

FINANCIAL SERVICES AND THE INTERNET

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1. SUMMARY

Use of the Internet is growing in the financial sector, where companies are in a phase of active product development. The supply of services is being affected. Technical developments are also resulting in increasingly easy accessibility for broad groups of customers. Self-service via telephone and the Internet has become one of the key concepts. Individual customers can act with ever-greater freedom when it is a matter of seeking information and choosing alternatives.

The results of Finansinspektionen's study and analysis show that use of the Internet offers many advantages. However, there are also question marks associated with current developments, and the report deals with them in greater detail.

Increased competition, greater efficiency and new industry drift

The Internet as a communications technology holds a substantial potential for the financial sector. Competition can be stimulated, in part through lower entry barriers for new players and through continuing industry drift. The new technology offers a large profitability potential since distribution channels can be rationalized.

The pace of developments at the present time is rapid. According to a survey conducted by the Finansinspektionen, the number of bank customers who have connections to deposit accounts and payment services via the Internet will more than double during the course of the year 2000. Nearly one third of Swedish bank customers are expected to have such connections by the end of the year. At the same time, self-service involving trading in shares and other securities by private customers is expanding. By the end of 2000 nearly 500,000 customers are expected to be able to trade shares via the Internet.

During 1999 Internet technology made possible so-called "e-markets" where banks are making it feasible on their websites for corporate and private customers to establish contacts and order the products of the banks' corporate customers. This is paving the way for a new and broader form of industry drift, in which banking services are integrated with the sale of nonfinancial products.

Risk management in companies

Security issues are broad in scope and far-reaching in importance. The problems that can affect a company that is conducting an established operation based on modern information technology -- the Internet, for example -- are substantial. It is important to analyze the risks not only for a company's management but also, to a high degree, for the Boards of Directors, shareholders and customers who are involved, as well as for the Finansinspektionen.

As regards security against unauthorized trespass, sabotage and other operational risks, the finance companies themselves make a relatively optimistic assessment of being able to control them. Corporate measures proceed from the security solutions and technology

currently available. However, security measures must be gradually developed and adapted to match the particular circumstances and threat pattern for the particular company.

However, there are no definitive security solutions available. Consequently, a high risk awareness is required among companies, along with continual, conscientious security work.

Security aspects from the customer's point of view

Acceptable protection for a company's customers can be assured by using today's security technology and pertinent information. Despite this, security matters rank high when customers are asked to list their questions and problems in order of importance.

This situation must be taken seriously. No technical system is "absolutely secure," even though calming claims of this type unfortunately may be made. When communicating with customers on security problems and security systems, the financial companies must be more candid. Vague messages should be eliminated. Typical problems and faults that may occur should be stated. In addition, the consequences for the customer should be described -- the responsibility for unauthorized transactions, for example -- and alternative procedures should be recommended, for example when Internet services are not functioning due to temporary technical problems.

It is especially important to observe this demand for "truth and consequences" if a company imposes a special responsibility for information disclosure, or a financial responsibility, directly on individual customers.

Support and information

The self-service that the Internet in many cases offers customers imposes special demands on the customers' ability when it comes to managing the new technology and financial knowledge, with respect to the services' characteristics, risks, etc. At the same time, there is less personal contact, with the result that customers themselves, to an increasing degree, have to be able to interpret and benefit from the information that companies are presenting on their websites.

As a result of the attractive pricing and easy accessibility associated with the Internet, new, less experienced categories of customers are becoming more diligent users of the network in more and more product areas. In principle, anyone can himself or herself execute very complicated and risky transactions.

The conclusion to be drawn from this is not that customers' freedom of action should be restricted. Instead, demands for information and support are increasing.

Advisory services

When advisory services are provided via the Internet there is not the same possibility for dialog that exists in connection with traditional verbal advisory services. Moreover, it is becoming increasingly difficult to draw a distinct boundary between providing information and giving advice. Accordingly, special requirements should be imposed on the information that is presented. Customers must understand clearly, from the start, what the prevailing conditions and limitations are. For example, is advice being given, or merely information on various alternatives that are available?

Certification and control of websites

It is important that "superficial" players be identified, that misinformation can be countered with correct information, and that the information presented on the financial companies' websites is controlled effectively.

An attractive alternative is based on attempts to create for consumers -- in part through certification -- "lighted highways" on the Internet that lead to the websites, portals, etc. of the more reputable participants. This principle has been implemented in Great Britain in an organization, TrustUK (www.trustuk.org.uk), that is operated by the industry and supported by the Government.

Consideration should be given to the conditions that are available for forming a similar body in Sweden.

Virtual information and advisory agencies

An intensive effort focused in part on increased consumer information and certification of websites would be of great importance for the integration of private markets in the EU countries. Thus there are arguments favoring the creation of a common network of virtual information agencies and advisory services for the member countries.

The foundation for the network could be a common portal for the member countries. From the portal, consumers could then move to an advisory service agency's website of their choice. The agencies' pages could contain -- in a choice of EU languages -- simple and clear information pertaining to regulations, judicial bodies, supervisory authorities, etc. in the chosen country.

Integrity

It is important for financial companies to make clear to their customers how information that they obtain about customers -- through electronic tracking, for example -- is handled. Customers should not have to be in a state of uncertainty with respect to the question of integrity, and should not have to make a special request for this type of disclosure.

Regulation

The starting point should be an arrangement that ensures a necessary level of consumer protection without hampering positive developments in the new areas of technology. Systems that are based on the principle of the companies' assumption of responsibility and participation are to be preferred as long as this principle is adequate to ensure stability and safeguard consumer-protection interests. If a need for a special regulation is noted, the regulation should initially be coordinated among the EU countries. Work on a new directive is under way; among other purposes, it is designed to regulate the information that should be provided to a consumer before a contract is signed, as well as the consumer's right to change his/her mind.

Measures adopted by Finansinspektionen

The demands that should be imposed on the financial companies with respect to procedures for risk control, customer support and provision of information on the Internet field have been discussed comprehensively in the report. The conclusions presented in the report have given rise to the following measures by the Finansinspektionen.

Supervision. In order to be able to examine, monitor and evaluate operational risks, including IT risks, the Finansinspektionen has established a special risk-analysis unit. The new function, which becomes effective September 1, 2000, will direct attention to the risks associated with the use of the Internet by financial companies. However, work assignments will not be limited to examining existing risks. Since the pace of developments is rapid, while experience shows that the introduction of a new technology and new solutions causes vulnerability, monitoring and analyzing future trends from the point of view of risk involved will also be important tasks.

Ongoing monitoring and supervision, in the form of on-site checks, for example, indicate that the information and support provided by companies may not be adequate, or that it does not reach customers, for their attention and compliance. If problems are identified which are primarily the responsibility of some other public authority, this authority will obviously be contacted in order to solve the problem.

Regulation. As long as they are adequate to ensure basic stability and protect consumers' interests, systems that are based on the principle of the companies' assumption of responsibility are to be preferred. However, the possibility that supplementary standards and support and general guidelines may have to be issued by Finansinspektionen cannot be excluded. Taking internationalization into account, any new legislation should be coordinated among the EU countries.

Certification and quality control. Contacts will be established with the industry organizations that are affected, as well as with the Consumer Agency, for the purpose of exploring the possibilities of introducing a system similar to the TrustUK system in Great Britain. In discussions with industry representatives there is also reason to gain

refer to the fact that no special advisory agency in the securities field is available (to consumers). This "hole" in the financial-protection network for individual customers is becoming increasingly significant in a situation where large groups of customers are being encouraged to execute advanced financial transactions in the securities field themselves, via the Internet.

