

INTERNATIONAL LAW ASSOCIATION

NEW DELHI CONFERENCE (2002)

COMMITTEE ON INTERNATIONAL MONETARY LAW

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15 January 2002

Introduction

A. Activity of the Committee 2000-2002

Since the London Conference of the ILA in July 2000, the Committee (generally known under its acronym MOCOMILA) has held two meetings: in Oslo (11-12 May 2001) and in Florence (1 December 2001). The topics discussed in the Committee are set out in sections 1 to 5 hereafter.

Section I of this report, by Prof M Giovanoli, addresses developments in the field of international financial standard setting, following upon the report presented to the London Conference in 2000. Section II, by Dr K P Follak, discusses developments in the international harmonization of the regulatory and supervisory frameworks, in particular the current review of the Basel Capital Accord and developments in EU regulation. Section III, Part A by A Sáinz de Vicuña and Part B by Prof J V Louis, collectively addresses monetary law developments in the context of European Economic and Monetary Union and the external representation of EMU. Section IV, Part A by A Sáinz de Vicuña and Part B by T C Baxter, Jr, reviews developments in the fields of electronic money, e-banking and e-finance in the EU and the US respectively. Finally, Section V by Prof Mario Giovanoli reports on recent developments regarding international cooperation in the fight against terrorist financing. This report reflects the views of the individual rapporteurs and not necessarily those of any institutions with which they are associated.

The Chairman also wishes to acknowledge the assistance of two BIS staff members, namely P.F. Panchaud and J.H. Freis, Jr, in drafting and editing various parts of this report.

In all these areas, international monetary law is evolving rapidly. The Committee considers that it is important to continue to follow carefully future developments in this field, although no specific resolutions are being submitted to the ILA New Delhi Conference.

B. Seminar on “Dollarization”, Currency Boards and similar arrangements

The Committee is organising, in cooperation with CEMLA (Centro de Estudios Monetarios Latino-Americanos) and with the support of the Bank for International Settlements, a seminar destined for central bank lawyers on the topic *Legal Aspects of Currency Boards, “Dollarization” and Similar Arrangements* in Mexico City. This seminar, which was originally scheduled for early October 2001, had to be postponed following the events of 11 September 2001 and is taking place on 14-15 February 2002. The following issues will be addressed, with the participation of a number of external experts:

Issues at Stake

Overview, typology and history of arrangements involving the adoption of, or the linkage to, a foreign currency (*Mario Giovanoli*)

Economic and financial background of currency boards and dollarization (*Charles Enoch and Anne-Marie Gulde, IMF*)

“Host” Country View; Bilateral and Multilateral Arrangements

Dollarization: legal aspects of the adoption of the US dollar in the Ecuadorian monetary framework (*Diego Regalado*)

Currency board: the Hong-Kong experience and its legal aspects (*Stefan Gannon*)

Convertibility law: the Argentine experience (*Rolando Llamus*)

A bilateral monetary treaty: Switzerland-Liechtenstein (*Peter Klausner*)

A multilateral monetary arrangement linked to a foreign currency: the BEAC experience (*Samuel Gako*)

“Home” Country View and International Law

The US approach (*Thomas Baxter*)

The European approach (*Antonio Sáinz de Vicuña*)

An International law view (*Michael Gruson*)

An IMF view (*François Gianviti*)

Lender of last resort responsibilities (*Cynthia Lichtenstein*)

Specific Aspects

Impact on Payment Systems (*Thomas Baxter*)

Changeover issues (*James H. Freis, Jr*)

Private law and conflict of laws issues (*William Blair*)

Concluding Remarks

A challenge to monetary sovereignty? (*Mario Giovanoli / Dominique Carreau*)

Section I

International Financial Architecture:

Legal Aspects of International Financial Standard Setting

Since the year 2000, the international financial architecture went through a period of consolidation. No new entity was added to the number of international bodies (international organisations, committees of experts, or others) involved in the development and the implementation of international financial standards, which play a crucial role in the prevention of international financial crises (for a comprehensive overview of this issue, see report of the Committee on international monetary law to the ILA London Conference (2000), section I, as well as Mario Giovanoli, *A New Architecture for the Global Financial Market: Legal Aspects of International Financial Standard Setting*, in: *International Monetary Law, Issues for the New Millennium*, edited by Mario Giovanoli, OUP: London 2000, 3-59). Although the very decentralised structure of the bodies involved in IFS-setting was not significantly rationalized or streamlined, the very important contribution of the Financial Stability Forum (FSF), established in 1999 to improve coordination among those bodies, needs to be underlined. In particular, the FSF pursued its activity in assessing vulnerabilities affecting the international financial system and in reviewing the implementation process of the IFS's (see www.fsforum.org).

A. New substantive International Financial Standards (IFS's)

Most of the IFS-setting entities actively continued their work and published a number of documents, which are available either directly on the FSF website or through the links which are provided on that site to the relevant IFS setting bodies. It is sufficient to highlight here a few selected developments:

- the Basel Committee on Banking Supervision (BCBS) pursued its consultations on The New Basel Capital Accord of January 2001 (see section II A of this report). Furthermore, the BCBS published in October 2001 an important document on Customer Due Diligence for banks;
- in October 2000, the IAIS (International Association of Insurance Supervisors) published its revised Insurance Core Principles, originally issued in September 1997, together with its Insurance Core Principles Methodology;
- on 1 January 2001, the CPSS (Committee on Payment and Settlement Systems) published the Core Principles for Systemically Important Payment Systems; the CPSS also published, both in November 2001, Recommendations for securities settlement systems as well as its Survey of electronic money developments (see also section IV of this report);
- in September 2001, the FSF's working group on deposit insurance published its report Guidance for developing effective deposit insurance systems, meant to assist countries wishing to introduce such systems and fostering their introduction everywhere;
- following the events of 11 September 2001 the FATF (Financial Action Task Force) supplemented its 40 Recommendations on money laundering (originally issued in 1990 and revised in 1996) with 8 additional recommendations specifically dealing with the fight against terrorist finance (October 2001), see section IV of this report.

More generally, it is interesting to note the shift towards distinguishing the most fundamental standards (the so called "Core Principles"), at present 12 sets published as such by the FSF from among the great number of IFS's. Not only does this approach help prioritise the most essential standards which need to be implemented first, but it also contributes to ensuring a greater coherence among the great number of IFS's (the more specific often referring back to the relevant Core Principles) and thus enhances the legitimacy and acceptance of the whole process.

