphasized the essential role of effective ‘home country’ banking supervision as the most appropriate model of regulation and stressed that the ‘host country’ should retain an auxiliary role through cooperation and consultation.⁴⁸ Of course the proposed ‘home country’ model still requires some indicators as to the circumstances which justify this restrained regulatory intervention of the ‘host’ authorities. In that respect, the Committee has adopted the ‘directed at’ test and listed a number of non-exhaustive indicators useful in determining whether e-banking activities are directed at the residents of a foreign country, including language, currency, domain name linked to the local market, other designs suggesting a local connection and local advertisements.⁴⁹

The position taken by national authorities is far from consistent. For example, the *Swiss Federal Banking Commission* has confirmed that banks and securities dealers based outside Switzerland are allowed to offer their products and services to Swiss clients via the Internet with no obligation under Swiss law, provided that they have no physical presence in Switzerland (branch offices, agencies) and do not employ anyone locally. Even if advertising is deliberately targeted at Swiss clients no local rules apply.⁵⁰ On the opposite extreme, the Indian authority has announced that Internet services to local residents from institutions other than locally incorporated and authorized banks are strictly prohibited.⁵¹ Between the two positions, other national authorities accept that ‘out-in’ services may be supplied to local residents on the condition that ‘host’ authorities are involved and local rules apply.⁵² In most cases however, globally and regionally, application of national law to online financial services seems to have converged around the two principles. With variations, supervisory authorities and enforcement

44 *ibid*

45 7-8.

46 9

47 Basel Committee *Management and Supervision of Cross-Border Electronic Banking Activities* (Publication No.99 Basel 2003).

48 *ibid* 3-4.

49 Annex I.

50 Swiss Federal Banking Commission *E-Finance* at <<http://www.ebk.admin.ch/e/faq/faq4.htm#4C>> (6 December 2003)

51 Reserve Bank of India *Report on Internet Banking* (RBI 2001) at <<http://www.rbi.org.in/sec21/21595.pdf>> (6 December 2003) para.8.3.4.

52 Eg Hong Kong Monetary Authority *Authorization of Virtual Banks* (Guideline May 2000) at <http://www.info.gov.hk/hkma/eng/guide/guide_no/20000505e.htm> (6 December 2003).

mechanisms relating to advertising and financial promotion⁵³, banking and financial regulation⁵⁴, consumer protection⁵⁵ and conduct of investment business⁵⁶ have been mobilised as soon as online information and network-based services were directed at or affected a given national market.

Some commentators dismiss the foregoing developments as grounds for real concern and argue that the application of national law to online activity on the basis of ‘effects’ or ‘targeting’ is an unexceptional phenomenon.⁵⁷ Cross-border electronic commerce being functionally identical to traditional cross-border activity is unworthy of special treatment. They also argue that the fear of globalization of jurisdiction in the online world may be partially attributable to the poor understanding of the fundamental distinction between the claim to apply national law and the ability to enforce it.⁵⁸

They particularly emphasize the –arguably tough- limitations of cross-border enforcement in the domain of economic regulation or criminal law: the exercise of coercive power is strictly confined within the boundaries of the sovereign state.⁵⁹ In the absence of bilateral agreements, which are unlikely even in advanced instances of international cooperation, the outright enforcement of national public law by foreign authorities is still out of the question⁶⁰. Hence, they claim that the alleged risk of global or regional liability does not accurately reflect the realities of enforcement jurisdiction and may not be that pressing a problem after all: the potential multiple claims of *prescriptive* or *legislative* jurisdiction will fail for lack of enforcement jurisdiction, unless the firm maintains local assets or an established place of business. Even in the case of private law claims, the lack of physical establishment or local assets will induce potential claimants to resort to the country of origin of the firm, the cost of which is likely to be a major deterrence. Ironically, then, for all the talk about how the Internet transcends territorial borders and triggers multiple regulatory

53 See C.Reed, “Managing Regulatory Jurisdiction: Cross-Border Online Financial Services and the European Union Single Market for Information Society Services” 38 *Hous.L.Rev.*1003-1035; A.Gkoutzinis, “The Promotion of Financial Services via the Internet- A Comparative Study of the Regulatory Framework” 17 *B.JIBFL* 29-36 (2002); G.Borges, *The Localisation of Electronic Banking Transactions: The German Perspective*, pp 49-52 in N.Horn (ed.) *Legal Issues in Electronic Banking*, Kluwer, London, 2002.

54 See A.Gkoutzinis, “European Banks and the Cross-Border Provision of Services via the Internet: Commercial Practices and Regulatory Concerns” 3 *J.Int’l.Bank.Regul.*208-229 (2001); W.Long, “A New Regulatory Consensus to Jurisdiction over Financial Services on the Internet” [1999] *J.Int’l.Fin.Mar.* 95-103; H.Christiansen, *Electronic Finance: Economics and Institutional Factors*, p.26, OECD Occasional Paper, Financial Affairs Division, 2001; A.Steck and K.Landegren, “Cross-Border Services into Germany” 11 *J.Financ.Reg.&Compl.* 21-25 (2003).

55 See, e.g., N.Reich & A.Helfmeier, “Consumer Protection in the Global Village” [2001] *Dick.L.Rev.* 111-137; F.Deussere, “International Jurisdiction over E-Consumer Contracts in the European Union” 10 *Int’l.J.L.Inf.Tech.*344-366 (2002).

56 See, e.g., International Organization of Securities Commissions, *Second Report on Securities Activities on the Internet*, Annex I, June 2001; P.Rutledge & J.Haines, *Electronic Markets*, Butterworths Compliance Series, London, 2001; S.Choi, “Assessing Regulatory Responses to Securities Market Globalization” 2 *Theoretical Inquiries L.* 613-647 (2001), pp 641-643.

57 Eg JL Goldsmith ‘Against Cyberanarchy’ (1998) 65 *U.Chi.L.Rev.*1199; JP Trachtman ‘Cyberspace, Sovereignty, Jurisdiction, and Modernism’ (1998) 5 *Ind. J. Global Leg. Stud.* 561.

58 *Ibid.*

59 H Baade ‘The Operation of Foreign Public Law’ (1995) *Texas Int’l.L.J.* 429.

60 W Dodge ‘Breaking the Public Law Taboo’ (2002) 43 *Harv.Int’l.L.J.* 161.

claims, it is the same borders which impose formidable constraints upon excessive regulation and enforcement.

On close inspection however, banks would be unlikely to take advantage. To the extent that the violation of the law of Member States in which offers of services are addressed creates a deficit in market and consumer confidence, the bank has sufficient incentives to comply.

Further, the very impracticality of top-down enforcement is not unquestionable. Few bank managers would relish the prospect of having enforcement orders pending against them in other Member States. Outstanding legal actions and judgments overseas may damage the bank's reputation at home. The Yahoo case is a strong example. When a French court sought to limit Yahoo's (a Delaware corporation) right to publish information on the direct sale of racist and Nazi memorabilia on its websites that were illegal in France, Yahoo decided to litigate with intensity on both sides of the Atlantic in proceedings which lasted more than three years in order to dismiss the case on both procedural and substantive grounds.⁶¹ Yahoo could probably afford to ignore the French order which could not realistically be enforced. Its decisive stance probably demonstrates the importance attached by large multinationals to domestic and international reputation. To be perceived by the public as ignoring the applicable law is simply not an option. The argument applies *a fortiori* to internationally active banks because they are subject to more rules than a relatively unregulated commercial entity and primarily because reputation in banking is simultaneously more important and inherently more vulnerable than the reputation of commercial undertakings. It is notable that adverse publicity initiated by supervisory authorities against uncooperative non-established Internet banks has already been added to the enforcement arsenal of the German bank supervisor.⁶² Moreover, international banks would probably have assets in most Member States. Fourth, the threat of national authorities to exclude non-compliant entities from vital participation in local payment, clearing and settlement facilities could be an indirect enforcement remedy. Ultimately, cooperation and coordination between the 'home' and the 'host' Member States at the supervisory and law enforcement levels would ensure that the pertinent enforcement issues were adequately addressed.

Internet realists also argue that self-restraint in cross-border activities is an effective elixir against excessive jurisdictional claims.⁶³ It is commonplace that a carefully implemented strategy of voluntary constraints through technical means or identification of the customer's country of residence will insulate the bank from cross-border legal and regulatory risk. The orderly retreat, however, into a policy-induced partition of national markets is certainly not a serious policy response in the single financial market which purports to achieve precisely the opposite.

It is therefore not disputed that Internet services are 'functionally equivalent' to other economic activities. They are since they involve transactions between real entities, which are located in real places. Hence they are within the full reach of national coercive mechanisms. Our quest however is to choose the best among

61 M Love 'International Jurisdiction over the Internet: A Case Analysis of Yahoo! INC. V. La Ligue Contre Le Racisme et l' Antisemitisme' [2003] Temple Int'l & Comp.L.J.261.

62 A Steck and K Landegren 'Cross-Border Services into Germany' (2003) 11 JFRC 21

63 J Goldsmith (n 57)201-202.

eligible realistic models of governance for the single financial area. This perspective seldom goes down to a question of whether national intervention accords with public international law.

Kuhn has demonstrated in his path-finding work on the evolution of scientific models that general theories are constructed in the light of presuppositions, which set the boundaries for the academic discourse.⁶⁴ New findings are assigned in their 'right place' with the assistance of these boundaries, also known as 'paradigms'. The lapse of time brings to light more and more findings, which do not fit neatly into the boundaries of the established framework, and at a certain stage the collapse of the presuppositions is inevitable. At that stage, new paradigms are born and a new conceptual framework for analysis is needed.

