From uncertainty to uncertainty
Developments in securities law and the Internet in the United Kingdom

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Introduction

The remarkable growth of the Internet has been fuelled in the main by the attraction it holds both to users and to commercial entities for whom it appears as a new marketing medium to be exploited. The attraction comes down to the fact the Internet is both highly flexible in its utility and essentially borderless in its operation. Any entity that has an Internet presence can immediately communicate with another no matter where they may be located geographically. The far reaching nature of the Internet has raised concerns about the possible lack of controls over activities that are conducted across it. These concerns range from the trivial to the more serious, and grow as the commercial exploitation of the Internet gathers pace. Perhaps one of the activities which raises great scope for concern is the provision of on line financial services, and in particular the offering of securities related services. The intangible nature of the Internet, a logical network laid over a physical telecommunications network, fits well with the intangible nature of financial services. As a consequence financial services are proving to be both very attractive and very easy to provide across the Internet.

Remarkably, the Internet does not exist as a single network. Rather the Internet is made up of a collection of separate and distinct networks that inter link and communicate with each other, or more correctly allow the computer systems attached to these networks to communicate with each other. The notion that the Internet is unregulated or incapable of being regulated is a fallacy. Each of the individual networks that together make up the Internet is situated in at least one or more legal jurisdictions and the laws and regulations of those jurisdictions apply to those networks irrespective of whether or not they connect to other networks, and irrespective of the services offered over those networks. The existing telecommunications or telephony networks provide an immediate analogy. This itself is hardly surprising as the Internet as a whole uses portions of these networks. Each of these telecommunications networks is subject to the laws and regulations of the individual jurisdictions in which they are situated irrespective of the fact that they and interconnected through interconnection agreements, or that they physically exist within several distinct jurisdictions.

The Internet is not a new jurisdiction. Indeed it could be said that it is not really a new environment but rather a new means of communication, albeit a highly flexible one. The fallacious argument that the Internet is either unregulated or incapable of regulation is based on a misunderstanding partly of the Internet itself but also of the question of the applicability of law. Laws and regulations apply within a particular jurisdiction, of that there is not doubt. The fact that the Internet is simply a new method of communication means that laws and regulations which govern communications, or the content of material that may be communicated, or activities that can take place as a result of communications will apply to the Internet. The questions for most regulators is not whether laws or regulations are applicable for they most certainly are, the question is whether such laws or regulations are enforceable.

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Regulations, to be enforceable need to be applied in a manner which is pertinent to the operation of the Internet itself. This is the challenge facing both the regulators and the legislators in the area of securities law. Contrary to a popular perception, the financial regulatory authorities in several major jurisdictions have quite correctly identified the Internet as simply being a means of communication. This is currently the view of the Security and Exchange Commission in the United States, The Australian Securities and Investment Commission, and the Financial Services Authority in the United Kingdom. The regulatory question with regard to the United Kingdom is not whether the regulations governing securities law apply but rather how do they apply and how are they enforced.

The regime within the United Kingdom

The regulatory and legal regime within the United Kingdom is presently undergoing a fair degree of change. Though the area of securities is presently governed, along with other financial activities, by the Financial Services Act 1986, it will soon be regulated by what is currently the Financial Services and Markets Bill 1999 when this comes into force sometime within the next year. The Financial Services and Markets Bill, aside from its aim to provide a new statutory framework for the Financial Services Authority, aims to bring together the disparate laws and regulations covering various financial services and related activities, known unsurprisingly as the regulated activities[2], into a single legal regime. With regard to the area of securities law the Bill in the main intends to continue the regime established under the Financial Services Act with a few updates and amendments though it does seek to extend the powers of the regulator, the Financial Services Authority, from those granted under the Financial Services Act.

The proposed regime under the Financial Services and Markets Bill is thus a development from that currently existing under the Financial Services Act, and as such any attempt to discern its possible shape and effect will require a discussion and understanding of the current regime. With this in mind this report will initially address the regime under the Financial Services Act before attempting to examine what the future may hold for securities law and the Internet in the United Kingdom.

The Financial Services Act 1986

The view of the Financial Services Authority, that the Internet is simply a means of communication, has the immediate effect of bringing within their remit any activity controlled by the Financial Services Act which is carried out over the Internet. Indeed the Authority holds that the provisions of the Financial Services Act apply equally to the Internet as they do to other forms of communication[3]. In the main this causes few problems and could be seen as an enlightened position and partly comes about by accident due to the wide drafting adopted within certain definitions of the Act itself. The result is that the financial regulations, and in particular the securities laws and regulations automatically apply to the Internet.