Consumer protection within the EU. Finansinspektionen will discuss with a number of parties – including the Consumer Agency, the Swedish Government and the European Commission – the formation of a network of virtual advisory-service and information agencies.

2. INTRODUCTION

2.1 BACKGROUND AND PURPOSE

A key feature of the new financial environment is the greater corporate use of internal IT systems in combination with various external networks. Linked via the Internet, these networks can be used for the distribution of services and for communications with customers. The solution gives companies greater potential for expansion and growth in trading in financial services, while simultaneously offering customers greater freedom of action when, for instance, they wish to seek financial information and develop self-service in areas such as payment services and securities trading.

Although this trend offers numerous advantages, it also gives rise to certain questions.

Firstly: The rapid pace of development. There is a risk that certain aspects of security solutions, customer support and customer information will be overlooked. Experience confirms that the introduction of new technology and new solutions for communications and trading entails vulnerability. Technical problems arise, traditional patterns for customer contacts change and customer confidence is affected.

Secondly: Corporate risk exposure is altered. Companies are exposed to new operational risks when business processes, computer systems and personal systems are continually revamped and developed. Consequently, IT and Internet usage imposes high demands on corporate analytical capacity and the ability to identify, measure and control operational risks. Operational risk refers to the risk of direct or indirect losses arising in a company due to disruptions in business processes or systems, faulty processing, breach of regulations or external events.

Both of these questions surrounding Internet use are highlighted in Finansinspektionen's report. The primary purposes of the report are to:

- present an overview of Internet applications in the financial area
- identify and analyze a number of key questions and problems.

The analyses and deliberations contained in the report proceed primarily from the customer's perspective and the requirements for attention and communication imposed by the new financial environment. It also contains discussions about the measures that could be introduced to strengthen customer confidence in the Internet as a communications technology.

2.2 METHODOLOGY

This report was drawn up by the Director General's Office, Policy and Coordination, at Finansinspektionen. It has been compiled using the following underlying material.

1. A survey encompassing 15 companies active in the banking, securities and insurance sector.
2. A compilation of the various experiences gained from Finansinspektionen's supervisory activities, for which an internal reference group has provided the underlying material.
3. Discussions with an internal reference group comprising:
Camilla Carlell, doctoral student at the Business Administration Dept, University of Stockholm, Henrik Kellnäs, IT consultant, Kerstin Osterman, corporate lawyer, Folksam, Maria Renmyr, head of the Board of Supervision of Estate Agents, Daniel Westman, doctoral student at the Dept of Legal Information, University of Stockholm, various players and industry organizations, Swedish Office of Science and Technology in Silicon Valley, Office of Fair Trading (U.K), and a written report by Camilla Carlell "Comparisons between a Human and Virtual World".

3. DEVELOPMENT OF THE INTERNET AND FINANCIAL SERVICES

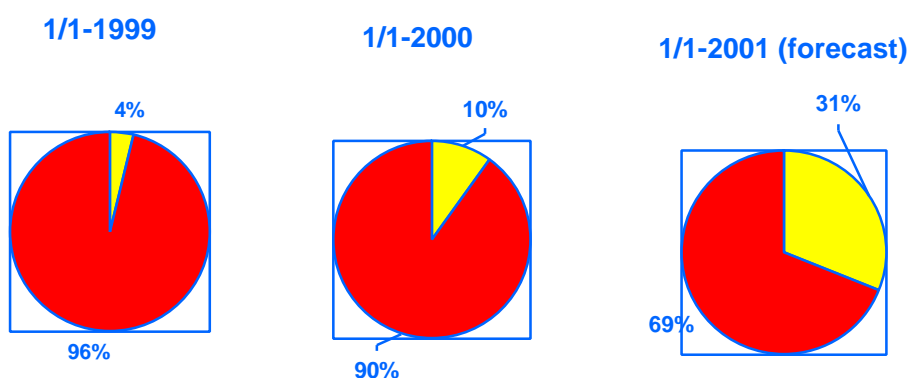
3.1 EMERGENCE AND EXPANSION OF THE INTERNET

The financial sector has undergone a considerable transformation in terms of markets and product offerings in recent years. Technological advances have influenced the range of services and led to superior accessibility for all major customer groups, notably through the development of services brokered via telephone and Internet. Self-service has become one of the key concepts.

The basis for the recent growth in Internet services was laid in the mid-1990s following the establishment of the World Wide Web. However, growth did not really accelerate until 1998 and 1999 when households gained access to home computers on a broad front. Suddenly, the right infrastructure was in place and thus the conditions were offered for broad groups of private customers to utilize a number of applications offered by Internet for advanced communications. According to the public opinion research company MMXI Nordic, some 50% of the Swedish population between 21 and 79 have connections to the Internet.

Finansinspektionen's survey of 15 financial companies confirms the impression that Internet usage by private customers is set to skyrocket. This applies, among other areas, to bank loans and deposits, which represent an important gateway for customers to various areas of the financial system. The survey indicates that the proportion of private customers that have concluded agreements with banks providing access to accounts via the Internet has increased threefold this year alone. The share is estimated to be almost 31% toward the close of 2000.

Figure 1. Percentage of private customers in banks with Internet links*

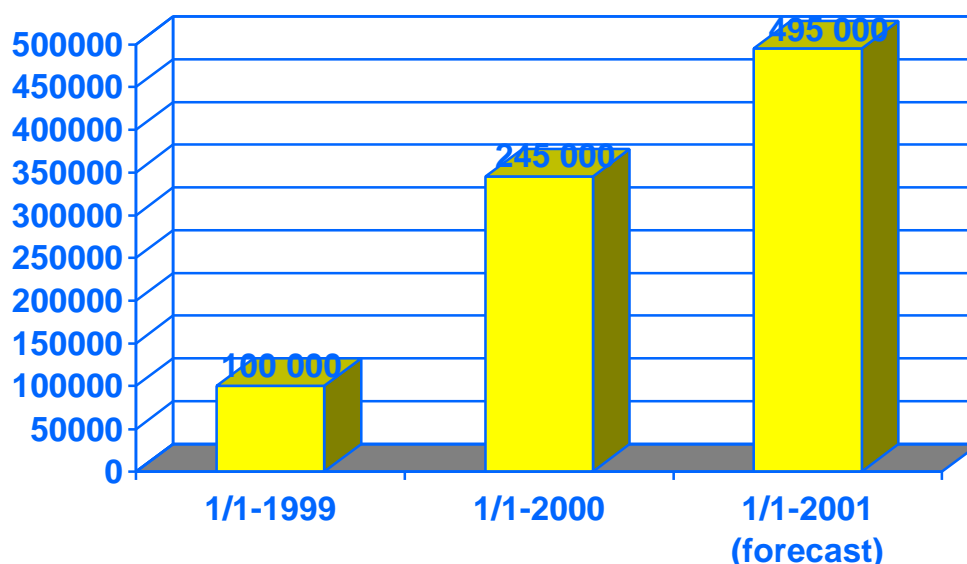


Private customers ■ with/ ■ without Internet connections

* The figures are based on the underlying material provided by Skandinaviska Enskilda Banken, Merita Nordbanken (the entire group), Svenska Handelsbanken, FöreningsSparbanken, SkandiaBanken and Sparbanken Finn

The significance of the Internet as regards trading in securities is rising also considerably. At the beginning of 2000, the companies in Figure 2 had link-ups to 245,000 customers. This figure is expected to rise to almost 500,000 by the end of 2000.