Trachtman, though an Internet realist himself, has identified the scale of cross-border contacts as the new paradigm which network technology has induced into being. In his view, the Internet has not raised new problems but it has freed us to think more clearly about the political and distributional choices involved in the conflict of laws and the allocation of regulatory jurisdiction between sovereign states.⁶⁵ The unprecedented frequency of cross-border effects of online exchange of information, which are seldom neatly adapted to jurisdictional, necessarily territorial, pigeonholes, has accentuated an old problem and exposed the 'incompleteness' of current social and regulatory responses to transnational trade.

Prominent economists have also argued that the economies of scale unleashed by the interconnection and interoperability of network technologies compel convergence around a single uniform framework for international governance and regulation and curtail substantially the rationale for institutional variation, unilateralism and experimentation inducing a new paradigm in international jurisdiction, law and regulation.⁶⁶

Policy makers must analyse and choose, having regard to a long list of purely functional, economically efficient and flexible criteria which must look beyond the mechanistic reliance on mere legitimacy, afforded by effects, territorialism and sovereignty. Law and policy should strive to foster innovation and facilitate welfare benefits brought about by investment in research and technology. To the extent that optimal regulatory objectives are not compromised, regulatory policies should not inhibit changes in business models. Poorly adjusted regulatory approaches are unlikely to match the exceptional qualities of network technology in the provision of banking services.

The benefits of network technology, as they were presented in the first chapter, and the cost of 'imperfect' mutual recognition and duplication of legal control call for a better analysis of the governance model of the single financial market. The fracture of physical boundaries by electronic networks, which unleash

64 T Kuhn *The Structure of Scientific Revolutions* (3rd edn University of Chicago Press Chicago 1996).

65 JP Trachtman (n 57) 574.

66 BJ De Long and D Beier 'An Analytical Framework' (paper presented in the conference "The Digital Economy in International Perspective Washington DC May 1999) at < <http://economy.berkeley.edu/events/deip/summary.html>> (6 December 2003);

an unprecedented opportunity for cross-border trade and wealth creation, and the failure of regulatory policy to follow suit and facilitate this process, even within the relatively controlled environment of close-ended internal market arrangements, offers the conceptual framework within which therapeutic liberalization policies should be revised.

Policy makers have conceded that the legal and regulatory framework of electronic commerce should be proportionate, transparent, consistent and predictable.⁶⁷ The globalization of jurisdiction is a poor contribution to this objective and does not reflect the way that people do business today. If there was ever a time for a new approach, it is now that computer networks attain in real life the objectives of market integration that the internal market project strives to achieve through law-based initiatives.

It now appears that the European Court of Justice (ECJ) supports this view. In December 2003 the ECJ confirmed that the contribution of the Internet to 'freer' cross-border trade in goods and services exceeds considerably the value added by other means of delivering goods or services at a distance and potentially entails structural changes in the way that the single European market is henceforth constructed and governed. In *Deutscher Apothekerverband*⁶⁸ the German government and local business interests contended that the sale of medicines for human use via the Internet to German residents by *Doc Morris*, a company established in the Netherlands, was prohibited by German legislation whereby the sale of medicinal products is physically restricted to pharmacies and may not be imported commercially by way of mail order through authorized pharmacies in other Member States on the basis of individual orders placed by consumers over the Internet. The Dutch supplier argued that such a prohibition is contrary to Article 28 EC regarding the free movement of goods.

It will be recalled that national rules which regulate the ways in which products are marketed such as advertising rules or the specific prohibition to sell medicines outside pharmacies (as opposed to rules which concern the production and composition of products) fall outside the scope of the Treaty rules on the free movement of goods provided that they apply in the same way both in law and in fact to the marketing of domestic products and those from other Member States alike.⁶⁹ In plain terms, marketing legislation which applies to domestic and imported goods alike does not amount to a prohibited restriction of free trade even if it has collateral trade effects. In the specific litigated case it was clear that the prohibition made no distinction between local or overseas suppliers and local or overseas products. German suppliers were prohibited from selling medicines on the Internet inasmuch as the defendant Dutch company. The ECJ however assessed the broader 'trade' implications of network technology:

[T]he emergence of the Internet as a method of cross-border sales means that the scope and, by the same token, the effect of the

67 OECD Ministerial Conference *A Borderless World: Releasing the Potential of Global Electronic Commerce* (Ottawa October 1998) Conclusions.

68 Case C-322/01 *Deutscher Apothekerverband eV v 0800 DocMorris NV and Jacques Waterval* (11 December 2003) unreported.

69 Joined Cases C-267/91 and C-268/91 *Keck and Mithouard* [1993] ECR I-6097 paras 15-17.

prohibition must be looked at on a broader scale (...); for pharmacies not established in Germany, the Internet provides a more significant way to gain direct access to the German market. A prohibition which has a greater impact on pharmacies established outside German territory could impede access to the market for products from other Member States more than it impedes access for domestic products.⁷⁰

What the ECJ accepts - contrary to the traditional view put forward by national governments and the Commission - is that the question whether the particular prohibition amounts to a measure having equivalent effect to a quantitative restriction on cross-border trade must now be answered not in the light of past experiences as to impact of marketing legislation on the free movement of goods but in the light of the potential contribution and the capabilities of the new technology. The pertinent criterion is now offered by the trade opportunities opened by computer networks and the adverse trade consequences of not exploiting those opportunities rather than by the enquiry as to whether overseas and local suppliers are subject to identical rules. In technical terms under the *Keck* jurisprudence, the capabilities of the Internet protocols create in themselves systemically important 'differences in fact' between cross-border and purely domestic trade which bring marketing rules of the recipient country within the scope of the free movement provisions. This principle must now inform descriptive and normative arguments regarding the model of governance of e-commerce in general and e-finance in particular within the single European market.

For the single financial market, the issue at stake is eloquently summarized by *John D. Hawke*, the Chairman of the Electronic Banking Group of the Basel Committee:

In some ways, electronic banking...epitomizes the supervisory challenge that the Basel Committee was created to address. The technology on which it is based is inherently transnational. One of its very purposes is to give the banks that employ it the ability to offer products and services to customers wherever they might be located, without regard to national borders. The issue that's presented for supervisors and policy makers is how such offerings can or should be regulated in this transnational environment. It should be obvious that if every jurisdiction into which an e-banking offering was broadcast attempted to regulate the offering, or the offeror, the major benefit of the new technology could very quickly be lost. One is tempted to say that if no mechanism existed for coordinating bank supervision internationally, one would have to be invented to deal with the challenge that e-banking presents.⁷¹

The EU would be unwise to encourage the exercise of regulatory, supervisory and enforcement control against non-established banks on grounds that online services are directed at or affect local residents or other interests. Were such a

⁷⁰ *Deutscher Apothekerverband* (n 68) para 73.

⁷¹ JD Hawke 'Electronic Banking' (paper presented at the International Monetary Seminar Paris February 2001) at <<http://www.occ.treas.gov/ftp/release/2001-14a.doc>> (6 December 2003).

strategy to be enforced within a single financial market of ‘imperfect’ mutual recognition, it would become a prime example of the global regulatory ‘incompleteness’ towards the real requirements of the new economy and would probably nail the coffin of the project for open, unrestricted and resourceful pan-European financial markets via electronic networks. It has now emerged that the ECJ is prepared to frown upon the readiness of national authorities to invoke outdated concepts of market control to inhibit instances of transnational market access via computer networks.

4. The Normative Value of “Home Country” Control on the Basis of Equivalence

Draining the pool of disturbances to the internal market cause is invariably a *de-regulatory* and frequently a *re-regulatory* process. It is *de-regulatory*, because it entails the abolition of law-based elements which disturb market openness and hinder cross-border economic activity. Existing “de-regulating” mechanisms amount essentially to allocation of jurisdiction between competing Member States, whatever the details of the various models⁷². Participating polities must decide whether the country of origin of the services may alone supervise, the recipient state may alone supervise, they may both supervise subject to limitations or indeed a central agency may alone supervise. Second, the process is *re-regulatory* in the case where the undertaken commitments for market openness are complemented by or premised upon agreements on the introduction of common regulatory and supervisory standards.

4.1 The Dynamics

The credible negotiation of a workable integration model presupposes that the implications of national regulatory goals on cross-border market openness are carefully assessed and, most importantly, accommodated in the final arrangement. The perspectives of “liberalisation” and “regulation” are other-regarding. No liberalisation negotiator shall disregard national regulatory preferences and no national legislator or regulator shall forget that national standard-setting and exercise of supervision occur within an integrated transaction domain and it is therefore likely to affect entities which are located beyond the national borders. In principle, different national laws and supervisory practices reflect the objective and subjective dissimilarities of Member States. Objective dissimilarities are different national needs, problems and resources. Subjective dissimilarities are different choices, preferences and perceptions with regard to similar needs, problems and resources⁷³. Hence, the optimal settlement of the rivalry between “regulation” and “liberalisation” is a dynamic and multi-faceted process in which many virtuous and less virtuous forces operate, often in different directions.

72 See J.Trachtman, “Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis” [1995] *Colum.J.Trans’IL*. 37-122, at pp 62-63.

73 See U.Procaccia and U.Segal, *The Case Against the Harmonization of Private Law*, pp 639-669 in K.Hopt & E.Wymeersch, *Capital Markets and Company Law*, OUP, 2003.