B. Progress regarding the methodology for developing IFS's

It appears that significant progress was made with regard to the process for developing IFS's. In this respect, the problem is to ensure an appropriate balance between maintaining a viable size for the working groups drafting the standards, on the one hand, and ensuring a broad consultation of all interested parties, on the other hand. Indeed, if the working groups and committees were to be too large, it would seem difficult to establish in an acceptable time frame standards which are more than the least common denominator; in other words, the danger is that both the contents and the process of developing standards would be watered down whenever too many participants are included in the working groups. Conversely, it is important to take into account the concerns of a great variety of markets which might be affected by these standards and to submit standards to a broad consultation process in order to ensure a wide degree of acceptance ("ownership").

In this respect, two examples are noteworthy. First, The New Basel Accord, drafted by the Basel Committee on Banking Supervision, went through a very extensive and nearly worldwide consultation process. This consultation not only involves national authorities and supervisors of a great number of countries, but also extends to private sector participants and to the banking industry at large. Second, the Guidance published by the FSF's Working Group on Deposit Insurance was developed through the preparation of a series of discussion papers and a consultative process that involved over one hundred countries, thus drawing heavily on the practical experience of its members and other countries. For this reason, the Guidance is reflective of, and designed to be adaptable to, a broad range of country circumstances, settings and structures.

This broadening of the consultation process at the international level is in line with similar processes known in various, but traditionally not in all, countries concerned. This international approach helps in spreading around the world similar practices which are also applied at the EU level. Through the inclusion of market participants and the general public, it fosters the accuracy of the suggested standards and also facilitates the development of professional market associations, which in turn contribute to financial stability.

C. Progress regarding the implementation process of IFS's

In the absence of an international legislative body or of any sort of world financial authority (as advocated by some, see John Eatwell and Lance Taylor in *Global Finance at Risk*, New York, 2000), the IFS's developed at the international level are mere recommendations and are not, as such, legally binding. They can only be implemented at the national level, within the jurisdiction of each sovereign state. This implementation can take various forms: a number of IFS's need to be incorporated into national legislation at various levels, others are to be taken into account in the administrative practice of a variety of national authorities (particularly supervisors), finally, others are to be applied as good practice (standards or codes) by banks and financial service providers themselves.

Ways and means to foster implementation of IFS's at the national level have continued to be thoroughly explored by the Financial Stability Forum (FSF), particularly by its Follow-Up Group on Incentives to Foster Implementation of Standards, which delivered its final report in September 2001; this was a follow-up to the report of the Task Force on Implementation of Standards of 15 March 2000 (both available on www.fsforum.org).

It has become customary to distinguish between "official incentives" (through the action of international organisations, international groups of experts or national authorities), on the one hand, and "market incentives" (through reactions of market participants), on the other hand. As regards the former, the role of the IMF and of the World Bank is crucial, as these institutions monitor the implementation of IFS's through their Reports on the Observance of Standards and Codes (ROSCs) and Financial Sector Assessment Programs (FSAPs), as well as within the Art. IV surveillance process of the IMF (see www.imf.org). During the period under review, the number of ROSCs, FSAPs and Article IV consultations relating to the implementation of IFS's has considerably increased, and the majority of them have been made public. It is particularly important to note that these reports deal not only with emerging economies, but also increasingly with industrial countries, thus evidencing the aim of universal applications of IFS's. This development shows a commitment by the industrial countries to practice what they preach (in the literal as well as figurative sense since they dominate the IFS development process) and no doubt fosters the sense of "ownership" of IFS's, and thus their broader and hopefully worldwide acceptance.

Peer pressure within groups of experts has established itself as another type of official incentive for the implementation of IFS's. While this approach seems unproblematic to the extent that countries are represented in specific groups assessing the implementation of standards and have often explicitly accepted to be subject to this type of assessment, this is less evident for countries which are not members of such groups. Not only are there questions regarding the acceptance of such assessments, but even their legal basis is unclear, particularly when the results of these assessments are published (sometimes even without prior consultation of the countries concerned), particularly in the form of lists classifying the countries as being more or less cooperative with regards to the implementation of some international standards. This is not to say that implementation of such standards is not desirable and even essential (e.g. in the context of money laundering and terrorist finance), but the assessment procedures should no doubt be further improved.

Another type of "official incentive", this time at the national level, is when the supervisors of a given market subject access to this market by foreign financial service providers to the condition that they are subject to reliable supervision in their respective home countries, including the observance of standards and codes of good practice. If this is not the case, the host country market authorities would require further specific conditions to be fulfilled before granting access to their market. This type of approach is in itself wholly legitimate and probably one of the most efficient; however, it is necessary to ensure that national authorities do not impose unreasonable conditions, which might not be in harmony with good international practice and international rules on conflict of jurisdictions.

Attention should be drawn to the implementation process of IFS's within the European Union through legally binding directives, which impose upon member States the obligation to take appropriate measures in order to reach specific results with regard to the implementation of IFS's, while leaving a certain leeway with respect to the legislative and administrative means through which these results are obtained in each national jurisdiction. It would be interesting to research further to what extent a similar process could not be applied, on a voluntary but well structured basis, at the international level.

Finally, on specific aspects of the implementation of IFS's in an important emerging economy, two particularly enlightening speeches held on 12 March and 3 July 2001 by Dr Y.V. Reddy, Vice-Governor of the Reserve Bank of India, both available on www.bis.org.review/rev01a.html, deserve to be mentioned.

D. Developments with respect to crises resolution

Fortunately, no major international crisis occurred in the period under review. However, two developments deserve to be mentioned here. First, the International Monetary Fund revived previous proposals regarding sovereign debt restructuring and suggested that the possibility of creating a specific mechanism inspired by the corporate reorganization features of insolvency law be examined (see the address by Anne Krueger, 26 November 2001, available on www.imf.org).

Second, a different issue arises in connection with the crisis in Argentina, which occurred around the turn of the year 2001-2002, when the long-standing currency board arrangements linking the Argentine peso to the US dollar proved no longer sustainable. The circumstances surrounding the disappearance of these arrangements suggest that there might be some benefit in devoting some forethought to a viable exit policy for this type of arrangement, which in itself, political and economic conditions permitting, can contribute to financial stability.

Section II

International Harmonization of Regulatory and Supervisory Frameworks

A. Review of the Basel Capital Accord

Regarding substantive regulatory convergence, the Basel Committee's 1988 Capital Accord establishing common minimum capital standards for banking institutions had been one of the most significant achievements. In an attempt to respond to certain criticisms that developments in the financial industry had left the Accord somewhat outdated, the Committee launched a project on a review of the capital adequacy regime to replace the 1988 Accord. In 1999, a consultation paper was published suggesting three pillars for the solvency regime, ie prescribed quantitative capital ratios as a cushion for risks, a supervisory review process, and measures to encourage market discipline.