Figure 2
Number of private customers with agreements to conduct share trading via the Internet*



*The figures are based on the underlying material provided by Svenska Handelsbanken, Sparbanken Finn, Aktiespararnas Investering, E. Öhman Fondkommission, Teletrade Solutions, FöreningsSparbanken, Avanza, Erik Penser Fondkommission, Skandinaviska Enskilda Banken and SkandiaBanken

The Finansinspektionen's survey also shows increased transaction intensity, The total average number of settlements per day made by customers at the companies in Figure 2 was about 8,000 in the second half of 1998. The corresponding figure for the second half of 1999 has increased to 21,000.

For the insurance sector, the survey shows that the companies are active in marketing on the Internet of their own brand and a number of insurance products. Since continuing transactions and trading in services plays a subordinate role in the insurance area, priority is given to information. These companies are also about to build up various types of advisory services.

As expected, the Finansinspektionen's underlying material shows that links via the Internet have had the greatest impact in financial areas in which accessibility and

transaction intensity mean most. Certain innovative groups in the market have moved ahead of the majority of private customers in recent years. The current year marks the real breakthrough in Internet use.

The tendency to use Internet solutions does not yet apply to major corporate customers. Finance companies have developed Internet solutions for these to a minor degree. In terms of amounts, corporate transactions are larger than those of private customers, which increases the risk of intrusion and criminal behavior aimed at corporate payments flows, share trading and so forth. Also, the corporate sector has a large share of foreign payments. Security surrounding such information handling must be built up in another way than for private customers, and involve such aspects as authorization controls, identification routines and information traffic on the web. Consequently, links for major companies are built on networks other than the Internet.

3.2 RANGE OF INTERNET SERVICES

The range of Internet services is developing and changing rapidly. Accordingly, the account below presents only an overview of the various types of services currently offered consumers via the Internet. It is based on the replies the Finansinspektionen received from companies in the previously noted survey (Appendix 4).

BANKS

The following Internet services are offered by banks that provide their customers with services via the Internet.

Accounts: Customer may go in and check their balances in various accounts in the bank. Certain banks also offer the possibility to open accounts via the Internet.

Payment services: Customers can make transfers between accounts and pay bills.

E-invoices and e-giro are the designations for two different ways of handling invoices.

E-commerce: Certain big banks have begun to develop e-commerce sites by linking up corporate and private customers. In such cases, the banks offer corporate and private customers the possibility to establish contact and order the products of the bank's corporate customers.

Loans: Customers can download application documents from the bank's web pages. Some banks also offer the possibility to apply for loans through the Internet. However, an agreement is not concluded until the customer manually signs the debt instrument. In a memorandum of October 13, 1999, Finansinspektionen noted that since the main principle according to the Consumer Credit Act (1992:830) is that credit agreements shall be drawn up in writing, Finansinspektionen feels that, pending future regulations and practical guidelines, it cannot accept that the handwritten requirement is replaced by an electronic signature.

Securities trading: Customers are offered the possibility to sell and buy mutual fund units. Some banks also offer the possibility to conclude agreements concerning fund custodial accounts through the Internet and provide share price information. Customers can buy and sell shares through the Internet. Some banks also offer the possibility of concluding agreements covering share custodial accounts through the Internet.

Information: Customers gain access to highly extensive information. In addition to information concerning the bank's products and services, several banks also provide information concerning share prices, index trends and so forth.

Advice: The term advice is not unambiguous. As a guide, however, the act prohibiting professional advice in certain cases (1985:354) defines advisory services as operations "in which professional experts offer advice or other assistance to others in legal or financial matters". In the survey responses, several banks state that they provide advice, although the extent of this varies. Some banks state that they provide general private advice in financial questions while others almost exclusively focus their advice on market and corporate analyses in the securities area.

In the bank sector, traditional customer contacts via branch offices and postal services continue to dominate. The capacity of the office network, however, is limited and the possibility to service several customers simultaneously is considerably larger via the telephone and Internet. Finansinspektionen's survey shows that individual smaller banks already use the Internet as their dominant customer channel.

SECURITIES COMPANIES

The Internet-based operations of securities companies are, of course, focused on trading in securities. A number of other services such as lending, payment services and various types of information are linked to this.

Securities trading: Via Web-linked securities companies, customers can trade shares and other securities such as options, warrants and convertibles. The companies also offer their customers the possibility to sell and buy mutual fund units.

Advice: Only one of the respondent companies in the survey stated that it provided advisory services via the Net.

Share price information: Share price information is frequently somewhat outdated when shown on the screen.

Analyses: The companies usually provide their own analyses and those of others.

It should also be noted that certain banks and securities companies provide mobile services via wireless application protocol (WAP) and SMS. Although these services are available for use, the suppliers of the necessary technical support in the form of, for instance, mobile telephones have not provided the products in large numbers.

The survey responses regarding the securities companies' customer contacts showed that companies that are independent of the banks use the Internet as the overwhelmingly most common customer channel (with one exception). Of the total number of customer contacts, some 70–95% are via the Internet. Internet services are supplemented primarily by telephone services.

All the securities companies covered by the survey state that their customers have the possibility to conduct a transaction by telephone if the Internet service is down. Finansinspektionen has also imposed requirements to the effect that if the technical system fails, a customer should have the possibility to submit the order in some other manner.

INSURANCE COMPANIES

Information. The companies use their web pages to provide various types of information on life and non-life insurance policies.

Sales. A number of insurance companies currently offer their customers the possibility to conclude non-life insurance agreements via the Internet. However, none of the surveyed insurance companies conclude life insurance policies via the Net. One reason for this may be that, in the event of a dispute, insurance companies must show that the person insured is actually the policyholder who signed the application and can thus ascertain that the particulars provided are correct. In the report entitled "The Internet and Insurance" (1998:7), Finansinspektionen concluded "that the use and acceptance of what are referred to as digital signatures will gain special significance in the life insurance area and ultimately the burden of proof will be determined by a court of law pending possible legislation on the matter".

Not surprisingly, the insurance companies included in Finansinspektionen's survey reveal that the telephone is the primary channel for customer contact. One of the companies state that 25% of customer contacts are via the Internet, while in the case of the others only a small percentage of customer contacts was via the Internet.

INSURANCE BROKERS

Brokering. On September 16, 1999 Finansinspektionen registered the first insurance broker who planned to "broker" via the Net. Although this approval covered the brokerage of personal policies, it has now been extended to also include the brokerage of non-life insurance. In addition, a number of insurance brokers subsequently received approval to broker via the Internet.

Advice. An insurance broker who provides his services via the Internet must be able to fulfill the legal requirements governing insurance brokerage. These require that the web page through which brokerage is to be conducted shall include advice which, at a minimum, corresponds to that conventionally submitted to the customer.

3.3 NEW TECHNOLOGY GIVES RISE TO RENEWED INDUSTRY CONVERGENCE

An obvious advantage of the range of Internet-based services is that individual customers can act more freely in terms of information searching and choice of alternatives. An ever-increasing number of constraints are disappearing in financial-services trading. Technology is progressing and new e-commerce sites for both financial and non-financial services have emerged. Concepts such as industry convergence thus gain new and heightened implications. Financial companies do not only compete among themselves but also with telecom and Internet companies in moving customers out onto the Net and thereby providing information on products and services. In addition, the bank's range of financial services is supplemented by the marketplaces for non-financial services provided by the banks.

At the same time, companies are beginning to note other restrictions in the environment in which they work. Shortcomings in terms of customer time, attention and their ability to access the information and conduct transactions represent increasingly tangible constraints. When the competition for customer time and attention stiffens, companies will be compelled to invest larger resources in the marketing and development of the Internet-based sales modules – such as portals and proprietary web pages – that they use

* Portal is the term used to refer to the web sites that are, or want to be, starting points for web surfers.