First, there is the collision between *optimal* and *actual* regulatory perspectives. For normative purposes, even the most zealous enthusiast of unrestricted international trade in financial services would probably confirm the legitimacy and economic rationale of some degree of market control. Prudential banking regulation and supervision is concerned with the soundness of banks for purposes of systemic stability and the protection of depositors, who lack or cannot evaluate by themselves information about the safety of their savings⁷⁴. Rules of conduct regulate the behaviour of intermediaries in the provision of investment services in order to protect market integrity from manipulative practices and maintain investor confidence⁷⁵.

Yet, this normative wish-list may often contrast sharply with reality. National regulatory perspectives are different and they do not necessarily serve optimal economic efficiency. Their assessment and reconciliation in the context of the “liberalisation perspective” is a pressing need but their textbook economic rationale is not necessarily the only one to be considered by a realist negotiator. The plain truth is that individual national perspectives are often dictated by less than optimal preferences which reflect fundamental differences among participating states rooted deep down the political, economic and social tissue, including sheer protectionism, a doctrinal attachment to redistributive socialism, paternalistic intervention in the operation of markets, inconsistent claims put forward by various competing interests lobbying for favourable regulatory arrangements, or simply shortage of high quality information about better alternatives, lack of resources and poor regulatory sophistication and expertise and a combination thereof.

This painful reality suffices to underscore the political gymnastics required if a workable balance between mutual recognition and equivalence is to be achieved. Although the internal market project is particularly appealing to enthusiastic supporters of open markets and enhanced competition, even the most passionate among this breed would be unlikely to accept *any* common standards on the sole condition that they were capable of securing market integration. Conversely, states with a strong preference to wide notions of “fairness”, “social protection” and “intervention” will not easily change course for the sake of the common market. The content of common rules matters and it matters a lot. In the eyes of negotiating Member States, the liberalisation perspective cannot alone purify rules and practices, which have been considered and dismissed at national level.

The second parameter is closely related. The coordination of national regulatory perspectives in the context of market integration entails necessarily the voluntary partial loss of national sovereignty and domestic control over incoming activities, the level of which will be no doubt debated and probably shape the final model of the liberalisation arrangement.

Third, the emphasis on the different national regulatory goals shall not create the impression that Member States share identical integration objectives. This point is often missed but it is immensely important in understanding the premises of

74 See R.M. Lastra, *Central Banking and Banking Regulation*, pp 71-72, Financial Markets Group, London, 1996.

75 See E.Avgouleas, “The Harmonisation of Rules of Conduct in EU Financial Markets: Economic Analysis, Subsidiarity and Investor Protection” 6 *ELJ* 72-92 (2000), at p.6.

individual states' attitudes during internal market negotiations⁷⁶. On paper, the internal market brings benefits for all and enhanced opportunities within an atmosphere of competition. In practice, it creates positive trade possibilities for states with efficient financial services industry, while less efficient Member States face and fear the prospect of domestic services being displaced by competition⁷⁷. This does not mean that market integration shall be halted altogether. It is inevitable that eventually some will win and some will lose. The argument nevertheless points to the diversity of existing "liberalisation perspectives". It is likely, for example, that "less efficient" financial centres regard market openness not as a benefit in itself but as an opportunity for domestic reform and modernisation. In extreme cases, bare priority to national interest may instinctively accept a certain degree of market fragmentation as "unavoidable". It is self-explanatory that national perspectives of market integration exert a great influence on how proactive individual Member States are in pursuing the internal market cause. Predictably, genuine "aficionados" will be more proactive than "opportunists", let alone "protectionists", but the former would naturally expect some form of reciprocity before opening-up their markets.

Fourth, the task of reconciling national regulatory perspectives, even the most virtuous and economically efficient, with the liberalisation perspective amounts occasionally to attempting squaring the circle⁷⁸. Law and economics scholars have been sceptical about the possibility of pursuing policies aiming at both economic efficiency and fairness, the creation of a liberal market order and social democracy, market openness and corrective intervention⁷⁹.

Take prudential banking regulation where the likely antagonism between strengthening banking supervision and opening-up national markets has been convincingly demonstrated⁸⁰: simply put, policies which strengthen the stability of the banking system are more often than not restrictive of entrepreneurship and risk-taking on which the value of free markets relies. Widely used supervisory policies and techniques imply direct restrictions and limitations on market entry, the scope of permissible activities and the levels of risk that individual banks may lawfully assume while other types of prudential measures may have collateral 'trade effects'.⁸¹ It is not always unproblematic to achieve the optimal balance.

76 See M.Blair, *Financial Services: The UK Regulator's Assessment of the 1992 Programme*, 125-134 in M.Andenas & S. Kenyon-Slade (Eds.) *EC Financial Market Regulation and Company Law*, Sweet and Maxwell, London, 1993.

77 See the empirical study of P.Brenton et al, "Technical Barriers to Trade in the European Union: Importance for Accession Countries" 39 *J.C.M.S.* 265-284 (2001).

78 See J.Trachtman, p.42, supra note 72; G.Shaffer, "Reconciling Trade and Regulatory Goals: The Prospects and Limits of New Approaches to Transatlantic Governance through Mutual Recognition and Safe Harbor Agreements" 9 *Colum.J.Eur.L.* 29-77 (2002), p.31.

79 See, e.g., R. H. Coase, "The Problem of Social Cost" 3 *J. L. & Econ* 1 (1960); L.Kaplow & S. Shavell, "Fairness versus Welfare" 114 *Harv.L.Rev.*961-1380 (2001), pp.967-976; *ibid*, "The Conflict between Notions of Fairness and the Pareto Principle" 1 *Am.L.& Econ. Review* 63-77 (1999).

80 See I.Walter, *Financial Integration Across Borders and Across Sectors: Implications for Regulatory Structures*, pp 37-40, in J.Kremers et al (Eds.) *Financial Supervision in Europe*, Edward Elgar, 2003; S.Key, "Trade Liberalization and Prudential Regulation: The International Framework for Financial Services" 75 *International Affairs* 61-75 (1999); R.M.Lastra, pp 428-436 in L.Mistelis et al (Eds.), *Foundations and Perspectives of International Trade Law*, Sweet and Maxwell, 2000.

81 RM Lastra 'Cross-Border Trade in Financial Services' in I Fletscher L Mistelis and M Cremona (eds) *Foundations and Perspectives of International Trade Law* (Sweet and Maxwell London 2001) 432-6; S Key 'Trade Liberalization and Prudential Regulation: The International Framework for Financial Services' (1999) 75 *International Affairs* 61.

This ongoing antagonism explains the inevitability of agreeing common EC standards of prudential supervision before opening-up national markets on the basis of the Second Banking Directive. It also explains the anxiety of the ECJ prior to the coming into force of the 1992 internal market framework to justify restrictions on the free movement of banking services on grounds of systemic financial stability and depositor protection (as we will see in chapter 3). Finally, at the WTO level, this creeping antagonism explains the so-called ‘prudential carve-out’ in paragraph 2(a) of the Annex on Financial Services to the GATS whereby a country may take prudential measures to ensure the integrity and stability of the financial system or to protect recipients of financial services regardless of any other obligation or commitment undertaken in the context of the GATS negotiations.

Others have focused on the dyad “market integration versus social protection” and have argued that liberalisation through the de-regulatory abolition of law-based obstacles and the reduction of disturbing transaction costs does not fit neatly with claims for increased standards of investor, depositor and consumer protection⁸². Even if the scale of the rivalry is exaggerated, the distrust between proponents of liberalisation and advocates of social protection is real. The former want to limit the use of regulations as barriers to trade and the latter want to prevent market openness from serving as a barrier to domestic and international regulation⁸³.

The true proportions of the task are revealed when one realises that the process of reconciling free trade and regulation is anything but static in two respects. First, in relation to regulatory objectives the scale and nature of which require joint and concerted action at the international level, convergence and coordination of national regulatory policies is an almost instinctive response dictated by the sense of collective welfare. Hence, in view of the global dimension of financial services and information networks, the EU solution must be compatible with non-EU harmonisation or coordination initiatives and sufficiently flexible to address global and regional challenges. One of the best examples is the ongoing work for the development of a global and regional financial architecture. The international convergence of national policies, the creation of international institutions for the development, monitoring and implementation of common standards in international financial relations and the international cooperation of national authorities are to a great extent driven by the desire to ensure global financial stability⁸⁴. This must be regarded as a sensible reaction to the defiance of national borders by the forces of financial globalisation⁸⁵ rather than strictly as a “liberalisation policy”⁸⁶. Second, the

82 See M.Dougan, “Minimum Harmonization and the Internal Market” 37 *C.M.L.R.* 853–885 (2000), at 857-859; N.Reich, *Internal Market and Diffuse Interests*, pp 1-26, Story, Brussels 1990; R.Dehouse, “Integration v. Regulation? On the Dynamics of Regulation in the European Community” [1992] *J.C.M.S.* 383-402 ; S.Weatherill, *EC Consumer Law and Policy*, pp 1-36, Longman, 1997.

83 See D.Vogel, *Trading Up: Consumer and Environmental Regulation in a Global Economy*, p.3, Harvard University Press, 1995.

84 See H.Tietmeyer, *International Cooperation and Coordination in the Area of Financial Market Supervision and Surveillance*, Report to the G-7 Finance Ministers and Central Bank Governors, February 1999.