With respect to actual capital ratios, the proposals provided for a more diversified approach to risks. To this effect, two methods had been suggested initially: (1) a move towards risk weightings based on external credit ratings by recognized rating agencies as the standard approach, and (2) risk weightings based on internal bank models, subject to supervisory approval and adherence to qualitative and quantitative guidelines.

On the basis of the comments received, a revised and extended version was released as a consultation paper in January 2001, comprised of an overview of the proposals, the New Basel Accord and eight supporting technical documents. The official consultation process on these papers with the banking community initially was to extend through 31 May 2001. Yet, as several aspects seemed to require further assessment by working groups of the Basel Committee, additional supporting documents were circulated in January 2002, and a revised proposal will be issued for consultation during the course of 2002. Following this consultation period, the proposals will be finalized and it is recommended that they come into force pursuant to national implementing legislation on 1 January 2005. (All of the Basel Committee's documentation may be found on the internet website of the Bank for International Settlements at www.bis.org).

1. Quantitative Capital Ratios

At the present stage, the discussions have reached the following results: internal ratings by banks as a forerunner of risk models will be permitted as well as external ratings by rating agencies, subject to quantitative and qualitative criteria. The reason is to avoid regulatory arbitrage between rated and unrated assets of the same credit quality. For the determination of capital requirements for credit risks, three alternative methods will be introduced:

1. the Standard Approach, which is a modified version of the existing Accord using standard risk weights;
2. the Foundation Internal Risk Based (IRB) Approach, where banks may use their own default experience, but the resulting loss ratios and a capital matrix will be set by the supervisors. The

concept of default experience is based on the “Probability of Default”, i.e. the probability that a customer defaults within one year.

3. the Advanced Internal Risk Based Approach, where banks may use not only their own default experience, but also their estimates of resulting losses (after enforcement of collateral, defined as “Loss given Default”). The ratio of capital charges for estimated losses will be determined by supervisors.

The banking book exposure will be categorized into 6 broad classes of assets with specific risk profiles and benchmark capital charges: corporates, banks, sovereigns, retail, specialized lending (project finance), and equity. A number of important credit mitigation techniques will be accommodated as well; the Advanced Internal Risk Based Approach includes every type of collateral.

Technically, the validation of banks’ default and loss experience will have to employ similar methodologies as those which are already in use by internal models for the determination of the capital adequacy of trading books: estimates based on theories of probability, subject to backtesting under stress scenarios. More sophisticated risk models will be a final target of the supervisors and the banking industry; however, further investigation is intended, which might take several years.

The main concern of regulatory capital is still credit risk, i.e. „the risk of loss arising from default by a creditor or counterparty“ (see: *The New Basel Capital Accord, an explanatory note*, Basel January 2001, Annex 2). Market risk – i.e. „the risk of losses in trading positions when prices move adversely“ – has already been covered by an 1996 addendum to the Basel Accord, implementing separate capital charges for trading books. However, the new proposal includes operational risk – „the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems, or from external events“. In this area, a separate capital charge has been proposed, expected as an average 12% of the overall capital requirements. Regarding the determination of the minimum regulatory capital, banks will have to choose from a menu of three alternatives: a basic indicator, a standardized or an internal measurement approach. Interest rate risk will not (yet) be included in quantitative capital ratios but rather be part of the supervisory review process. However, additional capital charges will be required in case a bank’s internal models indicate a decline of more than 20% of capital as a result of a standardized interest rate shock of 200 basis points (so-called „outlier regulation“).

Following the Basel proposals, the explicit goal is to deliver a more risk-sensitive methodology that on average neither raises nor lowers regulatory capital for banks, after including the new operational risk capital charge. Although undoubtedly capital requirements may increase or decrease for an individual bank depending on its risk profile, it remains unclear whether banks in general will need more or less capital than before, because the capital adequacy matrices have not yet been finally defined for all segments. Therefore, an impact study by the Committee is under way to support the final calibration of capital charges.

2. Supervisory Review and Market Discipline

The second regulatory pillar – the supervisory review process – requires supervisors to ensure that each bank has sound internal processes in place to assess the adequacy of its capital on the basis of a thorough evaluation of its risk. This internal process would then be subject to supervisory review and intervention, where appropriate. As a part of this process, interest rate risks in the banking book will be supervised following the supplementary document „Principles for the Management and Supervision of Interest Rate Risk“, a revised version of a related 1997 paper. Basically, banks’ internal systems will be recognised as the principal tool for the measurement of interest rate risks.

The third regulatory pillar aims to support market discipline through enhanced disclosure by banks: The proposed framework encompasses disclosure requirements and recommendations, including the way the bank calculates its capital adequacy and its risk assessment methods.

3. Problems and Open Questions

Although the tendencies towards more realistic and more sophisticated capital requirements must be welcomed, it cannot be denied that planning and maintaining the capital necessary to cover a bank’s portfolio might become more difficult than before, because ratings and probabilities of default of a given portfolio are subject to changes caused by external factors such as economic cycles, and cannot be influenced by the bank. Pricing credit products should become more realistic due to sophisticated instruments, e.g. validated loss experiences, but originators might have to rely on results supplied by electronic systems and might not be able to judge the consequences of their decisions by themselves. Reliance on external rating agencies would transfer responsibilities from the banking industry to rating

companies without a related capital base or even an obligation in the event of negligence. Furthermore, a few deficiencies and inconsistencies are already visible at the present stage of the discussion.

First of all, the systematic rationale of capital requirements is not clear in that the Committee states that expected losses have to be covered as well as unexpected losses. With the inclusion of expected losses the general complex of loan loss provisioning is affected. The problem is that the definition of a provision or loan loss reserve is determined by national law. From a supervisory point of view, in a number of countries loan provisioning seems insufficient in that it is restricted to a concept of incurred or current losses. However, the terms of and the borderlines between expected and unexpected losses have not yet been finally defined by the Committee. Basically, expected losses would include two different elements:

- specific provisions for incurred or current losses, directly linked to identified loans and circumstances, and realised as actual impairment of capital;
- loan loss reserves intended to cover expected future losses, not directly linked to identifiable instances of impairment of individual loans.