The company's own web pages offer a presence on the web and the potential for direct interaction with the customer. The content of websites can vary from resembling an information brochure to giving full e-commerce capacity. Companies benefit from the already developed customer relationships and can encourage new customers to find the site, thanks to strong brands and attractive products.

Today, Swedish companies generally use business models in which the platform is their own web sites. There is also a tendency towards a more developed portal approach, whereby a broader product range and more suppliers are represented.

Nordbanken's Solo concept resembles a public portal that includes a marketplace for e-commerce. Via the portal, Nordbanken offers its corporate customers virtual shop space and payment solutions. The customer uses Nordbanken's portal as the starting point and can visit a number of companies, based on the department store model. The customer pays for any purchases and services directly from its account at the bank to the seller's account at the bank. Consequently, a prerequisite is that both the seller and the buyer have accounts in the bank.

Several other variations on the department store model exist in the Swedish market. One example is Etrade, which has signed agreements with a large number of mutual fund companies to broker the end-customers' purchases and sales of fund units. On their web sites, the companies offer customers the possibility to buy and sell fund units in the companies with whom they have concluded agreements. In addition, groups such as

SEB and Skandia market a range of funds that includes more than just their own fund products.

Certain web sites contain comparative information concerning certain specific financial products, such as housing loans and insurance policies. Customers are attracted to these sites through the offering of detailed information of an educational character, exhaustive price comparisons and the possibility to conduct certain types of transactions online. Examples of companies that provide various types of information and price comparisons are Jahaya.com and Goodguy.

4. COMPANIES AND THE INTERNET

Finansinspektionen has elected to highlight the more widespread use of the Internet from two points of departure. The account below presents findings and certain conclusions that have been drawn from the analyses, viewed from the corporate perspective. The consumer perspective is dealt with in Section 5.

4.1 NEW OPPORTUNITIES – FOR WHOM?

In the past decade, information technology has considerably influenced the output of financial services, resulting in new products, new distribution channels and greater automation.

As a communications technology, the Internet is well suited for financial companies since their customer operations largely involve information flows rather than physical goods. It is easier for new companies to establish a presence and e-commerce business, since the Internet is essentially not a particularly costly technology and is independent of the customer's technical infrastructure.

Several factors indicate that Internet utilization has a positive impact on competitors in the financial area. The Internet facilitates the establishment of new companies that can rapidly achieve geographic market coverage with a cost-effective organization. Naturally, the established players can and must utilize the same conditions for attaining higher efficiency. The number of employees in companies can be limited through, for example, outsourcing and the efficient use of the technology.

In the banking area, the signs of these processes are already becoming evident. The automation of services is progressing at a high pace. The number of offices is declining and cuts have been made in certain areas of the workforce. However, in this context, it should be noted that the focus on new technology simultaneously involves considerable investments in hardware, software and new recruitment.

A characteristic of the development is the emphasis on an increasing degree of self-service and an ever-larger transactions intensity in, for example, everyday payment services and securities trading. The current rapid expansion of Internet connections and applications in the banking sector and securities market hardly suggests that the map of the Swedish financial market is being redrawn. In terms of conventional gauges such as market share and customer base, the leading financial groups appear to be maintaining their strong grip.

So, are other changes more (perceivable)? Obviously the relationship between company and customer is being reshaped through the growing use of the Internet. Finance companies are being compelled to formulate entirely new strategies and develop new business models – and not just adapt their traditional services and sales sites. The

following quote from “The Banker” (March 2000) indicates expectations of more changes in the future:

“ When you hear a Nordic bank talking about its customers as “guests” and when it wants to be thought of as a “partner” not an “institution” and when it says it is marketing expertise rather than its own products and services, you know things are changing fast.”

4.2 RISK MANAGEMENT

Internet services give rise to operational risks among financial companies. Operational risk refers to the risk that direct or indirect losses will emerge in the company due to disruptions in business process or systems, incorrect processing, breach of regulations or as a result of external occurrences. In pace with technological progress, an increasingly important question is whether there is an increase in the extent of operational risks.

Operational risks can lead to direct costs:

- disruption due to external occurrences, such as sabotage, technical faults, processing failures, etc.
- reconstruction to rectify faulty systems
- compensation to customers or payment of deductibles in the event of various types of losses.

It can also lead to indirect costs or a loss of income when:

- operational disruptions or failures occur
- customer confidence in certain operations, technical solutions or a brand is undermined.

Modern financial companies who base their operations on the use of technology find it very difficult to protect themselves against events that can trigger these sequences and implications. Awareness that serious technical failures, trespass and sabotage can always occur, irrespective of systems and security solutions, mean IT strategies and IT security problems assume the status of central management issues.

Technical problems and computer failure are, of course, not a new phenomenon in the financial sector. Temporary halts in transactions in bank office networks or bank ATM systems occur occasionally. Neither are attempts to trespass the companies’ computer systems an uncommon occurrence. The current, rapid expansion of Internet use, however, means that companies are generally more exposed and more technically dependent than in the past. Also, it is more common to see the emergence of small niche players using mainly virtual alternatives for their customers, such as securities services.

With an ever-increasing number of links to the companies' internal systems and larger transactions volumes, there is greater sensitivity to disruptions and intrusions that can result in financial loss. In addition, there are capacity constraints and other conscious restrictions by companies in their dimensioning of their IT systems. These constraints may mean, for example, that customers are disconnected and are unable to act during shorter or longer periods. These disruptions frequently occur in sensitive situations involving severe fluctuations on the stock market, for example, for which accessibility and the ability to react have high priority among customers.

It is important to conduct a detailed analysis of the operational risks relating to IT and Internet use, not just for the companies' executive organizations but also for the company's boards, and for Finansinspektionen. It is hardly a bold forecast to presume that external analysts, rating institutions and shareholders will demand considerably better transparency and information as increasingly larger parts of the financial sector's earnings and expansion potential are linked to IT and Internet solutions.

Companies have several possibilities to manage these risks. These include:

- identification and measurement
- risk management, including risk coverage through insurance
- investment in security systems
- adjustment of capacity to meet increasing IT use.

In a memorandum dated December 10, 1999, Finansinspektionen formulated certain basic requirements for finance companies offering services via the Internet. These primarily affected the following four areas:

- Requirements governing contractual regulation of affiliation, product range and division of liability between company and customer.
- Requirements governing the so-called audit trail so that transactions undertaken can be reconstructed and followed up in the event of audits or claims.
- Requirements regarding relevant security solutions, including preparedness to meet disruptions.
- Requirements that all Internet players under supervision, including small niche players, offer their customers some other communication alternative, such as via telephone.

When market conditions change and develop, there is a need to revise and develop these requirements further. E-commerce is becoming ever more widespread, with more advanced features. The rapid emergence of almost exclusively virtual players in the international market with operations in several countries is also an important factor.

Finansinspektionen's general recommendations FFFS 1999:12 and FFFS 1994:36 covering internal control highlight the responsibility of corporate boards. Responsibility applies to overall operations, financial situation and risks. A healthy development of operations requires that the particular company designs and maintains systems for

control and monitoring of the risks that arise. As regards the development of IT systems, operations and management, Finansinspektionen's general recommendation is that the review function responsible for follow-up has access to the special expertise required in the area.

In the IT area, requirements regarding identification through various forms of risk analyses represent a key element. All risks cannot be eliminated and neither are there any definite security solutions available. The best situation entails that there is high risk awareness in companies along with continual, conscientious security work as reflected in risk analyses, risk reports and various contingency plans.