Were this to be the only issue arising from the view expressed by the Financial Services Authority then this would be all that there is to analysing the regime within the United Kingdom aside from a description of that regime itself[4]. Fortunately, or unfortunately as the case may be the use of the Internet in the area of financial services, and securities in

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[2] Schedule 2 Part I of the Financial Services and Markets Bill 1999

[3] See "Carrying on investment business over the Internet" available at http://www.fsa.gov.uk/enf/els6.htm

[4] For such a description see that given in "Recent Developments in Securities Laws: United Kingdom" IBA #### by Chris Ashworth, Ashurst Morris Crisp

particular, raises issues which pose difficult problems for the Financial Services Authority. These occur in the three areas of (i) carrying out investment business electronically, (ii) promotions of investment business, and (iii) that of the question of jurisdiction and enforcement which arises due to the borderless nature of the Internet.

(i) Carrying out investment business electronically

Carrying out investment business is strictly controlled by the Financial Services Act 1986. Investment business is broadly defined[5] and involves activities such as dealing in investments, arranging deals in investments, managing investments, giving investment advice and establishing, operating or winding up collective investment schemes[6]. Section 3 carries a blanket prohibition on carrying out investment business in the United Kingdom unless a person is authorised to do so or is exempted from requiring authorisation. Should a person be located within the United Kingdom then they would automatically fall within the scope of section 3 and the question would arise of whether what they were doing would fall within the definition of investment business. The question arises therefore of whether a person outside of the United Kingdom would fall within the scope of section 3.

The wording of section 1(3)(b) is interesting in that it does not refer to physical location or permanent place of business unlike that of section 1(3)(a). It simply refers to engaging in investment business within the United Kingdom, subject to a few additional narrow exclusions. To fall within this section a person does not need to reside or indeed have a place of business within the United Kingdom. All that is required is that the investment business in which they engage falls within the United Kingdom itself. The exclusions that are applicable are very narrow and generally cover dealing in investments or arranging deals in investments providing that these are conducted through an authorised or exempted person or were unsolicited, and giving investment advice or managing investments providing that these services were unsolicited or not offered in contravention of the regulations dealing with promoting investment business[7] in section 57.

The question immediately arises of how the controls over carrying out investment business apply to the Internet. An Internet site on which investment business is carried out, if it is situated within the United Kingdom would automatically fall within the provisions governing the carrying on of investment business. The question is more pertinent when it comes to examining the position of Internet sites outside of the United Kingdom, but which are nevertheless accessible by persons within the United Kingdom.

There is no real guidance on this question either from the Financial Services Act itself or from the Financial Services Authority. In its two letters dealing with the question of investment business over the Internet[8] the Authority merely states that persons must be authorised or exempted in order to carry on investment business. Given its view that the Internet is simply another communications medium it is probably safe to assume that the Financial Services Authority could possibly hold that an Internet site that is based outside of the United Kingdom that engages in activities that fall within the definition of investment business and accessible to users within the United Kingdom as carrying on investment business for the purposes of section 3. This would come from a reading of its views on the jurisdictional issues relating to the promoting of investment business and the narrow exclusions available under section 1(3)(b). The consequence of this is that overseas Internet sites offering

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[5] Section 1(2) and Schedule 1 Parts II and III
[6] Schedule 1 Part II paragraphs 12 to 16
[7] Schedule 1 Part IV paragraphs 26 and 27
[8] "Investment Business" available at http://www.fsa.gov.uk/enf/els9.htm and "Carrying on investment business over the Internet" available at http://www.fsa.gov.uk/enf/els6.htm

securities based financial services or information may unwittingly find themselves subject to the jurisdiction of the Financial Services Authority unless they take steps to close off access to their sites from users in the United Kingdom.

Operating an Internet site is one method of conducting investment business which falls within section 3. In general such an Internet site would act as a form of information provision or act as a communications point between the users and the providers of a service. There would be some form of human activity involved in the actual conduct of the investment business itself. Increasingly, however, improvements in the technology underlying the provision of services across the Internet has resulted in providers being able to construct fully automated services which require no input or interaction on behalf of the provider other than to watch over and maintain the service. All the interaction would be between the users of the Internet site and the site itself.

The question exists of whether or not such an automated system would be regarded as falling under the definition of investment business. If it were to fall under the definition then the operators of such a site, irrespective of their geographical location, might well require authorisation under the Financial Services Act. The recent case of *Re Market Wizard Systems (UK) Ltd*[9] is to the point and gives some guidance on the views of both the Financial Services Authority and ultimately the view that the courts might take. It should of course be remembered that regardless of its views on the matter the Financial Services Authority is not and has never claimed to be the ultimate arbiter of the interpretation of the Financial Services Act. That position belongs to the courts alone.