85 See S.Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*, ch.2, Cornell University Press, 1996.

86 See J.Norton, “A New International Financial Architecture?- Reflections on the Possible Law-Based Dimension” 33 *Int’l Law.* 891-924 (1999).

regulatory aspects of safety, soundness and social protection are fluid and constantly evolving in the light of emerging new risks and enhanced consumer expectations. Unsurprisingly, this adds the advent of e-commerce into the equation. A credible integration strategy must no doubt accommodate the resuscitated interest of regulators and policy makers in risks predominantly associated with network technology, such as transactional security, protection of privacy, the lack of proximity and personal contact and reliability of information⁸⁷.

4.2 The Concept of “Mutual Recognition”

Mutual recognition refers to the agreement between sovereign states whereby they agree to the transfer of regulatory authority from the host country where a transaction takes place to the home country from which a product, person service or firm originate.⁸⁸ It reflects the general principle that if a service can be provided lawfully in one jurisdiction, it can circulate in any other participating country without having to comply with the laws of these other jurisdictions.

The term ‘mutual’ denotes the parity and reciprocity of the undertaken obligations. The ‘recognition’ is of the equivalence, similarity, compatibility or at least acceptability of another state’s regulatory framework and represents the scope *rationae materiae* and scale of the reciprocal obligations.

The equivalence of national norms is conceptually static because it reflects a ‘fact’ and a situation which exists, whereas the ‘recognition’ is conceptually normative and dynamic because it mandates a certain action and leads to a new arrangement between participating Member States. Member States take stock of the equivalence and convergence of national regulatory frameworks, evaluate and accept the remaining differences and undertake reciprocal obligations to open-up national borders to banks and services originating in the ‘mutual recognition’ area.

Mutual recognition is a hybrid of negative and positive integration. It goes beyond the mere elimination of barriers in that it pursues liberalization through the equivalence of national regulatory perspectives and the measured and safe allocation of regulatory responsibility. In parallel, it is not a typical model of positive integration in that the replacement of national rules by common EC standards is not strictly required. It is an instrument of regulation, because the division of responsibility among participating jurisdictions has a clear normative element; it is also a means of deregulation, because a disturbing layer of national control is abolished.

Ideally, services lawfully provided in one Member State may freely circulate across national borders. Hence, mutual recognition secures market openness and promotes the values of the single financial area while simultaneously avoiding the

87 See Basel Committee, *Electronic Banking Risk Management Issues for Bank Supervisors*, pp 11-25 in *Electronic Banking Group Initiatives and White Papers*, Basel, 2000; European Central Bank, *The Effects of Technology on the EU Banking Systems*, pp 34-39, Special Paper Series, Frankfurt, July 1999; T.Glaessner et al, *Electronic Security: Risk Mitigation in Financial Transactions Public Policy Issues*, A World Bank Report, Washington DC, June 2002.

88 Eg K Nicolaidis ‘Mutual Recognition of Regulatory Regimes: Some Lessons and Prospects’ in OECD Proceedings *Regulatory Reform and International Market Openness* (OECD Paris 1996) 171-2.

excessive policy and transaction costs of full harmonization and centralization. It thereby preserves local regulatory choices and preferences, respects the principle of ‘subsidiarity’ and stimulates potentially healthy regulatory competition. On the other hand, the principle of equivalence serves as the necessary platform upon which mutual recognition may be achieved in mutual trust and confidence in the actual convergence of formerly incompatible regulatory values of participating jurisdictions.

To create the necessary equivalence in the substantive rules of different legal systems, a coordinated process of legal harmonization is normally required. Harmonization purports to bring about consonance or accord in the legal institutions of the Member States, in other words to reduce the disturbances caused by legal plurality and diversity. Legal harmonization is a dynamic process in that it changes the *status quo* and induces a new legal environment into being. Equivalence is a descriptive concept and denotes an existing state of affairs whereby legal institutions are corresponding or virtually identical in value, effect or function. In any case, the correlation between mutual recognition and the establishment of common rules is strong and the policy of minimum harmonization as basis for mutual recognition sound.

Paradoxically, in contrast with legal harmonization and despite its historical significance, the concept of mutual recognition is only marginally referred to in the EC Treaty.⁸⁹ On closer inspection however this statement does not fairly represent the treatment afforded to mutual recognition by primary Community law.

By virtue of the Single European Act of 1986 (SEA), mutual recognition received ‘Treaty status’ and was elevated into a basic component of the institutional apparatus leading to the completion of the 1992 internal market project. Article 19 of the SEA introduced a new Article 100b in the Treaty of Rome according to which ‘the Council, acting in accordance with the provisions of Article 100a, may decide that the provisions in force in a Member State must be recognized as being equivalent to those applied by another Member State’. In parallel, the SEA 1986 introduced the pivotal Article 8b of the EEC Treaty (the precursor of Article 14 EC) whereby the aim of progressively establishing the internal market over a period expiring on 31 December 1992 was expressly to be attained through the process of mutual recognition regulated by Article 100b EEC. After the completion of the 1992 project, the provision of Article 100b was thought to be redundant and was eventually repealed by Article 6(54) of the Treaty of Amsterdam in 1997.⁹⁰ The importance however of mutual recognition was not ephemeral, not least due to the contribution of the case law of the ECJ.

4.3 The Model of “Home Country” Supervision

The model of “home country” supervision is an advanced version of mutual recognition. On a solid basis of equivalence and mutual trust, participating states recognise one another’s substantive rules and supervisory control as the solely applicable legal framework of services originating in the respective territories. Banks

⁸⁹ EC Treaty arts 47(1) and 293.

⁹⁰ Treaty of Amsterdam amending the Treaty on European Union, the Treaties Establishing the European Communities and Related Acts [1997] OJ C340/1

are required to comply with the regulatory framework of their home jurisdiction regardless of whether the services are provided domestically or to customers in another participating state. In turn, the home Member State ensures that law enforcement and supervisory control encompasses the operations of firms established therein without distinction of final destination, whereas the country of destination of services refrains from enforcing national rules and administrative measures against incoming services originating in another Member State. Rather than an *ad hoc* and delicate evaluation of the various ingredients of a narrow concept of mutual recognition, “home country” supervision presumes *a priori* the equivalence of national standards as well as the restrictive effects and the disproportionality of the coexistence of more than one level of national control. Responsibility for regulation and supervision is solely vested in the “home country” of the firm and the cross-border provision of services is subject to a single regulatory framework.

Ideally, services lawfully provided in one Member State may freely circulate across national borders. Hence, mutual recognition secures international market openness and promotes the values of the single financial area while simultaneously avoiding the excessive policy and transaction costs of full harmonisation and centralisation. It thereby preserves local regulatory choices and preferences, respects the principle of “subsidiarity” and stimulates healthy regulatory competition⁹¹. On the other hand, the principle of equivalence serves as the necessary platform upon which mutual recognition may be achieved in mutual trust and confidence in the actual convergence of formerly incompatible regulatory values of participating jurisdictions.

The principle of equivalence of national standards as a necessary precondition of “home country” control reflects the inextricable connection and reciprocity between the “liberalisation” and the “regulatory” perspective. “Uncoordinated” and unconditional mutual recognition puts into question the very rationale of national regulatory policy and produces high policy costs in the form of deep compromise of national regulatory perspectives. Hence, it is resisted and dismissed out of hand as a perilous concession of market access and an implausible waiver of local control and sovereignty vis-à-vis firms and services, towards which the essential trust and confidence are lacking⁹².

91 See G.Majone, *Mutual Recognition in Federal Type Systems*, p. 11, EU Working Paper, 1993; A.Sykes, “Regulatory Competition or Regulatory Harmonisation? A Silly Question?” [2000] *J.Int'l.Econ.L.*257-264; J.M.Sun & J.Pelkmans, “Regulatory Competition in the Single Market” 33 *J.C.M.S.*67-89 (1995).

92 See G.Horlick, “Sovereignty and International Trade Regulation” 20 *Can.-US L.J.* 57-67(1994); K.Gatsios and P.Holmes, *Regulatory Competition* in P.Newman (Ed.) *New Palgrave Dictionary of Economics and the Law*, Macmillan, London, 1998; R.Karmel, “Reconciling Federal and State Interests in Securities Regulation in the United States and Europe” [2003] *Brooklyn J.Int'l.L.* 495-549; G.Hertig, *Imperfect Mutual Recognition for EU Financial Services*, pp 218-229 in R.Buxbaum et al, (Eds.) *European Economic and Business Law : Legal and Economic Analyses on Integration and Harmonization*, Walter de Gruyter, Berlin 1996; German Federal Government, *Position on the Follow-up Communication to the Green Paper on EU Consumer Protection*, COM (2002) 289 final, 25.09.2002; R.Cranston & C.Hadjimmanuil, *Banking Integration in the European Community: The European Commission's Unfinished Agenda*, p. 351 in J.Norton et al (Eds.) *The Changing World of International Law in the Twenty-First Century: A Tribute to the Late Kenneth R.Simmonds*, Kluwer Law International, London, 1998.

Given the diverse national views on what constitutes a market failure and how this shall be corrected, the model of “uncoordinated” mutual recognition leads to the situation in which services lawfully provided in the country of origin may upset public policy objectives in the country of destination and produce effects which are unacceptable for the “host” jurisdiction. In the absence of equivalence, Member States are likely to regard the respective regulatory framework of fellow Member States as being of poor quality and low economic efficiency; or too liberal and insufficient to meet their own standards of social protection, fairness and financial stability; or both.