The problems that can arise during, for instance, extensive sabotage of IT systems or data trespass, can lead to immediate and extensive disruptions in operations. These risks can undermine market confidence in companies or result in disruptions that resemble liquidity risk. Attempting to solve these problems by means of solvency requirements is not effective, but nevertheless all corporate management and boards must be prepared for the various incidents that can arise – including very serious but unlikely events – and, on the basis of this perspective, discuss strategies and action alternatives in order to main continuity of operations and protect their own assets and those of their customers.

In brief, we can conclude that security questions are broad ranging and significant. The disruptions that can hit a company conducting advanced operations based on modern information technology, such as the Internet, are extensive. It is important to analyze the risks not just for the sake of companies' executive bodies but also to a great extent for the particular corporate boards, shareholders and customers, as well as for Finansinspektionen.

As regards security against unauthorized trespass, sabotage and other operational risks, the finance companies themselves make a relatively optimistic assessment of being able to control them. Corporate measures proceed from the security solutions and technology currently available. However, security measures must be gradually developed and adapted to match the particular circumstances and threat pattern for the particular company.

However, there are no definitive security solutions available. Consequently, a high risk awareness is required among companies, along with continual, conscientious security work.

4.3 MARKETING AND CUSTOMER RELATIONS

As shown by the earlier account, the Internet has become a significant marketing channel for most companies in the past few years. Traditional advertising of services and products is now supplemented by the circulation of information via the Web or the mass dispatch of e-mails. The cost advantages compared with traditional alternatives are obvious.

The development of technology has also opened up new opportunities to adapt marketing to suit various groups of potential customers and encourage them to personally seek information on products and services instead of passively receiving a certain message. International networks essentially make it possible for each organization to reach a global audience without having to move via traditional intermediaries (newspaper publishers, TV companies and so forth.).

In a report entitled "The Internet and Financial Services" (August 1999) Morgan Stanley Dean Winter claims that in the future one can expect that portals that comprise the starting point for many customers' visits on the net, will not only contain a broad product range but will also pool information for customers from competing companies who market competing products and services. Accordingly, the best portals can be expected to act as financial department stores in a true sense and also offer a cross-border product range among countries.

This does not mean that they need to be marketing channels for all types of financial services. However, the portals must include such a broad product range in one or a few segments that potential customers experience a degree of added value that they stay on for a closer look at the product line and return again when they require a financial service. If the customers do not experience this added value, they will quickly click to move to another website. Other ways of creating added value for customers is that the companies on the web pages offer education, analyses and advice in various forms.

Companies who limit their efforts to presentations and traditional marketing on their own website will, according to the Morgan Stanley analysis, encounter difficulties in making this concept sufficiently interesting and competitive to reach broad customer groups in future competition. An important conclusion is that a lack of customer time, attention and capacity to absorb information and conduct transactions will represent an increasingly tangible constraint for companies.

In this context, it is also necessary to emphasize that technical development does not in any way release the companies from other restrictions in operations, such as legal restrictions. Most countries have legislation that regulates how marketing is to be undertaken. In Sweden there are general, overall regulations contained in the Marketing Practices Act (1995:450). According to the Act, marketing should comply with generally accepted marketing practice and should otherwise also be appropriate vis-à-vis consumers and business people (§ 4, Paragraph 1). Generally accepted marketing practices refer to public standards as well as generally accepted formulation of practices in business and industry, such as the rules of the International Chamber of Commerce. Also, business people are compelled to provide information that is of special significance from the consumer viewpoint (Paragraph 2). More concrete rules governing information obligations are available in, for example, the Price Information Act and the proposed EG directive governing distance contracts involving financial services. In the insurance area, Finansinspektionen has drawn up stipulations governing information for life and non-life insurance (FFFS 1998:9 and 1995:32) which, among other things,

controls the information that insurance companies may give to customers before the contract is concluded.

The fact that an increasing number of people have access to the Internet, and that marketing via the Internet and e-commerce are developing, means that personal information transferred via the Internet is rising relentlessly. Essentially everything that occurs on the Internet gives rise to what are referred to as electronic trails. The Internet does not only increase the possibility to gather information, it also provides the conditions for processing information. Against this background, it is possible for companies to create customer profiles of those trading via these sales channels. Large amounts of information can be compiled and made available for instantaneous access. Information from various registers can be cross-referenced, making it easy to circulate personal information via the Internet to a wide audience.

The legal aspects that affect information processing and integrity are commented on from the customer perspective in the next section. It is interesting to note how the market values various business concepts on the Internet that are based on the companies creating and marketing detailed profiles of their customers. For example, Yahoo paid a vast amount to acquire Geocities (Web hotel). A decisive factor for the high valuation was probably that the membership profiles of Geocities were worth a few thousand kronor each.

* Internetworld, page 64, no. 10, 1999.

4.4 FINANSINSPEKTIONEN'S MEASURES

The monitoring of how companies develop the new information technology, distribution networks and customer relations represent the components parts of the general surveillance continually conducted by Finansinspektionen.

The task is to ensure that financial companies and markets function in an efficient manner that satisfies society's need for stability and individual customer demands for good consumer protection.

An important basis for this surveillance work is that the financial companies themselves always have ultimate responsibility for their operations. This responsibility is clearly expressed in Finansinspektionen's general recommendations regarding internal control and risk management. At the same time, it is evident that the requirements imposed on companies change continually in line with market development. Consequently, in the IT area in particular, there is a need to commence a closer dialog between the authorities and the various industry representatives regarding how responsibility can most appropriately be divided in the future. Finansinspektionen will establish such contacts to discuss the conclusions of this report and other matters.

In an effort to more effectively examine, follow up and evaluate operational risks, including IT risks, Finansinspektionen has set up a special risk analysis unit. The new

function, which comes into operation on September 1, 2000, will note the risks related to the use of the Internet by finance companies. Because the pace of development is rapid, plus the fact that that experience shows that the introduction of new technology and new solutions entails a certain degree of vulnerability, it will also be an important task for the function to monitor and analyze the future trends from the risk viewpoint.

What will result from the continuing dialog with the particular industry representatives and Finansinspektionen's ongoing studies is an open question. As long as it is sufficient to protect basic stability and consumer protection interests interest in the financial market, Finansinspektionen aims to retain the principle that self-regulation and solutions based on the companies' own acceptance of responsibility and participation is preferential. However, one cannot exclude the possibility that supplementary norms and support based on general guidelines from Finansinspektionen will be needed.

5. CUSTOMERS AND THE INTERNET

In almost all financial areas, customers can avail of services whenever they wish from home, workplace or any place of their choice. Market supply is characterized by increasingly sophisticated technical solutions and ever fewer restrictions. At the same time, new issues arise as regards market demand. Do customers have the attitude and capacity required by the new financial environment? How can companies meet the restrictions on demand as expressed by customers – primarily in the form of a lack of time and attention, as well as by a lack of confidence in the solutions marketed?

5.1 SECURITY

The initial reasoning of the Finansinspektionen regarding the vulnerability of finance companies must not be misunderstood by customers. All risks are relevant and must be noted but, viewed from the perspective of the individual customer, when he/she elects to conduct business via the Internet, security questions do not appear to be an obstacle. Acceptable protection for company customers against unauthorized trespass can be assured using current security technological and relevant information.

Nevertheless, a feeling of uncertainty and insecurity makes many customers cautious in using Internet services in the financial area. Security questions are high when customers are asked to rank their questions and problems. This factor must be taken seriously. No technical system is “completely safe” even although such claims are made unfortunately. Excessively vague messages to customers must be eliminated, otherwise an unnecessary loss of confidence occurs.