The case itself concerned a financial modelling programme which would download information on selected stocks on a daily basis. The programme would then perform calculations based on a proprietary financial model and indicate the positions that should be held on each of the individual stocks at a particular point in time, such as buy, sell, or hold. It did not give any indications as to the amount of stock that should be held and any trades in the stock had to be made independently. The company which produced the programme described it as "a risk management and investment trading/forecasting tool that does all the real work (technical analysis) for you".

The company argued that the programme was no more than "simply a matter of calculation based on historical data and the updates put in by the customer" and that it was in reality a "sophisticated and technologically based calculator." The court held that if the programme was one that simply analysed the historical data then the argument presented might have had merit. However, the court held that this claim did not sit well with the programme's other function of interpreting the resulting calculations to provide a guide as to what position should be held with regard to a particular investment. Given that the advice generated and subsequently displayed went beyond generic or general advice and instead went to the "merits of buying or selling options" the activity fell within the definition of investment advice in paragraph 15 of Schedule 1 Part II. As a consequence the company required authorisation to conduct investment business under section 3.

Automated systems can take various forms, from simply providing customised information through to acting as fully fledged securities trading systems. Whether or not such systems will fall under the definition of investment business in section 1(2), and so potentially expose the operator to liability under section 3, will depend entirely on the function of the system itself. It does not matter if the user of such a system has signed or accepted an agreement stating that the system is not conducting nor intending to conduct any investment business, such as providing investment advice or some other controlled activity. According to the court in *Re Market Wizard Systems (UK) Ltd* the test is an objective one and one which is focused

[9] [1998] 2 BCLC 282

primarily on the functionality and service provided. As Carnwath J stated "… it does not make any difference that the purchaser is warned that what he is receiving is not intended to be treated as [a controlled activity]. If, on an objective view, it is [a controlled activity] within the meaning of the statute, the agreement of the parties cannot make it something different." Nor does it matter that the operation of the system is down to the user himself. The statute does not focus on the operation of the investment business. Rather it focuses on its source. "The fact that it is the customer who is operating the programme does not change the nature of the [controlled activity] or its source."

Automated systems, therefore, may well fall within the definition of investment business and the operators behind those systems will require authorisation. The question of whether such a system will fall within the definition will depend on the specific facts. What is clear is that that lack of direct two-way interaction between the actual site operator and the user does not preclude the conclusion that the operator is carrying out investment business and the obligations that this entails.

(ii) Promoting investment business

The Internet is highly relevant to the issue of promoting investment business and indeed this is one of the main uses to which it is put in relation to financial services and securities over the Internet. The most obvious provision in the Financial Services Act that is relevant to the Internet is that concerning the issuing of investment advertisements[10]. However the general prohibition of unsolicited calls[11] is becoming increasingly relevant as new multicast technologies are developed to exploit the Internet and create a proactive information delivery system and this may well be deemed to apply to communications initiated by these technologies.

Section 57(1) of the Financial Services Act prohibits anyone other than an authorised person from issuing or causing to be issued an investment advertisement in the United Kingdom unless its contents have been approved by an authorised person. The drafting of the definition of an advertisement in section 207(2) is wide enough to catch any form of advertisement, no matter how it is published except by way of a sound or television broadcasting service.

Though the definition lists several specific means of publishing an advertisement the list is non exclusive. Indeed it could be argued that three of the specific examples given, those of a 'publication', 'circulars' and 'other documents' could possibly be attributed to some forms of publishing via the Internet. Periodical net news articles or advertising electronic mail messages might fall into the definition of circulars whilst electronic data files, when read on screen could conceivably fall within the term 'other documents' as electronic documents. Indeed Web pages and other forms of electronic publications such as electronic newsletters could easily fall into the definition of 'publication'. The issue is somewhat academic, however, as such publications, and other forms of advertisement information on the Internet, will fall within the general catch all provision of 'in any other manner' at the end of that definition. Consequently advertisements on the Internet, whatever their actual form, will fall within the definition of section 207(2).

That such advertisements fall within the definition of section 207(2) is not sufficient in itself. The prohibition is on the issuing of investment advertisements as defined in section 57(2). This definition builds on the definition of an advertisement in section 207(2) and states that it means "any advertisement inviting persons to enter or offer to enter into an investment agreement or to exercise any rights conferred by an investment to acquire, dispose of,

[10] Section 57
[11] Section 56

underwrite or convert an investment or containing information calculated to lead directly or indirectly to persons doing so." In short then section 57(2) governs any advertisement enticing persons to transact some form of investment business.

The accessibility of information via the Internet is such that users in any geographic location can easily locate and access information held on systems in any other location. The information can be called up and displayed on their screens in a moment. In essence any information or advertisement that is available on the Internet can be accessed in the United Kingdom. The methods by which users would access the information vary according to the type of service used to publish that information. Electronic mail is transmitted directly to individual users; they do not usually seek this information out and download it themselves though they can request that it be transmitted to them. Usenet or net news on the other hand would be specifically downloaded by users as would Web pages from a World Wide Web site on the Internet.