Specific provisions are linked to the definition of capital because capital necessary to cover current losses is not available and hence must be deducted. Some national accounting regimes, e.g. Germany, have the same view on expected but yet unidentified losses. Moreover, the first Basel Accord has cemented these links between provisioning and the definition of capital elements by recognising general loan loss provisions up to 1,25% of risk-weighted assets as eligible supplementary capital. As the current definition of regulatory capital is not among the topics of Basel II, it would be logical to carve out the whole complex of expected losses / loan loss provisioning for a separate discussion including the elements of regulatory capital. However, a related working paper (on the IRB Treatment of Expected Losses and Future Margin Income, July 2001) tries to introduce an interim solution according to which capital requirements for expected and unexpected losses would be permitted to be met by the sum of capital, specific provisions, general loan loss reserves not included in capital and possibly future margin income. This would trigger significant discrepancies; e.g. specific provisions imply current losses (i.e. capital already used up) and cannot be set off against unidentified expected future losses. Major inconsistencies between regulatory and corporate reporting should be avoided. Moreover, initially it had been the aim of Basel II to eliminate discrepancies between economic and regulatory capital. It might be hard to solve the dilemma between Basel II, national reporting standards and the requirements of a level playing field.

A further basic question concerns the underlying model of the target solvency standard. Basically, the credit risk approach analyses the risk of loss arising from default (default mode model), whereas a mark to market model would investigate the overall risk of devaluation of the bank's assets including price risks caused not only by defaults but also changes in the credit solvency, rating, credit spreads or interest rates. Normally, mark to market models are used for trading books, whereas default mode models are rather appropriate for banking books. The question whether maturities should have any impact on related requirements affects the underlying rationale of capital charges. Under the assumption that the target solvency standard follows a single period default model - i.e. the bank should be able to survive a determined horizon (holding period) - there is no room for maturity-driven capital charges. Basically, the concept of "Probabilities of Default" used in the "Internal Ratings Based Approaches" assumes a 1 year time span. In a multi-period model, the bank would have to survive its audit each year along the way. This means that at origination, capital must be sufficient to ensure that the cumulative solvency probability is met at each horizon over the maturity of the loan. Whereas many members of the Basel project require maturity adjustments, others – in particular members with a national long-term credit culture – fear, apart from model-based objections – negative macroprudential (procyclical) impacts caused by higher capital charges for long maturities.

Volatility of capital requirements is another problem. External rating agencies tend to define the probability of default of a certain rating class on the basis of a medium-term average rather than just according to the expected ratio of the actual following year (which would closely follow the economic cycle). This issue also affects consistency tests between external and internal ratings based approaches.

4. Outlook

Although the "Basel II" consultations have not yet been finalized, the agenda of a third Accord, which will have to deal with a new definition of capital elements and the inclusion of financial conglomerates, seems visible already. Regarding supervisory practice, the tendency towards internal risk models will result in more emphasis on the supervisory review process (i.e. pillar 2 of the "Basel II" proposal), even in countries accustomed to regulation by numerical ratios. Therefore, under some

national constitutional regimes, even the predictability (and hence legitimation) of regulation might be discussed.

B. Basel Accord and EU Regulation

The Basel Accord itself, in either the original 1988 or the proposed revision, does not have the force of law, but rather must be implemented by national legislation (see Part I of this Report). In the context of the Common Market, the approach to implementing the revised Accord within the EU member states is worthy of mention.

1. Implementation of the revised Basel Accord in the EU

The EU intends to implement the new Basel Accord through a formal Directive setting general guidelines. Technical details will be regulated by annexes to the Directive, subject to amendment through less formal legal procedures. Both the Directive and its annexes would need to be enforced by national legislation of the Member States. The first draft directive closely follows the Basel proposals, which is not surprising, due to the fact that the majority of Basel Committee Members are from EU member states, and are attempting to coordinate the Basel Committee and EU efforts.

A still unsolved problem is the different scope of consolidated supervision over financial services groups, in particular between the Basel regime and European regulation, which is a major obstacle in establishing level playing fields. Following the new Basel regime, investment firms would be consolidated only in the event they are part of a financial group with at least one internationally operating credit institution. This is significant progress compared with the first Accord, where investment services had been consolidated only insofar as they were considered as banking activities under the national regulatory system. However, the EU goes further. Following the implementation of the draft European Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (Proposal for a Directive on the supplementary suspension of credit institutions, insurance undertakings and investment firms in a financial conglomerate, 24 April 2001, COM (2001) 213 final), three types of groups have to be considered:

- Financial groups with homogenous financial activities are supervised on a group-wide basis subject to sectoral Directives.
- Mixed groups with financial and non-financial activities are supervised on a group-wide basis; some limited supervision is implemented under existing sectoral Directives.
- Financial conglomerates, i.e. predominantly financial groups with heterogenous financial activities, will be covered by the new Directive.

The EU has employed a broad definition of a group based on the concept of close links, e.g. in the case where companies are managed on a unified basis. Financial conglomerates will be subject to supplementary supervision including a series of quantitative and qualitative rules (in particular following Art. 4 – 6 of the Directive), which relate to capital adequacy, internal group transactions and risk concentration, as well as management. The prevention of multiple gearing of regulatory capital within the group, as well as managing the level of risk concentration are the main objectives of the Directive. Supervision over conglomerates will be based on three pillars, the effective internal control and management systems, reporting requirements to supervisors, and effective supervisory enforcement powers, (e.g. appointment of a co-ordinating supervisor).

2. Further Harmonization in the EU

Apart from prudential supervision, the EU has further developed the harmonization of banking regulation by a Directive on the Reorganisation and Winding-up Of Credit Institution (Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions, OJEC 5 May 2001, L 125/15). The Directive is based on the principle of home country control and home country jurisdiction of banks authorised in EU Member States. As opposed to other banking directives, this directive regulates not only measures taken by bank supervisors, but also by other administrative or judicial authorities (such as conservators, liquidators etc.). In particular, the following items are regulated and / or required:

- the bankruptcy law of the home Member State is applicable, including rights of third parties
- Procedural requirements in case of bankruptcy (notifications, official publications etc.);

- Branches of third countries: each branch is treated individually by the host supervisor. However, related authorities shall endeavour to coordinate their activities.
- Sole power of the home Member State to decide upon and to implement reorganizational measures (e.g. conservatorship);
- Mutual recognition of measures by administrative or judicial authorities to restore to viability credit institutions which they have authorised (including suspension of payments, suspension of enforcement, reduction of claims, etc.). Related measures must be effective in all Member States without any additional formality.

These changes, similar to the process of revising the Basel Capital Accord, are designed to update the banking and financial laws and regulations to better reflect the needs and realities of the evolving international financial markets.