A better approach is that companies show greater transparency towards customers. One aspect of this is to clarify and describe the typical disruptions and faults than can arise. In this context, the implications for customers should also be described and alternative action recommended. The need for truth and consequences for the customer is particularly important to comply with if companies impose a concrete information disclosure responsibility and financial responsibility on individual customers. Since the division of responsibility is not predetermined, it is necessary to gain customers’ attention. They can subsequently be developed with correct and clear information regarding what applies in various situations.

An important question in the use of Internet services is how responsibility for unauthorized transactions is distributed. For example it is impossible to eliminate unauthorized trespass by hackers into digitally stored material in a bank that affects customers' assets. In this case, it can be established that the claims relationship between a bank and a customer with an account in the bank is affected only by authorized withdrawals. Consequently, the bank is liable for compensating the customer if a hacker manages to make a withdrawal from the customer’s account. Finansinspektionen imposes demands on so-called audit trails so that the transactions conducted can be reconstructed and followed up in the event of audits or claims.

Unauthorized transactions can also occur as a result of some unauthorized person gaining access to the customer's security package or code. What responsibility does the customer or company have for such transactions? A comparison can be made here with unauthorized transactions using charge cards. § 34 of the Consumer Credit Act (1992:830) regulates responsibility for such withdrawals. The idea behind the legal rule is that the risk of financial loss that arises if a charge card is used by an unauthorized person is primarily to be borne by the creditor/card issuer. This party has the greatest potential to limit risk. However, it is probably impossible to apply an analogous rule to Internet services. In the end, it is the task of a court to decide the division of responsibility in the event of unauthorized transactions on the Internet. As far as is known, there has been no legal examination of this situation.

Even though the question of responsibility has not been decided by a legal body, it is regarded as being the responsibility of the industry to clearly show customers how the division of responsibility – as the industry views it – is between company and customer. As in the case of charge cards, it is the industry that has the greatest potential to limit risk through the choice of security solutions.

However, it is not sufficient to provide information about the division of responsibility and risks in using Internet services. Customers should also have instructions regarding how they should act in order to minimize the risk of unauthorized transactions.

The earlier discussion regarding security pointed at various disruptions in communications between company and customers as being a problem. In this context, it is important that the customer is informed about any alternatives that are available and what responsibility the company assumes if a transaction cannot be conducted due to temporary technical glitches or capacity constraints. Awareness does not only require that customers are able to assess the risks in a certain business situation or using a certain strategy, but also that customers are able to monitor their rights vis-à-vis the company providing the service.

5.2 INTEGRITY

In principle, everything that occurs on the Net gives rise to so-called electronic trails that are possible to follow. The Internet does not only enhance the potential to gather information, it also provides the conditions for processing information. This can result in insecurity for finance company customers since the companies in many cases gain access to sensitive and, occasionally, confidential information.

Naturally, companies involved in Internet operations are compelled to comply with the regulations of Personal Data Act (1998:204) and the confidentiality rules in, for example, the Banking Business Act (1987:617). As regards the handling of personnel information, the responsibility for surveillance lies primarily with the Data Inspection Board.

The question, however, involves more than just strictly formal dimensions. There is a basis for taking up the integrity question on ethical and moral grounds. What, for example, is regarded as an acceptable standard in the financial area? From this perspective, the conclusion of Finansinspektionen is obvious. It is important that finance companies clarify for their customers how the information gained by the company about them, such as via electronic trials, is to be used. Customers should not have to be uncertain about their integrity and should not have to demand such information through special arrangements.

5.3 SUPPORT

In many cases, the use of the Internet means that customers themselves conduct services that were previously done by trained personnel. This self-service imposes special demands on the ability of customers to handle the new technology and on their financial know-how as regards the nature of the services, and risks, etc. Personal contact between the customer and company is diminishing. This means that customers increasingly need to interpret the information provided by companies on their websites. In addition, the Internet can give customers a feeling of distance and anonymity. The impression of the contracts concluded across the net and their content can shift. The feeling of responsibility and reality may be reduced.

Even though responsibility and contact are experienced in a different manner via the net, the range of services are not always developed and adjusted to meet the conditions. In principle, any body can personally conduct highly complex and risky transactions. The attractive price pattern and easy accessibility associated with the Internet also means that new, less experienced customer categories become more frequent users in an increasing number of product areas on the net.

The conclusion is not that customer freedom of action should be limited. Instead, there is a greater need for information and support.

Authorization is accompanied by a certain responsibility for the services offered by the company. This responsibility entails a certain minimum level of support. This is not just a matter of generally providing customer support in the form of guidance, assistance and support as regards, for instance, technical or product-specific issues. In conjunction with the introduction of new services, it is extremely important for the company to consider whether the design and the demands imposed on the customers when using the services are such that special support is required in some form. It is not enough to subsequently follow up and check whether customers encountered any special problems that need to be rectified.

The support function is very important when relationships between customers and companies are being developed. The function represents a decisive competitive edge but is increasingly becoming a key instrument in product and quality development work in which companies learn from their customers. The importance of such information and re-linking is particularly great in the Internet area where past experience is limited and

future development is moving very fast. One must count on problems and events that may be difficult to predict.

5.4 ADVISORY SERVICES

Advice provided via the Internet will be increasingly common in the future. As companies increasingly use the Internet to educate and train their customers in various types of financial matters, it will also become more difficult to draw a clear line between what constitutes provision of information and what is advice.

In certain respects, circumstances on the Web differ from the situation in which advice is provided in a personal meeting between the customer and the adviser.

When providing advice in the traditional oral manner, the adviser has an opportunity to interpret the customer's specific needs and hence arrive at a joint solution which is tailor-made to meet the customer's individual prerequisites and preferences. The adviser has an opportunity to adopt a flexible approach to any predetermined patterns and models, and can also guide the customer if the adviser notes that the customer is about to make a decision which is inappropriate in view of his or her financial situation.

In the case of advisory services via the Internet, there is less opportunity for a personal interaction and mutual dialogue, irrespective of whether the information/advice is provided via e-mail or the company's Web pages. The latter form of advice is of particular interest. This may take the form of an indication by the customer of his/her "profile" on screen. The customer then receives alternative proposals on a standard template prepared by the company consisting, for example, of high, medium or low risk alternatives. It is then up to the customer to make a choice, and perhaps implement it, without having a dialogue with trained personnel.

One rather obvious conclusion is that the lack of oral dialogue on the Internet makes special demands on the information provided. The customer must be clear about the relevant prerequisites and limitations, right from the start. Is the customer merely receiving general information about the available alternatives? Is the advice restricted to the company's own products or is it provided on an independent basis? Which companies' products are represented in a marketplace? What are the parameters applied? Are advisory services covered by liability insurance? In addition, it is desirable that the customer has an opportunity to understand the differences in the degree of risk which the various alternatives may involve.

5.5 INFORMATION

The self-service concept is based, in principle, on the assumption that customers know "everything" about the services offered, operation of the computer and the restrictions which may apply, depending on the market infrastructure and the "rules of the game". The self-service principle assumes that there is an effective flow of information in

various phases of the e-commerce process. Such information may also involve the handling of payments, collateral requirements, etc.

The Internet has considerable potential as an information channel. Companies can use the Internet to supply information in a well-structured pedagogic manner, at the right time and to a wide group of customers. The possibility of providing explanations in an interactive form also creates excellent opportunities for drawing the attention of customers to new or amended conditions and terms.