The question of whether or not an investment advertisement accessed across the Internet falls within the scope of section 57(1) if it originates and operates within the United Kingdom is easy to answer and simply requires the nature of the advertisement to be determined against the criteria of section 57(2). The real question that arises from the use of the Internet is not whether advertisements delivered across the Internet fall within section 207(2) for they do, or indeed whether or not they fall within section 57(2). It is whether or not they fall within the scope of section 57(1).

Whether or not such advertisements fall within section 57(1) is determined by section 207(3) which states that an advertisement or other information that is issued outside of the United Kingdom shall, for the purposes of the Financial Services Act, be treated as if it were issued in the United Kingdom if it "is directed" or "made available" to persons it the United Kingdom. There are exceptions which relate to the information or advertisements being made available by way of periodical publications published and circulated principally outside of the United Kingdom, or in sound or television broadcasts that are transmitted principally for reception outside of the United Kingdom. The Financial Services Authority, in its guidance note on the issue of the treatment of information on the Internet[12] does state that it does not consider material on the Internet to fall within the definition of a "sound or television broadcast". It does state that there may be an argument that some electronic publications could fall within the definition of a "periodical publication" but goes no further on the matter[13]. Some publications that are indeed periodical in nature, whatever their form, be they World Wide Web pages, electronic mail messages, or net news postings may well fall within the definition of a periodical publication. The question of whether or not they do fall into the definition is something which can only be decided on a case by case basis. If they are deemed to fall within the definition the issue then becomes whether or not they were published and circulated principally outside of the United Kingdom.

The question is important due to the borderless nature of the Internet. Paper-based publications, such as newspapers or journals lend themselves to geographic segregation simply by dint of their being physical objects which would require physical transport to move between geographic locations. These publications can be, and often are published for particular regions or jurisdictions. Though they may be available in other non-targeted jurisdictions through the actions of specialist subscriptions or distribution they are aimed primarily outside of these jurisdictions. Section 207(3) would obviously act to exclude such publications which were clearly intended for securities markets other than the United Kingdom.

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[12] "Treatment of material on overseas Internet World Wide Web sites accessible in the UK but not intended for investors in the UK", Guidance 2/98.
[13] Paragraph 11 Guidance 2/98

The issue is much more difficult with respect to publications made available on the Internet. Any material on the Internet is potentially available in the United Kingdom. Whether it is directed at the United Kingdom is another matter. Unfortunately the section requires one or other of these trigger points, not both. The requirement that the material be directed at the United Kingdom is narrow and would exclude a great deal of material. Unfortunately this is counteracted by the other requirement that the material be simply made available to persons in the United Kingdom. Following this requirement potentially all material on the Internet will fall within section 57. The narrow exemptions to the restriction on issuing investment advertisements in section 58 may apply, but nevertheless the material will fall within the definition of section 57. Section 57(4) details a defence against unintentional breaches of section 57 but it is narrow and is not available to those who engage in investment business.

(iii) Jurisdiction and enforcement

The operation of section 207(3) with regard to investment advertisements and the lack of geographic limitation of section 1(3)(b) with respect to carrying on investment business lead to the inevitable conclusion that the jurisdiction that results from the operation of the Financial Services Act with respect to securities or other financial services offered over the Internet is potentially one that is world wide. In its guidance notes the Financial Services Authority seems to take the same view with respect to the question of its jurisdiction. Jurisdiction, however, is not the same as enforcement.

The Financial Services Authority has recognised that the question of enforcement within its theoretical jurisdiction is one which is fraught with difficulty and issues of practicality and as such has published some guidance as to when it would seek to enforce its regulations against operators and their sites which fall within its jurisdiction, irrespective of the geographical location. In essence the Financial Services Authority will claim jurisdiction where it can but then use its discretion when it comes to deciding whether or not to take enforcement action. The main concern for the Authority when deciding whether or not to take enforcement action is whether or not any of the breaches of the regulatory regime involve issues of investor protection.

The prohibition against issuing investment advertisements is powerful due to its wide ranging applicability, and in practice will be the governing factor in any decision to take enforcement action. Indeed the stated approach of the Authority is first to examine whether any breach of the prohibition against issuing investment advertisements has occurred. That a breach of the section 57 may have occurred may in itself be sufficient. However other factors will also be taken into account when deciding whether or not to take enforcement action against a site. Due to the particular nature of the Internet and the presentation of information that its operation entails, sites which carry on investment business will almost certainly also carry or issue information which in effect function as investment advertisements. As a consequence activities on the Internet which contravene section 3 or section 56 could also contravene section 57.