Section III

Effects of European Monetary Union on Monetary Law

Part A: Completion of the EMU

1. Main events since the 69th ILA Conference in London, in July 2000.

The achievement of the European Economic and Monetary Union (EMU) had three different stages, named Stages I, II and III. *Stage I* ended on 1 January 1994 after the entry into force of the Maastricht Treaty (on 1 November 1993) and with the establishment of the European Monetary Institute. *Stage II* comprised the preparatory phase, whereby (i) Member States had to achieve macroeconomic convergence and prepare their legislation for monetary union, (ii) the European Monetary Institute had to prepare for the establishment of the European Central Bank (ECB) and for the framework to be used in the performance of the tasks of the European System of Central Banks (ESCB), and (iii) the European institutions had to adopt the legislative framework for the introduction of the euro, assess the degree of macroeconomic and legal convergence of the Member States, and adopt the decisions necessary to ascertain which Member States would adopt the single currency and the composition of the ECB decision-making bodies. Stage II had a final phase between 1 June and 31 December 1998 where the EMI was replaced by the ECB while Member States still kept monetary powers through their National Central Banks (NCBs), which had been made independent in order to comply with Art. 109 of the EC Treaty.

Finally, *Stage III* of EMU began with a transitional phase starting on 1 January 1999 and ending on 31 December 2001, characterised by (i) the introduction of the euro as the single currency on 1 January 1999 in 11 Member States (Greece became the 12th Member State to adopt the euro, on 1 January 2001), (ii) the maintenance of the national currency units, the national banknotes and coins, legally re-characterised as ‘sub-divisions’ of the still only scriptural euro, and the national monetary legislation, but (iii) with the full transfer of monetary powers to the Community level, largely concentrated in the ECB.

At zero hours of the 1st January 2002 the transitional phase of EMU came to an end, the national currency units legally disappeared, euro banknotes and coins were launched, the national banknotes and coins started to be withdrawn from circulation, and national monetary laws within the participating Member States ceased to apply forever. On 28th February 2002, with the termination of the legal tender status of national banknotes and coins in the last of the participating Member States, the achievement of a monetary union in Europe will be a fact.

The main events related to EMU since the ILA Conference of July 2000 have been:

- In July 2000 the ECB changed the method for its main refinancing operation, the weekly liquidity tenders, from fix-rate into variable-rate tenders, whereby the ECB indicates a minimum bidding rate, credit institutions bid above that rate and the liquidity is distributed following the order of the bid rates. This is encompassed with the regular publication of ECB estimates of liquidity needs. This new method has been maintained until this date. All other monetary policy instruments applying since January 1999 have been kept unmodified. The Governing Council of the ECB has changed main interest rates several times.
- On 1st January 2001 Greece adopted the single currency and the central bank of Greece entered the Eurosystem (ie the constellation of ECB plus the 12 central banks of the Member States having adopted the euro as their currency, as opposed to the Treaty term “ESCB” which refers to all 15 EU national central banks plus the ECB). A collection of legal acts by both the Community and the ECB was necessary for this enlargement of monetary union, mirroring the legal acts adopted for the introduction of the euro in the first 11 Member States.

- The cash changeover was organised by Member States, Community institutions and by the ECB. The dual circulation period, initially foreseen for six months, was shortened by national legislation to a maximum of two months, ending therefore on 28 February 2002. The crucial aspect of preparing the changeover of banknotes by frontloading them to credit institutions and sub-frontloading them to retailers was organised by way of two ECB guidelines, adopted on 10th January (OJ L 55 24.2.2001) and 13th September 2001 (OJ L 257 26.9.2001), and such operation started on 1st September 2001. The Eurosystem established a Cash Changeover Committee to co-ordinate the activities of the NCBs related to the cash changeover, and played a pivotal role in the logistical preparations of the banking and related industry. Member States decided to permit early distribution of a limited amount of euro coins to the public ('starter kits') as from 15th December 2001, which were avidly collected by the population of the 12 countries.
- The Community institutions adopted the common legal framework for fighting against the counterfeiting of the new euro banknotes and coins, and mandated Europol, the EU police organisation, to co-ordinate national police forces in the fight against counterfeiting of euro banknotes and coins. A EU-wide common analysis centre and technical database for counterfeits was created at the ECB. Also, to achieve world-wide police co-operation in the fight against the counterfeiting of the new banknotes, Europol signed an agreement with Interpol.
- In December 2001 the ECB adopted a decision (OJ L 337 20.12.2001) organising the issuance of the common euro banknotes by all the component parts of the Eurosystem, including the ECB.

2. *The effects of European Economic and Monetary Union in the financial markets.*

The disappearance of national currency units should provide an impetus for the further integration of the euro area financial markets. Such integration is hampered by the subsistence of national barriers taking the form of taxation, regulatory and supervisory frameworks, and substantive laws.

With regard to taxation distortions, the Community has failed so far in achieving a harmonised regime regarding the taxation of financial income. Conflicting national interests and the competition of financial centres outside the EU hamper the necessary agreement. Lately, new proposals are underway to achieve a transitory regime leading to a final common regime on withholding taxes or information to be given to tax authorities with respect to savings.

Differences in regulatory and supervisory frameworks have prevented so far cross-border consolidation in the euro area of the banking sector, of capital market infrastructure, of organised markets. In March 2001 the European Council endorsed the recommendations of the 'Committee of Wise Men' on More Effective Securities Market Regulation in the European Union (the so-called Lamfalussy Committee), where proposals are laid down to achieve a streamlined procedure for Community legislation in the domain of capital markets and a closer co-ordination of supervisors at implementation level. The proposals of this Committee were adopted and led to the establishment of a European Securities Committee and a European Securities Regulators Committee, which should speed up the implementation of international agreements on securities regulation and their adaptation to market developments. These novelties form part of a Financial Services Action Plan which seeks to implement a whole range of measures aimed at establishing a truly European capital market by 2005. In addition, the recommendations of a Report of the Economic and Financial Committee of April 2000 on Financial Stability are currently being analysed and put in place, in order to strengthen the co-ordination of EU banking supervisors.

Differences in substantive laws are also being analysed and remedied. There is political agreement on a draft Directive on certain aspects of collateral (Proposal for a Directive on financial collateral arrangements, 27 March 2001, COM (2001) 168 final, OJEC C 180 E, 26 June 2001 P 0312-0318), a piece of legislation that will harmonise crucial aspects of the law of financial collateral. In the year 2001 the Community adopted a Regulation on cross-border insolvency, two directives on winding-up of credit institutions and insurance undertakings, respectively, and the Regulation establishing the Statute of the European Company (*Societas Europaea*) establishing the model statute for pan-European corporations.