Further, the model of uncoordinated mutual recognition may induce firms pursuing a policy of “lowest cost” location to set up operations in poorly regulated Member States without losing access to profitable markets elsewhere. Critics of decentralisation have argued that competing for the attraction of firms and investment provides incentives for deregulation in the form of reduced protection of soundness and safety and other societal interests, including protection of investors or consumers⁹³. This “race to the bottom” is accelerated under the pressure of powerful business interests, which may employ concerted actions to signal their preferences and the consequences facing jurisdictions which fail to respond. This race towards the low-cost location is believed to trigger a general competition in laxity by other Member States for fear of losing business, to the further detriment of optimal regulatory standards. Eventually, negative externalities will occur whereby the cost of failure of the lax regime will also be borne by private parties located elsewhere.

Within a “mutual recognition” area, jurisdictions which decline to enter this “race to the bottom” will necessarily place local institutions at a competitive disadvantage towards firms established in “regulatory havens” and create risks for the protection of local customers from genuine market failures⁹⁴. Academics have pointed to the US where regulatory competition seems to be working in the market for corporate laws, which gave rise to the so-called “Delaware phenomenon”⁹⁵. This school of thought attributes the success of Delaware in attracting a sizeable number of US corporations to the laxity of its corporate laws and the preference to the interests of directors at the expense of shareholders⁹⁶.

Others have been less enthusiastic about the idea of a “competition in laxity”⁹⁷. In the absence of empirical evidence, they have questioned whether, in the case of Delaware, shareholders are so naïve as to trust their savings to firms incorporated under rules so detrimental for their own interests. This latter analysis implies that rather than winning a “race to the bottom”, Delaware has won a race to the top by enacting efficient rules which are appreciated by both the business community and investors. *Romano* argues in particular that Delaware may have won the market for

93 See C.Bradley, “Competitive Deregulation of Financial Services Activity in Europe After 1992” *11 O.J.L.S.* 545 (1997), at pp 554-556.

94 See G.Alpa, “The Harmonisation of the EC Law of Financial Markets in the Perspective of the Consumer Protection” [2002] *EBLR* pp523-540; R.Coleman, (European Commission), “Financial Services and Consumer Policy: The Regulatory Challenge” [2001] *Euredia* 244-250.

95 See L.Bebchuck, “Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law” *105 Harv.L.Rev.*1435 (1992).

96 See W.Cary, “Federalism and Corporate Law: Reflections upon Delaware” *83 Yale L.J.* 63 (1974).

97 See, e.g., D.Fischel, “The “Race to the Bottom” Revisited: Reflections on Recent Developments in Delaware's Corporation Law” *76 NW.U.L.Rev.* 913 (1982).

incorporation not necessarily because its rules are superior but because it has gained a reputation for specialization, offering legal certainty and predictability for all market segments⁹⁸.

Even if the risk of “regulatory laxity” is fanciful rather than real, the prospect of mutual recognition without equivalence is not any more promising. First, as long as the risk of a race to laxity is perceived to be real, it suffices to destroy political consensus regardless of whether it actually is. Second, if regulatory competition leads to a race in excellence, less efficient financial centres would still run the risk of responding poorly and would no doubt be reluctant to grant unfettered market access in the absence of equivalence and a “level playing” field. Further, in relation to services as complex and significant for the long-term interests of recipients as financial services⁹⁹, transparency, predictability and certainty are greatly valued by customers, inasmuch as they are liked by firms. Market access in the absence of equivalence would result in the provision of services formulated under completely different rules, which the recipient would largely ignore. This would exacerbate the inherent problem of information asymmetry between the firm and the customer and would not enhance confidence in cross-border services within the single financial area¹⁰⁰.

4.4 The Normative Value of “Home Country” Supervision

The principle of “home country” supervision on the basis of equivalence and trust is the most effective integration policy when negative integration is insufficient and full centralisation is unachievable or undesirable. Legal plurality and diversity do no longer pose obstacles to market openness. Firms are subject to one set of familiar rules and one level of control. They avoid adaptation costs and therefore may achieve desirable economies of scale through the launch of a single website as the sole platform for outgoing cross-border services and a sole point of reference for domestic and non-resident consumers, competitors and supervisors.

The *ex ante* allocation of exclusive responsibility for prudential supervision and control on the country in which the bank is established eradicates repetition, duplicate costs and inconsistencies. It also deprives the “host country” of the opportunity to use regulation as a covert form of protection of local competitive interests¹⁰¹. In the absence of a federal supervisor, a pure model of “home country” control is the only model which secures non-duplicative supervisory control. This point is often missed but even uniformity of substantive rules does not correct the

98 See R.Romano, “Law as a Product: Some Pieces of the Incorporation Puzzle” *1 J.L.Econ. & Org.* 225 (1985).

99 See T.Visson (European Commission), *Community Approaches towards a Consumer Policy for Financial Services*, pp 31-38 in N.Fragakis, (Ed.) *Consumer Protection and Banking Services*, Hellenic Centre of European Studies and Research, Athens, 1997 (in Greek); A.Mörner, *The European Union, Financial Services and the Consumer*, pp 23-39 in P.Cartwright (Ed.) *Consumer Protection in Financial Services*, Kluwer Law International, London, 1999.

100 See P.Nicolaidis, “Competition among Rules” *16 World Competition* 113 (1992) 119-120; N.Moloney, “The Regulation of Investment Services in the Single Market” *3 EOBLR* 293-336 (2002), p.306; G.Hertig, “Imperfect Mutual Recognition for EC Financial Services” *14 Int’L Rev.L.Economics* 177 (1994), at p.182.

101 See European Shadow Financial Regulatory Committee, *Towards a Single Market in European Securities Trading: An Agenda for Reform for the ISD*, 8th Statement, 12.06.2000, London, available at www.ceps.be.

problem of duplicative supervision. Further, the applicable legal framework consists of the familiar domestic rules. It thereby becomes predictable, certain and transparent, conflict of laws is circumvented and surprises caused by regulatory reform and inconsistent enforcement policies in the “host jurisdictions” are avoided.

In relation to the “regulatory perspective”, the proposed model performs a plausible and realistic settlement of the rivalry between free trade and local control on the condition that national regulatory values and supervisory practices have converged to a mutually agreed level. Mutual recognition dispenses with pointillist harmonisation and thereby enables policy makers to concentrate on the essential constituent parts of equivalence. Hence, free economic movement is secured without the excessive “policy” and “transaction” costs of deeper centralisation¹⁰². The attained convergence secures the basis for equivalence and trust and prevents the unacceptable subordination of vital national regulatory preferences to the one-dimensional claim for a liberal market order. It also ensures that domestic and overseas firms are at competitive parity and that consumers are confident that incoming services and firms are subject to equivalent rights and duties as domestic firms in the recipient jurisdiction. This will significantly reduce the risk of confusion and enhance consumer confidence in the predictability of underlying substantive standards.

Further, the optimal level of equivalence of national standards contributes to the creation of positive synergies in the management of financial and network-driven risks which transcend national borders and are better dealt with at the international level¹⁰³. Other values promoted by “good” harmonisation and equivalence of rules may also be identified: the creation of level playing field for firms which lack mobility and cannot reap the benefits of regulatory arbitrage; an opportunity and a forum for domestic reform and a fresh review of national rules; an improvement in the quality of regulation through collaboration of pooled national expertise, especially for less developed Member States; the production of carefully designed and realistic law for international business, induced by the disciplinary effects of the expensive and inflexible amendment process and the collective sense of compromise; finally, the creation of a single point of reference for national legal education and professional training with obvious advantages for the mobility of legal skills.

Still in the realm of efficient regulation, it is expedient to examine the decision to vest the responsibility for consolidated supervisory control on the country of origin. In particular, it is questionable whether “home country” authorities have sufficient incentives to commit resources for the protection of non-voting overseas customers and whether for that reason it would appear rational to allocate responsibility to the “host country” which has a clear mandate and interest to protect domestic depositors. I do not subscribe to this view. The obvious reason is that we thereby return to the full pathology of “imperfect” mutual recognition. Interestingly however I have identified strong regulatory incentives.

102 See also E.B. Kapstein, *Governing the Global Economy, International Finance and the State*, p.80, Harvard University Press, MA, 1996; J J.H.Dalhuisen, “Liberalisation and Re-Regulation of Cross-Border Financial Services” [1999] *EBLR* 354-370, at p.354.

103 See L.White, *Competition versus Harmonization-An Overview of International Regulation of Financial Services*, pp 5-48 in C.Barfield, (Ed.) *International Financial Markets: Harmonization versus Competition*, American Enterprise Institute, Washington DC, 1996.

First, in our model the bank is solely established in the “home country” which is the first place where regulatory failure will probably cause systemic instability. Second, in all likelihood a sizeable portion of account holders will always be resident in the country of origin, which obviously creates incentives for rigorous supervision. In that respect, I cannot see how the country of origin will prevent the benefits of supervision, which are hypothetically driven by the aim to solely protect domestic customers and systemic soundness, from being indirectly enjoyed by non-residents. The allocation of responsibility for the operation of deposit guarantee schemes in the country of origin will also provide incentives for rigorous supervision in the knowledge that the local taxpayer will bail out supervisory failure towards domestic and overseas depositors alike¹⁰⁴. Further, competitive forces create enough incentives for rigorous supervision to the benefit of both resident and non-resident customers: a claim for reciprocity not necessarily in the same field; comity and a noble sense of performance of international obligations; the protection of reputation of the quality of local supervision and banking system; and finally, the self-interest to facilitate the competitiveness of domestic banks abroad, which will no doubt suffer if international markets receive a signal of underperforming supervision at source.

There is also considerable consensus that the country of origin is better placed to perform quality supervision which would cater for the complexity of markets, services and risks¹⁰⁵. Regulation theorists have confirmed the importance of territorial proximity for the successful formulation and implementation of public policy objectives¹⁰⁶. This is the thrust of subsidiarity in federal or quasi-federal structures, namely that public affairs shall be managed by authorities which are as close to the subject-matter as possible.