The Financial Services Authority has recognised that its effective jurisdiction, world wide by definition, is impractical and as such its enforcement powers need to be measured and tailored to remain effective. In deciding whether or not to take enforcement action the Financial Services Authority has stated that it will take into account the individual circumstances of each case. However the Authority has made available some general guidelines published both in the Guidance Note 2/1998 and in the summaries of its letters on its approach to financial services over the Internet. These guidelines show that the Authority is more concerned with the function of the information or Internet site rather than its form and consequently attempt to help determine when material was made available to, or aimed at the United Kingdom.

The location of a particular site does not automatically indicate whether material is made available in the United Kingdom. Whilst one of the factors to be taken into account is whether the site in located outside of the United Kingdom, the Authority has stated that the existence of a site within the United Kingdom would not in itself be conclusive evidence of where the material was aimed. This, though it might seem rather strange, is logical and reflects the nature of information publication on the Internet; that physical location does not necessarily determine the target for the information.

The extent to which any investment advertisement was directed at persons within the United Kingdom is an important factor any decision to take enforcement action. Whether the advertisement is directed at persons in the United Kingdom will depend on the facts of each case, but factors which will be taken into account include the language of the information, whether technical steps are taken to exclude investors from the United Kingdom, whether warnings and disclaimers are prominently published, whether positive steps are taken to ensure that persons in the United Kingdom are screened from the service itself, and the extent to which the service underlying the advertisements or promotion is available in the United Kingdom.

The steps to avoid directing the advertisement to the United Kingdom must be effective. Their existence in themselves is not sufficient. If the technical barriers are easily circumvented them they will be regarded as insufficient and no protection will be granted. Disclaimers and warnings are not a panacea for evading liability under the Financial Services Act and will not on their own amount to much. Though these factors apply to the question of whether or not an investment advertisement is directed to the United Kingdom they also apply, particularly with regards the question of whether or not potential investors are screened from the service, to site which may be held to be conducting investment business.

The question obviously arises of what of Internet Service Provider Liability for contravention of the Financial Services Act? The main provisions which would cause concern are section3 and section 57(1). Indeed the prohibition in section 57(1) against causing an investment advertisement to be issued could very well apply to an Internet Service Provider. The answer depends entirely on the relationship between the Internet Service Provider and the source of the information concerned. If the relationship is simply that of the unknowing service provider then the service provider will almost certainly not be held liable and will probably fall within the defence of section 57(4). The defence against liability under section 57(1) in section 57(4) is narrow and only applies to innocent dissemination of the information by a person whose ordinary course of business does not involve investment business. If, however there is a link between the service provider and the party supplying the information, such as a promotion, financial support, or knowledge or control of the activity then the Internet Service Provider may well be held liable in addition to the originating party. Each case will need to be examined on its facts.

What will or will not be held as knowledge or control will need to be determined by the courts. In any case the question will need to be decided for each particular technology and media used across the Internet as they each exhibit certain unique features that may well prove deciding in any case. The recent case of *Laurence Godfrey v Demon Internet Limited 26 March 1999, Case 1998-G-No 30* may be of some use, though it is the result of a preliminary hearing rather than a full trial. The media and technology concerned is that of usenet, a service rather similar to a bulletin board, but one which is distributed across the Internet. The case itself concerned a defamatory article posted on this service, a copy of which was carried by a usenet server operated by Demon Internet. Morland J held in the hearing that though Demon Internet had not initially known of the article, once they had been made aware of the article they were under an obligation to remove it. The operation of usenet servers is such that this is easily accomplished. Demon had not done so.

The case is unsatisfactory for several reasons but it does show the attitude that the courts may take where an obligation to take action arises out of subsequent knowledge. The case also turns on defamation law which has a nature all unto itself. Nevertheless the case does still serve to highlight the issues that Internet Service Operators may face if they subsequently gain knowledge of the activities that are prohibited or regulated. Whether they are able to act will depend entirely on the media and technology being used to propagate the information.

One source of concern is that of hyperlinks. Where hyperlinks in one World Wide Web page link to a site which is carrying on a prohibited activity the question arises of whether those links themselves constitute either the carrying on of investment business contrary to section 3 or issuing or causing to be issued an investment advertisement contrary to section 57(1). Again the answer will depend on the specific facts. Where the links, which can be anything from an animation to a textual link, contain nothing which suggests the merits of the information being linked, such as in a general listing of sites, or in a generic linking of sites, it may be safe to assume that the links will not contravene the Financial Services Act. However, if the links themselves serve to promote the underlying information then these may well be caught.

Though the decision to take enforcement action in the majority of cases will depend on the issue of whether or not information was directed to the United Kingdom, the Financial Services Authority has stated that it would almost certainly attempt to take enforcement action against sites which make misleading statements, a breach of section 47. This is irrespective of whether the information is directed to the United Kingdom and fits with the equally aggressive stance adopted by the Securities and Exchange Commission and the Australian Securities and Investments Commission.