3. *The legal convergence of the Accession Countries.*

Not only are the financial markets of the European Union integrating more and more among themselves, but in parallel the countries candidate to accede to the European Union are putting in place the legislation necessary to comply with the *acquis communautaire* in the financial field. Indeed, enlargement negotiations have progressed steadily, at least with 10 out of the 12 candidate countries. It

seems that there will not be transitory periods for the application upon acceding the EU of most, if not all, of the Community legislation in the financial field. This is why there is a large legal convergence in these countries vis-à-vis the EU. In the course of the last three years there has been a high degree of compliance with the EU financial *acquis*, and thus the legal panorama looks positive for a quick integration of financial markets once the enlargement project is achieved.

With regard to monetary policy, it is interesting to note that several accession countries have adopted currency board arrangements, taking the euro as the underlying currency. These arrangements should no doubt facilitate their future participation in the EMU in accordance with the provisions of the EC Treaty. New Member States will have to meet the convergence criteria of Article 121 of the EC Treaty before they can adopt the euro. Thus, after accession, the number of non-participating Member States will likely grow, whereas the «outs» at present number only 3 (United Kingdom and Denmark, who have an opt-out, and Sweden, which has a derogation for non-compliance with the convergence criteria) out of a total of 15 EU Member States.

Part B: International Relations of the EMU

The realisation of a monetary union for twelve States (and 300 million inhabitants), has implied the substitution of an equal number of currencies (including some internationally important currencies: the former DM and French franc, that were part of the SDR basket) by a single currency, the euro. The monetary union introduced an important novelty in the institutional structure of the European Union. A European Central Bank, at the centre of a European System of Central Banks, has been created for the management of a single monetary policy for the euro area. EU Member States, participating in the monetary union, have lost the power unilaterally to determine, define, change the value, or fix the interest rate of their currency. They take part in a system that implies an irreversible and irrevocable transfer of competences to a supranational authority. This qualitative change in the powers of the States concerned must have repercussions on the international monetary system and its institutional set-up.

Up to now, as far as the IMF is concerned, only marginal changes have taken place. So, as from 1 January 2001, the weight of the euro in the SDR basket has been defined, taking into account indicators common to the whole euro area. An observer of the ECB has been appointed to the Executive Board of the IMF since the beginning of the third stage, on January 1, 1999. It has also been decided that the standpoint of the Community would be presented to the Executive Board of the IMF by the competent member of the office of the Executive Director of the Member State exercising the Presidency of the Council of Ministers, assisted by a representative of the Commission. Some co-ordination has been provided, within the EU Economic and Financial Committee, and the Eurogroup, an informal grouping of the Finance ministers of the euro area, in order to arrive at common positions of the Member States of the monetary union in the organs of the Fund. Article IV consultations take into account the fundamental change that occurred in the economic and legal contexts. But, as a rule, pragmatism is the *leitmotif* and the situation is far from being satisfactory because the members of the IMF that have become involved in the monetary union have lost their influence within the Fund, and European institutions or the ECB have not replaced them.

The participation in the IMF and the representation in its organs is still organised as if EU Member States participating in monetary union had preserved their former competences. The larger Member States have appointed executive directors. Others are part of constituencies that include third countries. It is very difficult in these conditions for the euro area to speak with one voice as do the US for the dollar and Japan for the yen. The unity achieved internally is not reflected in the outside world. The quotas are still calculated as if trade within the economic union were external trade, which leads to what some consider as an over-representation of Europe.

The solution to the problems of an adequate representation of the euro area abroad is not easy. As the committee has already noticed in an earlier report, the Articles of Agreement of the IMF provide for the participation of countries and not of « international organisations ». It is a « Country based » not a « Currency based » organisation. But considering that the EU Member States are no more in a position to implement on their own their obligations to the Fund, should not the euro area be considered as a « country » for the purposes of the IMF Articles of Agreement?

Obstacles to a better insertion of the euro area in the IMF apparently come also from the EC itself. First, the status of all the EU Member States vis-à-vis the monetary union is not uniform. There are States with an exemption to the third stage of EMU: the UK and Denmark, and another, with a

self-imposed derogation status: Sweden. With the accession of new Members to the EU, the number of States with a derogation can be expected to increase. That situation represents a difficulty for the unitary affirmation of the EU in the monetary field, but there are ways of solving the problem if there is a political will to do so. After all, the non-participation in the single currency is *de jure* or *de facto* a provisional situation for a Member State of the EU.

Second, there is an asymmetry between economic and monetary union under the EC Treaty. In the economic chapter of EMU, there is no transfer of competences comparable to the one realised in the monetary sector, and it is undeniable that the competences of the IMF also concern a range of macro-economic policies, notwithstanding the fact that the basic role of the Fund is monetary and financial stability. That means that the ECB could not pretend to monopolise the representation of the EU. The EU Council is the monetary legislator of the EU. If there are in the future exchange rate arrangements for the euro, they will be adopted under Article 111 of the EC Treaty by the EU Council, in close collaboration with the ECB. So, the representation of the EU has to be assured by the collaboration of the Council, the Commission and the ECB. In many countries, the Central Bank and the Ministry of Finance share representation in the organs of the IMF. There is no reason to proceed in another way for the EU.

The IMF is not the only body where a unitary representation of the euro area should be provided. The ECB is represented as an observer in multiple of international organisations and caucuses (OECD, Basel Committee, etc...). The ECB, that has the legal personality and an international capacity under Article 6 of the Protocol on its Statute, became a shareholder of the Bank for International Settlements in 1999. The ECB Governor participates in the G7 (G8) Finance meetings, perhaps on a more regular basis than the Commissioner responsible for EMU. Improvements have to be adopted in that field.

In conclusion, now that the monetary union has successfully been completed within the participating Member States, it is time to turn outward and have the new monetary realities within the EU better reflected internationally.

Section IV

Impact of Electronic Money and Finance on Monetary Law

A. Developments in the European Union

1. Electronic Money

E-money schemes could be viewed as an alternative for the whole payment value chain because the final settlement takes place when the value is exchanged between the parties. Apart from card based e-money schemes, which have a long tradition in Europe, the latest development are software-based e-money systems, which store the electronic money centrally on a server that can be accessed by the client. This explains why, with few exceptions, E-money schemes in Europe are operated in general by credit institutions. It is a general view that, at least on the European level, the euphoria concerning the usage of e-purses that started a few years ago has not yet materialised: it has not taken the dimension that was foreseen at the beginning of the process a few years ago.