It should be noted, however, that the Internet does not, per se, facilitate the company's information assignment. The provision of relevant, complete and correct information on the company's Web pages is not sufficient to make the Internet an effective information channel. The information must also be systematized in a user-friendly manner from the customer's viewpoint. Web pages which are organized in an unpedagogic manner and which oblige the customer to search on various pages to get all the relevant information result in uncertainty about whether or not all the relevant information has been received. Naturally, this also applies when the customer receives information on paper.

The Internet also increases customers' need for information in the form of feedback. In the case of transactions, customers need more than a confirmation – they also need to know that the transaction has not been implemented prior to receipt of confirmation.

5.6 CERTIFICATION OF WEBSITES

From the consumer point of view, it is essential that attention is drawn to players who fail to comply with sound business practices, that false information can be countered by correct information, and that the information provided on websites issued by financial companies is monitored and checked in an effective manner. In a market which is changing rapidly, a safety net of this kind must be developed progressively and consistently, on a long-term basis. There are no simple solutions or short cuts.

Attempts to create "lighted streets" for consumers on the Internet, linked to the Web pages, portals, etc. of reputable participants is one interesting alternative in this context. In Great Britain, this principle has been applied by TrustUK (www.trustuk.org.uk), an industry body which is supported by the British government. One of TrustUK's functions is the certification of companies that meet the codes of conduct established by the industry and approved by TrustUK. TrustUK's own website will contain a list of companies that it has approved, links to these companies and a checklist of items that consumers should verify before they enter into agreements on the Internet. There are similar bodies in the US, for example TRUSTe (www.truste.org).

Consideration should be given to the prerequisites for establishing a similar body in Sweden. The TrustUK structure, which is based on the self-regulation principle, is reminiscent of the Swedish Consumers' Banking Bureau and the Consumers' Insurance Bureau. As a result, one alternative to the formation of a new body might be to extend the responsibilities and resources of these two bodies to include certification and

monitoring of the information provided on financial companies' websites. A solution of this nature might also include an assignment to counter false information on the Web by providing correct information.

A body established to perform the duties indicated above would require assistance, from public authorities, for example. The most rational solution would probably be for assignments in the financial area to be conducted jointly for all subsectors in the financial industry. If it proves that the prerequisites for a comprehensive solution of this nature cannot be achieved, attempts should be made to find other ways of developing standardized requirements and introducing joint certification symbols/labels. In this case, it is important to clearly indicate which body or bodies issue certificates, and the purpose of certification. A company supplying financial services in several areas may, in fact, have more than one certification body if this type of system is employed.

5.7 VIRTUAL NETWORKS

There are several reasons for supposing that the internal market in the EU will develop considerably in the next few years. The common currency, the euro, is expected to have a strong impact on corporate structures in various industries when national borders are penetrated and companies start to redefine what constitutes their domestic markets and their potential customers.

The EU is in the process of establishing common rules and guidelines for the choice of legislation, supervision, provision of information, settlement of disputes, etc. Finansinspektionen regards this as necessary but insufficient. A systematic focus on the certification of Web pages and additional consumer information would be a highly important factor in the integration of private-sector markets in the EU countries, for example, and would result in greater confidence in cross-border trade.

The potential offered by the Internet in this respect should be studied more closely, with the aim of improving consumer information. Establishing a common network of virtual information and advisory bureaux is one way of doing this. The technical prerequisites for a network of this type are excellent. In addition, people trading on the Internet also have access to information supplied via the Web.

A network such as that described above might involve a common portal for all member countries. Consumers would then be able to move on to the Website for the advisory bureau of their choice. The web pages of these bureaux – in the various EU language options – would contain simple, clear information about the rules, arbitration bodies, supervisory authorities, etc. in the country concerned. It would be advantageous from the consumer viewpoint if the Web pages for the various bureaux were structured in a similar manner.

There would appear to be almost unlimited potential for a network of this nature. In addition to customary information in the various EU languages, including consumer

information, the bureaux would be able to provide correct information to counter false information on the Web.

Finansinspektionen's certification proposal, which is discussed above, is also relevant in this context. One of the tasks to be fulfilled by the bureau or bureaux in each country might be monitoring and certifying company websites based in the country in which the bureau concerned conducts its operations.

5.8 REGULATION

Discussions are under way in many countries regarding the extent to which new legislation is required, or existing legislation can be amended, and also the degree to which self-regulation can be relied on. The Swedish Office of Science and Technology issued a report in 1999 entitled "Electronic commerce – legislation and regulations, a global study." The report indicates that the common view –in the US for example – is that self-regulation should be trusted, in the sense that entities other than the government formulate any rules that are applied, and that "unnecessary restrictions" which might interfere with market forces should be avoided. Self-regulation has become particularly important in the US in legislation regarding integrity. The US also has reached mutual agreement with Japan about electronic commerce. The main features of the agreement are that the private sector should lead developments in the e-commerce area and that the number of statutory provisions should be minimized, as far as possible.

The Japanese are aware of the risks of excessive scope for self-regulation, however. One danger is that companies which do not participate in the process may be excluded. Another risk, it is claimed, is that a phenomenon which is totally controlled by the industry is unlikely to gain consumers' full confidence. Instead, some form of joint regulation is proposed. The major Japanese trade associations have an important part to play in preparing guidelines which can be approved by both companies and consumers.

Self-regulation is also an important factor in Great Britain. The industry is developing codes of conduct approved by the Office of Fair Trading and TrustUK (see Section 5.6).

France considers that statutory rules are needed, but that a new regulatory structure specially adapted for e-commerce is not required. The French consider that existing legislation should be amended instead.

What should the Swedish attitude to regulation be, in this context? One of the fundamental requirements should be a structure that guarantees an essential level of consumer protection without inhibiting beneficial developments in new technology areas. A regulatory structure should be essentially based on the principle of responsibility exercised by companies themselves, providing this is sufficient to safeguard fundamental stability and consumer-protection interests. If it is considered that special regulations are required, they should be primarily coordinated for the entire EU Internal market. In point of fact, the European Commission has been preparing a directive for some time concerning the distance selling of financial services to

consumers. The question of whether the directive should aim for full harmonization or should be a minimalist directive is controversial.

The global nature of the Internet tends to strongly favor a harmonization directive. Consumers will be offered services by foreign players to an increasing extent. As a result, ensuring fully satisfactory consumer protection under national legislation is not feasible. Different rules also involve considerable difficulties for both customers and companies. It is not sufficient to be familiar with the rules in a given domestic market. There is considerable risk that consumers will believe, for example, that they have the same protection when buying from a foreign company as when they make a purchase in their domestic market. Another reason for harmonization is that financial groups increasingly contain companies with their registered offices in different countries.

Considerable time is often required to prepare EU directives. The protracted nature of the process is a problem if a need for special rules to protect consumers is identified. In this case, it may be necessary for Finansinspektionen or the Swedish Consumer Agency to actively promote industry agreements that apply until a possible EU directive is issued.

Consumers within the Community are also offered services by companies outside the EU, however. It is the EU's task to achieve agreement between member countries regarding joint European positions that can be presented in various international negotiations. Joint standpoints facilitate the task of trying to develop a global regulatory structure.

5.9 MEASURES TO BE TAKEN BY FINANSINSPEKTIONEN

Ongoing monitoring and supervision, in the form of on-site checks, for example, indicate that the information and support provided by companies may not be adequate, or that it does not reach customers, for their attention and compliance. If problems are identified which are primarily the responsibility of some other public authority, this authority will obviously be contacted in order to solve the problem. Joint, active efforts of the part of the industry and the relevant authorities are required to ensure the provision of satisfactory information to consumers in the Internet sphere.