A deterrence-based enforcement policy, through punitive measures and penalties in cases of harmful and non-compliant conduct, whereby failure to comply is followed by enforcement proceedings, may indeed suffer from the barriers posed by national borders. But the lack of territorial proximity is potentially fatal in a compliance-based system of supervision and enforcement, whereby the overarching aim of the regulator is to reduce the likelihood of breach through the creation of mutual trust, qualitative monitoring and close cooperation as opposed to punishment¹⁰⁷.

An effective system of qualitative compliance-based enforcement presupposes a good understanding of the regulated entity: What are the causes of breach in each particular case? Is it calculated and purposeful? Or is it due to sheer indifference, incompetence, poor understanding of the law, mismanagement, breakdown of internal control systems and organisation? This approach relies on mutual trust, incentives to comply, frequency in personal contacts, interactive participation, ongoing educational initiatives on the part of the supervisor and ability to learn and adapt on the part of the firm. These values are largely conditional upon the existence

104 See also M.Andenas, *Deposit Guarantee Schemes and Home Country Control*, pp 111-112 in R.Cranston (Ed.) *The Single Market and the Law of Banking*, (2nd Ed.), LLP, London 1995.

105 See D.Schoenmaker & P.Wierts, *Financial Supervision: Which Model for Europe?*, p.6, FMG Special Paper, July 2002.

106 See W.H. Reinicke, *Global Public Policy, Governing Without Government*, p.57, Brookings Institution Press, Washington DC, 1998.

107 See generally D.Singh, “Enforcement Methods and Sanctions in Banking Regulation and Supervision” *4 Int’l & Comp.C.L.J.* 307-343 (2002).

of physical proximity between the regulated entity and the supervisory authority, which non-established banks cannot enjoy. In relation to conduct of business rules, the failures in market confidence caused by lack of integrity and conflict of interests are directly linked to underperforming internal control structures and a failing corporate culture, which a distant, non-established regulator will find difficult to bring to light¹⁰⁸. The “home country” is familiar with the organisation, management structure and personnel and has accumulated valuable information for supervisory purposes¹⁰⁹. Provided that a line of communication, ongoing cooperation and coordination among “home” and “host” country authorities is established, the argument for “home country” control of cross-border internet banking activities is compelling¹¹⁰.

The dilemma “home” or “host” country control links with the current debate regarding a reformed governance structure for financial supervision in Europe and the eventual centralisation of supervisory functions at the European level¹¹¹. The basic argument in favour of moving to a European structure is that it might be difficult to achieve simultaneously a single financial market and stability in the financial system, while preserving a high degree of national based supervision with only decentralised efforts at harmonisation¹¹². On close inspection, the argument for centralisation is driven by possible efficiency gains in dealing with cross-border regulatory concerns after full integration has been achieved, and not so much by its contribution as an absolutely essential policy towards integration¹¹³.

I am not certain whether the efficiency gains from the creation of a “European FSA” will be sufficiently proportionate to the high “transaction” and “policy costs” associated with full centralisation¹¹⁴. I certainly cannot detect deficiencies in the proposed model of “home country” control over internet-based services which would exert leverage on the broader discourse. In relation to the latter, it is rightly observed that comparative lessons can be learned from the US where a fully functioning single market is successfully premised upon common rules but not a federal supervisor¹¹⁵. A second interesting observation relates to the questionable reconciliation of centralised supervision with the- still- less than uniform substantive regulatory

108 See E.Avgouleas, p.83, *supra* note 75.

109 See G.Walker, *International Banking Regulation: Law, Policy and Practice*, pp 94-97, Kluwer Law International, London, 2001; Basel Committee, *The Supervision of Cross-Border Banking*, Basel, October 1996.

110 See Basel Committee, *Management and Supervision of Cross-Border Electronic Banking Activities*, Electronic Banking Group, Basel, October 2002; J.Koendgen, *Rules of Conduct*, p.125 in G.Ferrarini (Ed.) *European Securities Markets The Investment Services Directive and Beyond*, Kluwer, London, 1998; European Central Bank, pp 39-40, *supra* note 87; K.Alexander, *The Need for Efficient International Financial Regulation and the Role of a Global Supervisor*, pp 273-295 in E.Ferran & C.Goodhart (Eds) *Regulating Financial Services and Markets in the Twenty First Century*, Hart, Oxford, 2001

111 See generally R.M.Lastra, *The Governance Structure for Financial Regulation and Supervision in Europe*, FMG Discussion Paper, London, 2003.

112 See X.Vives, “Restructuring Financial Regulation in the European Monetary Union” 19 *J.Fin.S.Res.* 57-82 (2001); A.Prati & G.Schinasi, *Financial Stability in European Economic and Monetary Union*, Princeton Studies in International Finance, No 86, 1999.

113 See D.Schoemaker & P.Wierts, pp 1-8, *supra* note 105.

114 See also K.Lannoo, *Supervising the European Financial System*, Centre for European Policy Studies (CEPS), 2002.

115 See R.M.Lastra, *supra* note 111 quoting Alan Greenspan.

standards applicable in the internal market¹¹⁶, unless of course full centralisation in standard-setting is regarded as an inevitable by-product of a central supervisory structure. Given the substantial controversy in principle, the remaining unresolved practical issues, such as structure, terms of competence and resources, and the absence of a clear Treaty basis, the prospect for a pan-European financial supervisor is, at best, distant.

Turning to the main discussion, it shall be noted that, while “uncoordinated” mutual recognition and full uniformity entail significant “policy” costs, the principle of country of origin on the basis of equivalence demonstrates the best elements of both worlds in that it achieves full market openness with as limited centralisation as possible. Insofar as harmonisation is only essential, an undiluted model of “home country” supervision carries along the benefits of decentralisation and unleashes the forces of competition at multiple levels¹¹⁷. Efficient legislatures and regulators are free to compete, experiment and innovate and firms may choose the most efficient regulatory framework in the safe knowledge that full circulation of services and market access is secured. Local needs are addressed by tailored rules and local control. Within the permissible scope for regulatory competition, national policy and law makers are exposed to discipline and self-restraint in order to avoid reverse discrimination against domestic firms. They will no doubt examine the applicable national law and revisit their supervisory practices proposing reforms in the light of applicable rules elsewhere to stimulate the competitiveness of the domestic financial centre¹¹⁸. Discipline results in carefully chosen regulation, which addresses real market failures and strives to be as sophisticated and costless as possible. It is hoped that competition will eventually result in further convergence in the long term.

Full mobility of services accommodates heterogeneous preferences and tastes. Customers are given the option to choose among services formulated under different national laws, which address different individual needs and risk appetite. Especially for customers in smaller Member States, the benefits may be even greater. Within an imperfect internal market, where adaptation and information costs per national jurisdiction are high, smaller Member States are characterised by an unfavourable ratio of legal and regulatory costs to profit margin and therefore may be commercially unappealing. Under the proposed model, the small size of the market no longer repels firms established overseas, with obvious beneficial effects for the level of choice, quality, sophistication and competitiveness available to local recipients. For firms established in small Member States the suggested policy create opportunities for Euro-wide market access without prohibitive entry costs of compliance and therefore enhances competitive parity and reciprocity in the single

116 See G.Di Giorgio, “Financial Market Regulation and Supervision: How Many Peaks for the Euro Area?” 28 *Brook. J. Int'l L.* 463, pp 485-486; V.Galanopoulou, “The FSA as an Institutional Model” [2003] *EBLR* 283, p.293.

117 See N.Reich, “Competition between Legal Orders: A New Paradigm of EC Law” [1992] *CMLR* 861; E.Wymeersch, *Regulating European Markets: The Harmonisation of Securities Regulation in Europe in the New Trading Environment*, pp 188-191 in E.Ferran & C.Goodhart, *supra* note 110; H.Tjong, “Breaking the Spell of Regulatory Competition: Reframing the Problem of Regulatory Exit” 66 *RabelsZ* 66-96 (2002), at pp74-85; N.J.Clausel & K.E.Sorensen, “Competition and Co-operation between Stock Exchanges in Europe-Legal Aspects and Challenges” 3 *EBOLR* 371-402 (2002), at pp 380-381; J.H.Dalhuisen, p.354, *supra* note 102.

118 See R.Dale, *The Regulation of Investment Firms in the European Union*, pp28-30 in G.Ferrarini (Ed.) *The Prudential Regulation of Banks and Securities Firms: European and International Aspects*, Kluwer, 1995.

financial area. In the national arena, less efficient firms will receive a clear signal for modernisation.

In contrast with the critics of the principle of country of origin, it is my view that insofar as the level of convergence is optimal and the equivalent standards are properly implemented and rigorously enforced, a corporate policy of “low cost” location is not an option and competition in laxity is therefore unlikely to occur¹¹⁹. Even when loopholes start to emerge, I do not detect scope for harmful abuse of the system at the expense of customers located in Member States which decline to water down their own standards. First, there is always the last resort of emergency resumption of powers by the country of destination, when trust is broken down. Second, as it is rightly observed, the risk for a harmful race to the bottom cannot be verified or dismissed unless the specific nature of competition in the financial area is examined¹²⁰.