As already reported in previous years, the European Central Bank has long taken the view that the issuers of e-money need to meet certain minimum requirements, be subject to license and regulation, and be subject to appropriate prudential supervision and consumer-protection rules. With regard to legal requirements, issuers of electronic money must *inter alia* be subject to the obligation to redeem e-money upon the request of the holder of the e-money, at par. Therefore, financial soundness and supervision are warranted. In this regard, two directives were recently adopted and have to be implemented by Member States before the end of April 2002:

First, Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions (OJ L 275, 27.10.2000, pp. 39-43): introduces a minimum set of harmonised prudential rules for electronic money issuance and extends the arrangements for the mutual recognition

of home licensing and supervision provided for in the Banking Co-ordination Directive 2000/12/EC (which consolidates the pre-existing banking directives, adopted on 20 March 2000, OJ L 126 25.5.2000) to electronic money institutions (ELMIs). Directive 2000/46/EC adopted a technology-neutral approach towards e-money by harmonising the prudential supervision of ELMIs to the extent necessary for their sound and prudent operations and their financial integrity. The Directive provides definitions of e-money, as well as of ELMIs, and further creates a level playing field for the issuance of electronic money by both traditional credit institutions and ELMIs, thus ensuring that all issuers of electronic money are subject to an appropriate and harmonised form of prudential supervision;

Second, Directive 2000/28/EC of the European Parliament and of the Council of 18 September 2000 amending Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions (OJ L 275, 27.10.2000, pp. 37-38) amends the Banking Co-ordination Directive (2000/12/EC) by including within the definition of credit institutions also ELMIs. Directive 2000/28/EC extends the redeemability requirement at par value imposed on ELMIs to traditional credit institutions. These amendments promote the harmonious development of the issuance of electronic money throughout the European Union to avoid any distortion of competition between electronic money issuers, even as regards the application of monetary policy measures.

2. E-commerce

On 8 June 2000, the European Parliament and the Council adopted Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market, known as the “E-commerce Directive”. Although this Directive calls for implementation by 17 January 2002, it is unlikely that most member countries will meet that deadline. The E-commerce Directive is a so-called “horizontal” Directive, which ensures the free movement of online services and determines that the supervision of services operators in the EU is performed by the authorities of the Member where they are established (“*country of origin*” principle). The Directive defines the place of establishment as the place where an operator actually pursues an economic activity *through a fixed establishment*, irrespective of where websites or servers are situated or where the operator may have a mailbox. Financial services offered in Member States have to be compliant with the laws of the country of origin and benefit from mutual recognition. It is interesting to note that contractual obligations are excluded from this “country of origin” rule. This means that all forms of web-based financial services contracts are excluded. Moreover, countries can still apply restrictions based upon public policy considerations to financial services provided within their jurisdictions. The Commission is, however, considering this issue.

The Directive also sets up transparency measures for commercial communications and “*electronic contracting*”, and will ensure recognition of the legal validity of electronic contracts. This means that member states should allow the possibility to conclude contracts electronically. It further exempts *intermediaries* (telecom and Internet service providers) from liability in cases of transport, caching and hosting of information, under certain conditions. It also encourages the development of codes of conduct, as well as co-operation between Member States and the resolution of differences through online dispute settlement mechanisms. In a related item, on 19 January 2000, the Directive on a Community framework for electronic signatures (1999/93/EC) entered into force. The Member States had to implement the Directive into national legislation by 19 September 2001. The main objectives of the Directive are first, to make sure that all European Member States accept the legal validity of an electronic signature and second, to make sure that all services relating to electronic signatures can be provided on the EU market without national obstacles. A political agreement was achieved in the Council of Ministers on the proposed Directive for the distance selling of financial services on 27 September 2001.

Keeping an eye on the 2005 deadline for integrated retail financial services set by the Lisbon Council and the Financial Services Action Plan, a debate on policy focusing on integrating retail services and strengthening consumer-friendly financial services was initiated during 2001. A first Communication from the Commission to the Council and the European Parliament of 7 February 2001 (COM (2001) 66 final) outlined the community’s e-commerce policy in broad terms and addressed the application of the directive on the provision of financial services offered on-line. An evaluation of the E-commerce Directive was offered in the Commission’s Report on E-commerce and financial services to the financial services policy group (http://europa.eu.int/comm/internal_market/en/finances/general/fspg-report.htm of 3 August 2001). The Communication from the Commission to the European Parliament and the Council on Financial Services - Political challenges - June 2001 - Fourth Progress report (COM (2001) 286 final) stressed the importance of moving forward in sensitive areas such as e-commerce and distance selling. On the occasion of a Study on the implementation of Recommendation 97/489/EC concerning transactions

carried out by electronic payment instruments and in particular the relationship between “holder” and “issuer” of 17 April 2001, a debate started whether recommendations should have a more binding effect. Finally, the Report from the Commission of 23 August 2001 on the Action Plan for Consumer Policy 1999-2001, recognized that rapid growth justifies a policy on financial services at the ECB level (COM (2001) 486 final).

3. E-trading Systems

E-trading encompasses both inter-dealer and broker-client electronic trading platforms, while *e-brokerage* relates to dealer to client electronic schemes usually for equity trading and *e-payments*, i.e. payments initiated electronically. Often, such terms are used as synonyms such as in the case of e-brokerage and e-trading (see Bond Market Association (2000), *Ecommerce in the Fixed Income Markets: the 2000 Review of Electronic Transaction systems*, www.bondmarkets.com).

The main feature of all electronic trading schemes is the automation of trade execution (see H. Allen, J. Hawkins and S. Sato, *Electronic trading and its implications for financial systems*, BIS Papers No. 7). The term electronic trading system describes “any facility providing some or all of the following services: electronic order routing (delivery of orders from users to the execution system), automated trade execution (the transformation of orders into trades) and electronic dissemination of pre-trade (bid/offer quotes and depth) and post trade information (transaction price and volume data)” (see Bank for International Settlements, Committee on the Global Financial System, The implications of electronic trading in financial markets, January 2001 www.bis.org). Alternative trading system (ATS) is used to describe “an entity which without being regulated as an exchange, operates an automated system that brings together buying and selling interests – in the system and according to rules set by the system’s operator – in a way that forms, or results in, an irrevocable contract.” (“The Proposed standards for alternative trading system” elaborated by FESCO on 11 June 2001, FESCO/01-035b).