Finansinspektionen will contact the relevant trade associations concerned and the Swedish Consumer Agency to investigate the possibilities of developing a solution similar to TrustUK in Great Britain. In discussions with industry representatives, there also appear to be grounds for reminding them that there is no special advice bureau in the securities sector. This "loophole" in the financial protection net is becoming increasingly critical at a time when broad groups of customers are being offered the possibility of personally implementing sophisticated transactions in the securities sector on the Internet.

Finansinspektionen will raise the question of the establishment of a network of virtual advice and information bureaux with various parties, such as the Swedish Consumer Agency, the Swedish Government and the European Commission.

6. INTERNET AND THE EU

6.1 PROPOSAL FOR A DIRECTIVE

PROPOSAL FOR A DIRECTIVE REGARDING DISTANCE MARKETING OF CONSUMER FINANCIAL SERVICES

Within the EU, work is in progress to produce a Directive regarding the distance marketing of financial services to consumers. The most recent official proposal (KOM/1999/385 final) was presented on July 23, 1999. According to this proposal, the plan is that there will be a so-called maximum harmonization directive (Point 9 in the preamble). However, this is just one of many controversial issues.

According to the proposal, "Financial service" pertains to all bank, insurance, investment and payment services. The proposal defines "Distance contract" as a contract for financial services that is entered into between a supplier and a consumer within the framework of a system for distance marketing, or the provision of services at a distance, which are organized by the supplier and which, for the purposes of the agreement, are based exclusively on technology for communication at a distance up to that point in time when the contract is entered into, and during the actual commencement of the contract. According to the proposal, "Technology for communication at a distance" relates to any technology that, without the physical simultaneous presence of the supplier and consumer, can be used as the basis for entering into a distance contract between the parties concerned. Accordingly, the proposal is not confined exclusively to Internet services.

It is not possible to provide any more detailed report on the content of the proposal in this document. Briefly, however, it can be stated that the proposal for a Directive is intended to regulate various issues in the following areas, among others:

- Information to the consumer before a contract is entered into
- Transfer of agreement terms and conditions and advance information
- Right of withdrawal after contract is signed
- Fulfillment of contractual terms and conditions and payment for services provided prior to withdrawal right being exercised
- Payment by card
- Messages that have not been requested
- Burden of proof

It can be noted that in a statement regarding the proposal on September 2, 1999, the Finansinspektionen claimed that many consumers would probably not feel confident in having to perhaps communicate with a company in a foreign language. To a certain extent, this uncertainty could be alleviated by the company presenting information on its website pages in different languages, for example, refer to: www.citibank.com. However, the presentation of information in different languages is not the same as the consumer being able to communicate with the company in all these languages.

Accordingly, in its statement, Finansinspektionen took the view that the text in the Directive should be supplemented by the company undertaking to provide information about where and through which medium a customer can turn for assistance on any questions and/or complaints, and specify in which language the questions should be answered.

In regard to complaints, the Finansinspektionen has on several occasions underlined the importance of companies handling such matters in an effective manner. The significance of efficient complaints handling is perhaps even greater in the case of cross-border trading. One way for commerce and industry to actively work towards the achievement of greater cross-border confidence would be to provide smoothly functioning routines for the handling of complaints. A company that offers special contact functions and undertakes to process and respond promptly to complaints within specified times is guaranteed to win the confidence and respect of customers within and outside its home market.

According to the proposal, the directive is to be incorporated in the national legislation by no later than June 30, 2002. However, since work is still in progress on the directive, it is difficult to comment on the final content.

PROPOSAL FOR A DIRECTIVE ON CERTAIN LEGAL ASPECTS OF INFORMATION SOCIETY SERVICES, PARTICULARLY ELECTRONIC COMMERCE IN THE INTERNAL MARKET (DIRECTIVE ON ELECTRONIC COMMERCE)

Work is in progress within the EU to produce an E-Commerce Directive regarding certain legal aspects relating to services provided within the information society, particularly electronic trading in the internal market. The proposal contains regulations aimed at facilitating e-commerce in the internal market through the introduction of uniform rules designed to promote a free flow of "information society" services between the member states. The proposal should cover the entire range of services offered to consumers via the Internet. Special attention should be paid to the following points in the proposal.

The member states shall ensure that their national laws allow contracts to be entered into electronically; furthermore, member states may not hinder the use of electronic contracts. The supplier of services is obligated to inform the user about the criteria and forms involved when entering into electronic contracts. As a result, there should be no doubts remaining about when a contract is entered into or how this is practically effected.

The proposal includes a provision about which country's law a supplier of services shall follow. In principle, this means that the country in which the supplier is established shall exercise control over the service supplier's operations and shall ensure that they conform to the national regulations applied in that member state. Similarly, the member states may not restrict the free operation of those information society services that originate within another member state.

The suppliers of services are obligated to provide users with the name, address and other details about where the company is established (including e-mail address) and how contact may be made with the provider of the services.

6.2 ELECTRONIC SIGNATURES

Within the EU, an EG Directive has been produced for a common framework for electronic signatures. The regulations in the Directive are based on electronic signatures that conform to the open-key system. This includes mainly regulations on the commercial rights of those parties who issue certificates, but also regulations on liability for damages and on the legal framework for electronic signatures.

6.3 SUPERVISION AND CHOICE OF LAW

The Internet makes it possible for consumers to use their own computers to enter into contracts and purchase products from foreign companies. This leads unavoidably to questions being raised in regard to the responsible supervisory authority for cross-border trading and which country's laws should be followed in the event of any disputes.

Supervision. For companies conducting financial operations within the EEA, one operating license is sufficient. The underlying idea is that companies that have been authorized to conduct operations shall be able to use such authorization as a basis for conducting the same, or part of the same operations, in another member state, either through the establishment of an affiliate or via cross-border operations. However, the company is mainly subject to supervision by the supervisory authority in the company's home country. In both instances, the company shall inform the home country supervisory authority about any planned cross-border operations. If the home country authority has no objections to raise of its own, it shall pass on the information provided by the company to the host country's supervisory authority.

The above principles were formulated prior to the breakthrough of the Internet and are thus not adapted to take into account the potential now offered by the Internet. For example, the Internet makes it possible for a consumer to visit other websites of companies in other member states and order products or services. It has not been established within the EEA whether this constitutes a cross-border operation. Within the EU, however, work is continuing to try and establish clear rules in this area.

Choice of law. In the insurance area, the question is to identify the contractual legislation that should be applied uniformly within the EU. The provisions are implemented in Swedish law through an Act (1993:645) regarding appropriate law for certain insurance contracts. As a main rule, life insurance is governed by the law of the country in which the insured party is domiciled or conducts operations. Non-life insurance is subject to the law of the country where the risk is located, if the insured

party is normally domiciled or has corporate management operations located there. No such corresponding choice of law alternatives exist in the bank or securities area.

The Finansinspektionen does not consider it necessary to provide any more detailed report on the prevailing choice of law regulations. These are addressed in detail in the report on the study into consumer rights in the IT society (SOU 1999:106).

In brief, it can be concluded that in Sweden's case the issues are mainly governed by international conventions applied by the EU member states. The core conventions (for example the 1980 convention on the applicable law for contractual obligations) contains special regulations designed to protect the consumer. However, the conventions were formulated prior to the Internet and the consumer protection regulations that exist are not always appropriate for the services provided via this new technology. Considerable uncertainty surrounds the questions of how to interpret the special conditions laid out by the conventions for the consumer to refer to the laws and legal processes in the courts of his/her home country. In the study referred to earlier, it is proposed that in the international work in progress in this area, Sweden should work towards achieving a simplification of the rules in order to strengthen the consumer's position.