In that respect, I am convinced that the multi-faceted value of reputation in the business of banking diminishes considerably the hypothetical race towards “less protective” jurisdictions¹²¹. Firms want to exploit reputation by locating themselves in the country which offers the most sophisticated level of regulation and increased safety, soundness and stability¹²². Regulators concerned with their banking system’s stability and efficiency are unlikely to water down their standards and enter the race to laxity¹²³. In parallel, non-resident customers will dismiss offers from banks located in unsafe jurisdictions, whereas residents in the “lax jurisdiction” will react with hostility against the lowering of standards of protection¹²⁴. In effect, the market will exercise disciplinary effects, which will ensure that jurisdictions do not go down the road of laxity and correct any attempt to introduce “cheap” but inefficient rules. Key industry insiders and regulators have confirmed this process¹²⁵.

119 See also J.Trachtman, *supra* note 72; P.R.Nielsen, *Services and Establishment in European Community Banking Law: A Study of its Legal Approach and its Implications*, pp 41-58, Jurist, Copenhagen, 1994; J.M.Josselin and A.Marciano, *The Economics of the Constitutional Moment in Europe*, pp1-23 in A.Marciano and JM Josselin, *The Economics of Harmonizing European Law*, Edward Elgar, 2002.

120 See A.Klevatorick, *Reflections on the Race to the Bottom*, pp 459-469 in G.Bhagwati and R.Hudec (Eds.) *Fair Trade and Harmonization, Prerequisites for Free Trade?*, vol.I, London, 1996

121 See P.V.Caysele & D.Heremans, “Legal Principles of Financial Market Integration in 1992: An Economic Analysis” *11 Int’l Rev.L.Econ.*83-99 (1991); H.Tjong, pp 74-85, *supra* note 117; N.J.Clausel & K.E.Sorensen, “Competition and Co-operation between Stock Exchanges in Europe-Legal Aspects and Challenges” *3 EBOLR* 371-402 (2002), at pp380-381; R.Cranston & C.Hadjjemmanuil, pp 354-355, *supra* note 92; J.M.Josselin and A.Marciano, *supra* note 119.

122 See R.Cranston & C.Hadjjemmanuil, *ibid*; D.Heremans, *Economic Aspects of the Second Banking Directive and of the Investment Services Directive*, pp 37-54 in J.Stuyck (Ed.) *Financial and Monetary Integration in the European Economic Community: Legal, Institutional and Economic Aspects*, Kluwer Law and Taxation Publishers, 1993; N.J.Clausel & K.E.Sorensen, *supra* note 121.

123 See G. Dell’Ariccia & R.Marquez, *Competition Among Regulators*, IMF Working Paper 73, Washington DC, May 2001.

124 See also F.Easterbrook, “The Economics of Federalism” *26 J.L.Econ.* 23 (1983), at p.28; J.M.Josselin and A.Marciano, *supra* note 119; H.Tjong, pp74-85, *supra* note 117.

125 Braithwaite and Drahos quote US Federal Reserve officials noting that “...it is a competitive advantage for our banks that they come from a solidly regulated home base”; in the Bank of England they were told that “...competition in market integrity is the main game”. The authors themselves argue that bankers worry more about systemic risk and loss of reputation and therefore the principle of lowest-cost location, while typical in relation to tax, is atypical in relation to financial regulation. See J.Braithwaite & P.Drahos, *Global Business Regulation*, pp 130-131, Cambridge University Press, 2000; See also the econometric analysis of G. Dell’Ariccia & R.Marquez, *supra* note 123.

Admittedly despite the convincing incentives of the “home country” to exercise rigorous supervisory control, some degree of diversity in the procedural administration and management of supervisory duties will always exist, which will add value in the perceived quality of national supervision. In an “open market economy with free competition” I see no reason why the quality of “home country” regulation and supervision cannot be part of the package that efficient financial centres will export and firms will use as a competitive asset¹²⁶. In principle, this is one of the key benefits of decentralisation. In practice, it is unrealistic to expect full convergence of qualitative elements before attempting full market integration. In fact, I am not sure whether it would be desirable after all.

Consumers surely can decide whether financial services originating overseas make financial sense for their own circumstances and whether, despite the benefits, the reputation of the firm, the applicable law or the quality of supervision in the Member State in question ensure an adequate level of protection. In their turn, firms may also use these elements as a competitive asset to attract profitable customers. At the same time, the informed consumer will protect the uninformed. To the extent that the forces of competition are in operation, the existence of enough well-informed consumers and the banks’ interest to implant consumer confidence and exploit reputation will drive the general quality of services, regulation and supervision up. Historically this process has been observed. In particular relation to new technologies, there is empirical evidence suggesting that banks are particularly keen to enhance consumer confidence through technical and legal means. On the technical side, large sums have rightly been invested in order to sharpen up the security of internet-based transaction systems and thereby stimulate demand for internet banking¹²⁷. Of course, there is no level of investment which would guarantee total security of online operations. Account data can be misused and funds can be misappropriated. If the proper access devices have been used, the bank cannot distinguish between rightful mandate and unauthorised communication. In the absence of a binding rule under English law and having satisfied a “systemic” duty of care through reasonable investment in security procedures, banks would be expected to allocate the loss to the account holder through standard terms of contract¹²⁸. Paradoxically they invariably agree to undertake the risk unless the customer fails to keep the security devices secret¹²⁹. *Mutatis mutandis*, the two examples indicate that the caricature of the race towards a poorly regulated or “unsafe” location as an appealing market policy is not a fair reflection of the true dynamics operating in the market for financial innovation and new technology, where reputation and trust is of paramount importance.

126 See generally D.Vogel, *Green and Global: A Review of Trading Up: Consumer and Environmental Regulations in a Global Economy*, Harv.Un.Press 1995.

127 See J.Claessens *et al*, “On the Security of Today's Online Electronic Banking Systems” [2002] *Computers and Security* 253-265; European Committee for Banking Standards, *Secure Banking over the Internet*, Technical Report 401, March 1997, available in <http://www.ecbs.org/Download/TR401V1.PDF>.

128 See generally C.Reed, *Consumer Electronic Banking*, pp 143-166 in C.Reed *et al* (Eds.) *Cross-Border Electronic Banking*, LLP (2nd Ed.) London 2000.

129 For example, my contract with Natwest Online Banking stipulates that “*If You have kept Your Security Details secret, You will not be liable for any NatWest OnLine Banking Service transaction on Your Account, which You have not authorised. If You suspect someone knows Your Security Details You must contact us immediately. If You fail to do so, You will be liable for any unauthorised transactions on Your Account*”.

The argument derives considerable credibility from the unrivalled capabilities of the new economy to stimulate competitive forces through transparency, scope for market research and the unprecedented power of information. Even voices which are less enthusiastic about the forces of globalisation and free trade concede that global information networks entail too positive an impact on consumers' power to access information not to trigger thought for regulatory reform¹³⁰. The difference in the wealth of information is qualitative rather than quantitative. In addition to high volumes of expert research information, formerly unavailable to anyone without sound financial resources, the internet is a goldmine of information in plain language about available firms and services, consumer rights and mechanisms of redress, which is made available by reputable commercial intermediaries and governmental or non-for-profit agencies. Further, the unique ability to search and, most importantly, to read online or store information without the pressure of time or aggressive sales techniques adds important value to the availability of information¹³¹. In that respect, the average internet user is in far better position than the average non-internet user seeking financial services on the high street. Insofar as the average user of internet-based financial services is identified as an educated information-seeker¹³², the choice and options are dramatically widened, the flow and transparency of information unprecedented and the ability of the firm to define the market in the international arena is diminished, the supremacy of "home country" supervision over outdated models of internal market governance is difficult to challenge on grounds of possible regulatory failure. In the words of the former SEC Chairman A. Levitt:

Information and ideas are flowing constantly over an affordable, accessible system giving individuals the same access to market information as large institutions. The Internet is a supremely powerful force for the democratization of our marketplace¹³³

4.5 Confidence and Trust

The model of "home country" supervision is viable only when it is solidly founded on mutual trust and confidence in the equivalence of national supervisory practices. As the European Court of Justice has observed "...the rule is a particular application of a more general principle of mutual trust between the authorities of the Member States"¹³⁴.

The optimal level of equivalence would probably be as easy to describe as it would be difficult to achieve. Guided by the binding normative elements of subsidiarity and proportionality, one could argue that the optimal level of convergence is achieved

130 See, e.g., J. Goldring, "Consumer Protection, Globalization and Democracy" [1998] *Cardozo J. Int'l & Comp. L.* 1-83.

131 See F. Ellis-Chadwick *et al*, "Online Customer Relationships in the European Financial Services Sector: A Cross-Country Investigation" 6 *Journal of Financial Services Marketing* 333-345 (2002).

132 See H. V. Steenis, *Online Finance Europe*, pp 24-25, September 2000, Report JP Morgan, European Banks Equity Research Group; K. Waite *et al*, "Consumer Expectations of Online Information Provided by Bank Websites" 6 *Journal of Financial Services Marketing* 309-322 (2002).

133 *Investor Protection in the Age of Technology*, Remarks to the U.S. Securities and Exchange Commission (March 6, 1998), at <http://www.sec.gov/news/speeches/spch205.txt>.

134 Case 25/88 *Buchara* [1989] ECR-1105 para. 18.

when full mobility of network-based services coexists with efficient regulation and vice versa. With less regulation than needed, full mobility will fail for lack of equivalence. With more regulation than required, the outer limits of valid Community action are overstepped. Excessive harmonisation does not necessarily disturb free economic movement, particularly under a genuine model of “country of origin”, but it entails “transaction” and “policy” losses which are not tolerated by the EC Treaty. It is also uneconomical in the light of the scarcity of harmonisation resources¹³⁵.