Financial Services and Markets Bill 1999

The Financial Services and Markets Bill, unlike the Financial Services Act, has been drafted partly with the Internet in mind. However, the Internet is not specifically regulated for within the Bill. Instead the aim has been to draft the Bill in such a manner that its provisions remain as far as possible technologically neutral in order to future proof these provisions against future technical developments, both in terms of services and the underlying technologies. It is in providing for this flexibility where the specific nature of the Internet has been borne in mind.

The Bill will itself build upon and extend the regime that currently exists under the Financial Services Act 1986. This regime covers most, if not all of the activities concerning securities over the Internet not by design by rather through the accident of wide drafting. One consequence of this is the wide jurisdiction which exists under the present regime and which proves somewhat problematical.

One major feature of the Bill is its heavy reliance on secondary legislation for any detail in its operation. Though the Bill contains many provisions, the aim is to use secondary legislation to provide the detail. Though this may seem somewhat strange it follows from the aim to provide a technologically neutral regulatory framework. The Bill aims to regulate financial services and markets irrespective of the technological framework over which these are delivered. By providing for a general legal framework with provision for secondary legislation, regulators are free to produce individual orders to deal with the specific requirements of each particular technology and its peculiar effects on a given service without distorting the overall framework. With this in mind the initially fluid and uncertain nature of the Bill becomes its strength. Whether the same can be said of the actual language used is debatable.

(i) The General Prohibition

The general prohibition within the Bill is contained within section 17 and prohibits persons from carrying out a regulated activity unless they are authorised persons or exempted persons. The difference in wording between section 17 of the Bill and section 3 of the Financial Services Act 1986 is a direct consequence of the consolidation which the Bill purports to effect. Section 20 of the Bill defines regulated activities widely in a rather peculiar manner. Essentially section 20 covers any asset, right[14], or interest which may be specified by the Treasury[15]. Schedule 2 Part I of the Bill does set out examples of what will constitute regulated activities and indeed serves to supplement the provisions of section 20. It does not, however, limit the operation of section 20 nor the scope for specified investments to be decided by the Treasury.

Such flexibility might seem to prove problematical in attempting to define the exact scope of the Bill and indeed the exact scope of section 20(1) will not be determined until the Treasury has published draft orders covering this provision. However, examination of the list of the general descriptions set out in Schedule 2 Part I would seem to confirm that the current regime under the Financial Services Act will continue. In addition to some extra activities the activities in Schedule 1 Part II of the Financial Services Bill 1986 which set out the activities constituting investment business are included in Schedule 2 Part I of the Bill with a few amendments. Consequently the current treatment of what will constitute investment business carried out over the Internet will continue under the new regime, subject as ever to any future order made under section 20(1).

One notable addition to the activities that originally constituted investment business is that of using computer-based systems for giving investment instructions. The reasoning in the case of *Re Market Wizard Systems (UK) Ltd* would quite easily hold under the new Bill, given that the operable definition of investment advice upon which that particular point of the case turned, that of paragraph 15 Schedule 1 Part II of the Financial Services Act, is essentially that given in paragraph 7 of Schedule 2 Part I of the Bill. The facts of the case do not deal with the question of using such a system to handle investment instructions, and it is arguable that the definitions of dealing in investments or arranging deals in investments would not cover such a system. Though a trading system on the Internet might well be caught under the definition of investment advice, or under the prohibition of financial promotion, any lacuna which might otherwise exist with the use of computers to handle investment instructions is negated by this amendment. Indeed, given the reasoning within the case of *Re Market Wizard Systems (UK) Ltd* any company behind an automated computer trading system on the Internet would be held as offering or arranging for a service which fell under the definition in paragraph 9, irrespective of the fact that the customer would be the party initiating the transfer of any investment instruction.

Section 353 of the bill defines what is meant by carrying on an activity in the United Kingdom. The language is somewhat peculiar in that the section defines what is meant by example. From first glance it would appear that the section is concerned with physical presence of an establishment or registered office within the United Kingdom and so would allow the activities of trading sites on the Internet to escape the jurisdiction of section 17. The restrictions themselves are required to give effect to the principles of home country rule and host country rule within the European Economic Area and to bring the focus of the regulatory regime more inward than it is at present. However, its scope can be restricted or increased by order made under section 20 and this could be used to bring Internet sites within

[14] Section 20(4)
[15] Section 20(5)

the jurisdiction of section 17. Indeed article 38 of the draft Financial Services and Markets Act (Regulated Activities) Order states that persons not carrying on any regulated activity from a permanent place of business within the United Kingdom should not be regarded as carrying on the activity in the United Kingdom unless they engage in the activity in a way which constitutes the carrying on of the activity within the United Kingdom.