A *sine qua non* condition of acceptability are common policies which reinforce the stability and soundness of credit institutions, foster integrity in the provision of investment services, bridge the information gap between consumers and firms, mandate the accuracy and fairness in all types of financial promotion, and therefore promote consumer and investor confidence in the operation of the market and the adequacy of the model of governance¹³⁶. Convergence in the management of risks which are more closely associated with network technologies is plausible, including policies for the protection of privacy and the integrity of circulating data, the reliability of information, the security of transactions, transparency and reliability of information, fraud and fairness¹³⁷.

Implementation of common standards alone does not suffice to stimulate confidence. Common regulatory values are of no benefit unless actually operating. In cross-border electronic banking, the lack of proximity between the “host authority” and the regulated entity create an initial reciprocal feeling of distrust, which is likely to be stronger on the side of the “host country” supervisor, given the dynamic nature of regulatory risks and perceptions and the limited scope for meaningful unilateral enforcement. For that reason, the arrangement is workable only when participating states have confidence in the will and ability of fellow participants to comply with the letter and the spirit of their obligations. Confidence is easier to build in a climate of supervisory cooperation and coordination, particularly in cases where the proximity between “home” and “host” authorities and the regulated entity is asymmetrical.

Distrust will thrive when the country of destination lacks information about objectives, concerns and practices of the country of origin. The creation of mutual trust presupposes sufficient information about supervisory practices and operations; close monitoring and ongoing assessment of compliance; mutual assistance and cooperation; avoidance of arbitrary behaviour; and immediate response of the country of origin in cases where the “host country” has communicated its regulatory concerns. The terms of mandate and scope *rationae materiae* of regulatory competence of supervisory authorities must also be acceptably equivalent in order to prevent loopholes in supervisory control. Admittedly, due to the different treatment

135 See generally V.Rege, “Theory and Practice of Harmonization of Rules on Regional and Multilateral Bases: Its Relevance for World Trade Organization Work on Trade Facilitation” 36 *J.W.T.* 699-720 (2002), at pp706-708.

136 See indicatively N.Moloney, pp 306-306, *supra* note 100; G.Hertig, p.182, *supra* note 100; G.Zavvos, pp 472-473, *supra* note 3; G.Alpa., pp 523-540, *supra* note 94; R.Coleman, *ibid*.

137 See I.Walden, “Regulating Electronic Commerce: European in the Global Economy” [2001] *ELRev.* 529-547; D.Piazolo, *The New Economy and International Regulatory Framework*, Kiel Institute of World Economics, 2001; M.de Cock Buning *et al*, “An Analysis of European Consumer Legislation in the Information Society” 24 *J.Cons.P.* 287-338 (2001).

of the public/private law divide in different Member States, full equivalence in national supervisory structures may not be achievable.

In that respect, the consolidation of national supervisory structures is superior to fragmentation into a multitude of national regulators¹³⁸, although the recent tide of consolidation in key European countries is probably driven by purely national considerations¹³⁹. A single supervisory authority for financial services per national market is well-suited to eliminate duplication in compliance costs and devise and implement a consistent enforcement policy vis-à-vis local and incoming services with obvious benefits for predictability and accuracy in the governance of the single financial market. It also provides for a single point of reference and communication for overseas supervisors, which is likely to strengthen and facilitate effective cooperation and coordination, exchange of information and mutual trust, especially in the event of crisis, and enhance transparency in applicable rules and terms of competence for firms and consumers. For consumers, a single point of reference and complaint handling has obvious advantages. Beyond that, the close personal contact among supervisors through frequent participation in European and international working groups and committees is another booster of mutual trust, cooperation and confidence¹⁴⁰.

Consumer confidence in the quality of supervision and law enforcement is also essential. Transparency and availability of key information is beneficial in that respect but other factors are particularly decisive. There is convergence of views in that an effective and consumer-friendly framework for cross-border enforcement of consumer rights, dispute resolution and out-of-court redress is likely to strengthen consumer confidence in online services and enhance the credibility of the model of “home country” control.

Any arrangement for “home country” supervision shall provide for emergency resumption of responsibility by the country of destination when domestic public policy objectives are at risk and confidence in the country of origin is lost. This does not call for “imperfect” mutual recognition which entails *ex ante* application of “host country” rules only because their underlying rationale is too precious to give away. It calls for *ad hoc* supervisory intervention against specific risks and incoming institutions in the event that the country of origin has failed to satisfy the conditions of the multilateral covenant. The management of the emergency powers on the part of the “host” authorities shall also be measured and justified.

Arbitrary “host country” measures impose restrictions on incoming firms against the letter and the spirit of the agreements and signal a protectionist intention. Reciprocity in trust and confidence entails obligations for the country of destination as well, which shall include a transparent and accessible emergency enforcement policy, reasonable efforts to consult with the country of origin prior to the emergency action and proportional response to the unfolding risks. Further, the country of destination

138 See C.Briault, *Revisiting the Rationale for a Single Financial Services Regulator*, FSA Occasional Paper 16, London, 2002; E.Ferran, “Examining the UK’s Experience in Adopting the Single Financial Regulatory Model” 28 *Brook.J.Int’L.* 257 (2003); V.Galanopoulou, pp 283-284, *supra* note 116.

139 See R.M.Lastra, *supra* note 111.

140 There are currently eleven European and six international groups of regulators where key European authorities participate.

shall be under an overarching duty to proactively pursue the end objective with measures which ensure the *de facto* access of non-established internet banks in the local market, such as rights of remote participation in local settlement, clearing and payment systems, abolition of residual requirements for local establishment or even access to local ombudsman schemes and consumer codes, at least until consumer awareness of the equivalence of “home country” arrangements is achieved.

The unrivalled qualities of the internet as a means of cooperation, coordination and transparency must be employed to the full. At an early stage *Henry Perritt* identified the significance of the internet in strengthening supervisory cooperation and facilitating the flow of information among national authorities, enhancing awareness of applicable practices elsewhere and reducing dramatically delays and supervisory gaps over cross-border risks¹⁴¹. In 1997, the Nobel Peace Laureate *Jody Williams* told the world how she managed to overcome her poor financial resources and coordinate via e-mail over one thousand governmental and non-governmental agencies leading to the signing of the Mine Ban Treaty in 1997¹⁴². The efficient use of electronic government in financial regulation and supervision and the exploitation of the internet as a means of communicating rules, information on proposed regulatory reforms and enforcement policies will no doubt raise the levels of transparency and enhance industry confidence in the model of domestic and internal market governance. It will no doubt facilitate the communication between the “home” and “host” country authorities and thereby enhance the credibility of the pure “home country” control arrangement and the confidence in the measured emergency action of the “host country” regulator.

On the institutional front, good spirited cooperation and coordination between the “home” and “host countries” are mandated by the overarching duty of loyalty to the cause of European integration and the specific aspects thereof which the EC Treaty imposes on Member States¹⁴³. The latter shall take all appropriate measures to ensure the fulfilment of obligations arising out of the Treaty or secondary integration policies and shall abstain from taking any sort of prejudicial action. The duty involves, *inter alia*, an obligation addressed to the full spectre of national authorities¹⁴⁴, including courts, to ensure that Community instruments are implemented in a timely manner¹⁴⁵ and effectively in a spirit of good faith¹⁴⁶; to cooperate with one another and with Community institutions and provide information in a climate of transparency about national regulatory action relating to the internal market cause¹⁴⁷; to avoid international commitments capable of affecting the *Community acquis*¹⁴⁸; and to ensure that national authorities are *de facto* capable of carrying out their duties arising out of Community action¹⁴⁹.

141 See H.Perritt, “The Internet as a Threat to Sovereignty? Thoughts on the Internet's Role in Strengthening National and Global Governance” [1998] *Ind.J.Global.Leg.St.* 423.

142 See J.Williams, *The International Campaign to Ban Land Mines-A Model for Disarmament Initiatives?*, 1997 available at <http://www.nobel.se/peace/articles/williams/index.html>.

143 See Art.10EC.

144 See Case C-344/98 *Masterfoods* [2000] ECR I-11369 para.49.

145 See Case C-315/95 *Commission v Italy* [1996] ECR 5743 para.7.

146 See Case C-320/99 *Commission v France* [2000] ECR I-10453 para. 9.

147 See Case C- 478/01 *Commission v Luxemburg*, para.22, unreported, 06.03.2003.

148 See Opinion of the ECJ 2/91 ff 19 March 1993 ([1993] ECR I-1061), para. 11.

149 See Case 130/78 *Salumificio* [1979] ECR 867 para.27.

5. Conclusion

I started by arguing that, leaving aside non-legal obstacles, the anaemic progress towards cross-border retail electronic banking may be attributed to the dilution of the principle of mutual recognition and “home country” control through the preservation and regular exercise of wide “host country” powers. I demonstrated that the pathology of “imperfect” mutual recognition is too great to bear in the light of the benefits of the internet economy. In parallel, on certain conditions the pure version of the principle of “home country” supervision seems to create a surplus of net policy gains over risks of regulatory failure.

I do not argue that the proposed model will necessarily work. I argue that on certain preconditions, which are by no means easy to fulfil, this arrangement is superior to a hybrid model of “home” and “host” country powers. My view is premised upon the spectacular failure of the current model and the broader supremacy of mutual recognition as a successful compromise between centralisation and decentralisation. It is also driven by my growing suspicion that the voices in favour of outright “host country” powers reflect an outdated model of consumer and regulatory policy which misinterprets the potential value of a genuinely single financial area, the appetite for competition, the properties and added value of internet-based services and the changing demographics of internet-based financial services.