The draft order is aimed at giving effect to the intention of reducing the jurisdictional scope inward from the existing regime. The Treasury has stated that it sees little merit it attempting to regulate entities that offer services within the United Kingdom and yet do not subsequently go on to carry out regulated activities within the United Kingdom. It also grants exclusions that are similar to those granted under the Financial Services Act. What is clear, however, is that carrying out any regulated activity within the United Kingdom, or in such a way that it would take place within the United Kingdom is not excluded.

(ii) Financial Promotion

It is perhaps by accident of drafting that investment advertisements on the Internet are caught by sections 207(2) and 207(3) and so by the prohibition of section 57 of the Financial Services Act. What is not certain is whether unsolicited messages by e-mail, net news, or even push technology transmissions are caught by the prohibition on unsolicited calls in section 56. The prohibition on financial promotion in section 19 of the Bill removes these uncertainties.

Section 19 prohibits a person from communicating or causing to be communicated an invitation to engage in investment activity, or information which is intended or might reasonably be presumed to be intended to lead directly or indirectly to engaging in investment activity. Authorised persons are exempted as are communications where the contents have been approved by authorised persons. The use of the word "communication" rather than the term "advertisement" is very useful as it essentially removes the distinctions that exist under the Financial Services Act between advertisements and unsolicited calls. In essence the prohibition covers all forms of media and any communication is covered subject to any order made by the Treasury under section 19(3).

Section 19(2) states that the prohibition will only apply to communications that originate outside of the United Kingdom if they are capable of having an effect in the United Kingdom. This wording differs from that in section 207(3) of the Financial Services Act and this is significant when attempting to define the resulting jurisdiction. On first glance it would seem to mean that any communication might be caught if it were available within the United Kingdom as under the current regime. However the use of the word "effect" leaves room for manoeuvre In the explanatory note to the Bill and the Treasury consultation document on Financial Promotion[16] it seems that the aim is generally to restrict the jurisdiction of section 19 to communications which are directed at the United Kingdom regardless of whether they are available in the United Kingdom. The proposed exclusion, to be made by order under section 19(3) is stated only to apply to communications which originate from overseas.

The proposed exclusion does seem to alter the existing view where the actual location of an Internet site is irrelevant, but in reality this may not be so. The aim is to move away from the general jurisdiction aimed at availability within the United Kingdom to one which is based on whether a communication is directed at the United Kingdom. Limiting the exclusion to communications originating from overseas would thus seem illogical given that sites situated within the United Kingdom may well be directed elsewhere and it is probable that the existing

[16] Financial Promotion – A Consultation Document available at http://www.treasury.gov.uk/pub/html/docs/finprom.html

view of examining the function of the communication will continue. The discussion in the consultation document would seem to support this view.

The Treasury has stated that in making an order under section 19(3) to provide for this exclusion its preferred approach is not to make an order providing for an exemption for communications that are not directed at the United Kingdom, leaving the actual definition of what does and does not constitute directed at to the Financial Services Authority, but to provide a list of indicators to help determine what could so constitute directed at. The aim is to allow the Financial Services Authority the flexibility which an undefined term would grant, but at the same time provide a fair degree of certainty to help determine what activities or communications might or might not be caught by section 19. The overall aim is, as with the current practice, to concentrate on the function or substance of the communication and not its form.

The approach is to ask whether or not a communication was directed at the United Kingdom irrespective of whether any information contained is relevant to that market or whether the information is available in the United Kingdom. Unlike the existing regime the availability of information is not the jurisdictional trigger. The trigger is whether or not the information is directed to the United Kingdom. One result of this is that there may be circumstances where information relevant to the United Kingdom market is not regulated under the Financial Services and Markets Bill. Though this does seem somewhat anomalous it is a direct consequence of the redefining of the competent jurisdiction under the Bill. It is also a close reflection on the current enforcement policy of the Financial Services Authority. In essence the scope of the jurisdiction is still world wide, but the actual information or sites that fall within that jurisdiction are determined by the question of whether or not they are directed at the United Kingdom.

The narrower jurisdiction has another consequence which will be welcomed. Part of the rational of the financial regulations is to provide adequate protection for the casual or small investor whilst allowing the sophisticated investor more scope to act. Consequently if such an investor were to undertake investments or make investment instructions having used a site which covered, but was not directed at the United Kingdom, they would be acting outside of the regulatory jurisdiction and so be outside of the protection granted by the Financial Services and Markets Bill. In essence this marks a return to the old dictum of caveat emptor for those who are knowledgeable enough and willing to move freely within the market.

The Treasury has recognised that the regulations should be technologically neutral. Unfortunately, though this is a laudable aim, the reality is that differing technologies affect the potential scope of regulations in differing ways. Though the aim of the regulations is to treat all media equally, in reality individual regulations may and indeed will need to differentiate between different media and different technologies in order to remain effective. Inevitably therefore, there will be slight differences in the way different media and technologies are regulated.

(iii) Enforcement and Jurisdiction

The most radical change in the current regime that will be brought about by the Financial Services and Markets Bill is the change in the scope of the jurisdiction. Rather than simply looking at the question of availability of the information in question, the Bill seeks to limit jurisdiction to information that is directed to the United Kingdom. This ties the question of jurisdiction and enforcement much more closely than the existing regime, where the Financial Services Authority exercises its discretion over its greater jurisdiction.

The change does, however, follow the existing enforcement policy of the Financial Services Authority and that is to be welcomed. The change does mean that certain sites and information will be beyond the remit of the Financial Services Authority, but that is a natural, if regrettable, consequence of the operation of the Internet.

Co-operative Enforcement

One of the attractions of offering financial services or securities related services across the Internet is the lack of geographic barriers to offering such a service. Though this has obvious advantages for those who wish to offer services when it comes to deciding on where to site a particular service it puts regulators in a great deal of difficulty. The world wide jurisdiction granted to the Financial Services Authority under the Financial Services Act, and to a more limited extent under the Financial Services and Markets Bill, is all very well so far as asserting jurisdiction is concerned. The question is whether or not that jurisdiction and any resulting enforcement action can be enforced.

Enforcement is usually only possible where a regulator or court can exert physical, as opposed to an intangible jurisdiction. The courts in England and Wales, and in the United Kingdom in general, have been very reluctant to assert jurisdiction over a matter where they would not be able to enforce any order that they might make, and regulators would face a similar dilemma. Though it would initially seem attractive to assert a world wide jurisdiction, an inability to enforce across that jurisdiction would not only render the question of the jurisdiction somewhat meaningless, it would also raise questions about the viability of the regulator or the regulations themselves and undermine the effectiveness of the aims of the regulations themselves.

Financial service regulators have laudable aims, the stability of the markets and consumer and investor confidence being at the forefront of these. The inability to enforce outside of their jurisdiction, due to the inability to reach the sites or operators on the Internet would prove detrimental to these aims. As a result the major financial service regulators, such as the Securities and Exchange Commission, the Australian Securities and Investments Commission, and the Financial Services Authority have stated that they would seek to enter into discussions on how best they might co-operate to prevent or control market abuse, fraud, and the practice of unregulated activities where these would affect market stability or consumer confidence.

Both the Financial Services Act and the Financial Services and Markets Bill contain mechanisms to allow such co-operation to take place. Section 128C in the Financial Services Act, and section 164 in the Financial Services and Markets Bill enable, in the case of the Financial Services Act the Secretary of State, and in the case of the Financial Services and Markets Bill the Financial Services Authority to exercise its powers in support of an overseas regulator. The overseas regulator must be recognised as a competent regulator. In the case of an EEA regulator this recognition is automatic under the provisions of the single market directives and the resulting European Passport for European investment firms. In the case of other regulators the recognition will depend on whether they meet certain criteria to do with their particular function. In practice financial service and securities regulators from the major financial jurisdictions should meet the test for recognition. Unlike requests for co-operation form EEA regulators, however, other recognised regulators may be asked to contribute towards the costs of taking any enforcement action.

Conclusion

The position adopted by the Financial Services Authority under the Financial Services Act would seem to be one of common sense, and indeed it is, given that, as with most financial regulatory authorities, its aim is not so much to prevent activities or markets from emerging but to preserve the confidence in and stability of the financial markets. However, it does raise issues particularly with regard to the uncertainly of jurisdiction and enforcement that should be rendered more certain.

The Financial Services and Markets Bill seeks to continue, and where necessary amend the present regime in so far as securities are concerned. This is welcome as it means that the existing practice under the Financial Services Act by and large will continue with few practical changes save those to do with the change of emphasis on the question of jurisdiction.

The change of emphasis on the question of jurisdiction under the Financial Services and Markets Bill, to that of claiming jurisdiction over where the information takes effect, would appear to circumvent the home country rule and host country rule principle enunciated in the single market directives. In reality, when it is seem in relation to the question of co-operative enforcement, it is complementary and a wholly natural companion to the principle of subsidiarity. The home country rule and host country rule principles within the European Union look to the question of authorisation and conduct of business. Under the Financial Services Act and the Financial Services and Markets Bill authorisations granted within EEA Member States are automatically recognised within the other Member States. It remains to be seen whether or not similar recognition will be granted between the major financial market jurisdiction outside of the EEA. Doing so would greatly simplify the regulation of securities on the Internet.