There is evidence lately that securities trading in Europe is migrating to electronic trading which was made possible by using new technologies, such as electronic trading platforms and matching platforms, which are heavily used in the inter-dealer professional market (see *The changing shape of fixed income markets* in: BIS paper No 5, the changing shape of fixed income markets: a collection of studies by central bank economists, October 2001, at p. 6). Forty percent of US Treasury securities transactions were estimated to be done electronically (see H. Allen, J. Hawkins and S. Sato, *Electronic trading and its implications for financial systems*, BIS Papers No. 7 at p. 36). An overview of current developments can be found in various publications (see, eg, S. Claessens, T. Glaessner and D Klingebier, *Electronic finance: reshaping financial landscapes around the world*, Financial Sector Discussion Paper, No 4, World Bank, September 2000, pp. 5-6, www.worldbank.org; Fan, M., J. Stallaert and A.B. Whinston, *Designing Electronic Market Institutions for Bond Trading*, Center for Research in Electronic Commerce, The University of Texas at Austin). The systems currently in use seem to have the advantage of allowing access to a centralised market for price discovery (see M. Wahrenburg, *Trading system competition and market-maker competition*, BIS Papers No 7, at p. 59) and are thus of interest in the debate over how a changing market architecture affects prices and quantities. In Europe some ATS formally operate under an investment firm license and some under an organized exchange legal regime.

The former Forum of European Securities and Exchange Commissions (FESCO) currently transformed into the Committee of European Securities Regulators (CESR) has issued “*Proposed Standards for Alternative Trading Systems*” (ATS) with respect to regulating the ATS, to which a number of associations (ISDA, TBMA, BBA etc) have provided their comments (www.europefesco.org). The outcome of the open consultation launched in June 2001 is under preparation in relation to the amendment of the Investment Services Directive.

As the foregoing shows, electronic money and finance as well as legislation with regard thereto continue to develop very quickly within the EU.

B. E-Money Developments in the United States

The United States continues to refrain from adopting new legal infrastructures aimed solely at governing stored value products and issuers. While this approach leaves open the possibility that the current legal infrastructure will not always apply to e-money schemes, it is justified by the fact that stored value products typically are small value products and by the belief that regulation at this early stage of development would severely hinder innovation. It must be understood that contrary to early expectations

some stored value products have not been well received within the United States. With the exception of certain closed environments such as military bases and college campuses, the first generation stored value products (e.g., Mondex, VisaCash, Digicash, Ecash) – digital currency stored either on a card or on a hard drive – have all but disappeared in the United States. Second generation stored value products are also struggling to survive. Near money products such as Beenze and Flooz have gone out of business, while open person-to-person systems such as PayPal, Yahoo! PayDirect, C2it which transfer "value" through the use of prefunded Internet accounts are still looking for a business model that works. To date, therefore, the United States has favored a freedom of contract approach to stored value.

1. Supervision/Regulation

Non-bank Issuers: There is no law in the United States that restricts the issuance of stored value to banks. Nor are there any overarching US rules comparable to the EU Directives regarding ELMIs discussed in the preceding Section of this report. The question arises, therefore, if a non-bank were to issue stored value in the United States, would it be subject to supervision and regulation? Since the introduction of stored value products in the United States, many of the states have taken the position that their money transmitter statutes would govern stored value issuers. These statutes typically require licensing of the issuer, require the issuer to hold funds in "permissible investments", and subject the issuer to minimum capital and audit/examination.

Over the last few years certain states have amended their money transmitter statutes specifically to address whether stored value services are covered. (see, e.g., Conn. Gen. Stat. Section 36a-596; Oregon (Chapter 571 of 1999 Session Laws, Section 2[7]); West Virginia HB 4591 (1998) Section 32A-2-1, Tx. Finance Code Section 152.002 (9)(2001)). In addition to questions about whether stored value services are covered by money transmitter statutes, as stored value has evolved from card based products to Internet payment options, questions about the coverage of remote issuers of stored value have arisen. Some state statutes require the physical presence of an issuer within the state's geographic boundaries before the statute will apply. Because it is possible to distribute computer based stored value at a distance, some money transmitter statutes may not be flexible enough for Internet e-money. This issue may cause some states to revisit their money transmitter laws if Internet e-money proves viable.

Bank Regulation: In 1999, the Federal banking regulators were directed by Congress to conduct a study of banking regulations that affect the online delivery of financial services and to report recommendations as to how existing legislative or regulatory requirements should be adapted for online banking and lending. In 2001, the Federal banking regulators invited public comment on this topic. (See, e.g., <http://www.federalreserve.gov/boarddocs/press/boardacts/2001/20010516/attachment.pdf>). The regulators have not yet completed their assessment of the comments or articulated any recommendations resulting therefrom. It is possible that this initiative could result in changes to the current legal infrastructure governing stored value issuers and products.

2. Other issues

Consumer Protection Issues: There are currently no U.S. Federal consumer protection laws designed specifically to address e-money. The Board of Governors of the Federal Reserve System proposed consumer protection regulations for stored value card products in 1996, but those regulations were never adopted. As reflected in most contracts between stored value issuers and users, however, it is widely accepted that current U.S. consumer protection laws apply to the funding of stored value accounts where a consumer bank account is used to provide the funding. Whether these protections extend to the use of the stored value remains unclear and will likely depend on the specific manner in which each stored value system operates.

Escheat: Two states, Arizona and North Carolina, have amended their escheat laws to clarify whether and when abandoned stored value escheats to the state.

Penal laws and Law Enforcement: In 1999, the Treasury Department's Financial Crimes Enforcement Network issued regulations that treat stored value as funds or monetary value whose issuers and sellers are a new class of financial institutions for purposes of the Bank Secrecy Act ("BSA"). While the regulations introduced licensing and suspicious activity reporting requirements, these provisions of the regulations do not apply to stored value issuers or sellers. The BSA's reporting requirements for currency transactions in excess of \$10,000, however, do apply to stored value issuers and sellers. In addition, intermediaries in transactions that transfer stored value electronically may, if otherwise covered, be subject to the funds transfer record keeping and travel rules contained in the BSA.

In comparing the EU and US approaches to adapting their legal structures to address e-money, one sees similar political decisions that any rules be technology-neutral and largely consistent with the law applicable to credit institutions. That being said, the recent EU directives should lead to common

treatment across the Member States, while in the United States a piecemeal approach at the State level has been accompanied by a cautious response at the Federal level.

Section V Terrorist finance

National and international efforts to combat terrorist financing are not a new feature of law and they already had visible implications for the financial sector before the tragic event of 11 September 2001. An example of the developments in the recent past can be found in Great Britain's Terrorism Act 2000. In many other countries, the fight against terrorism was included for many years in the measures aimed at combating organised crime. On the international level, it is noteworthy that the United Nations Convention for the suppression of financing of terrorism was concluded in 1999. The 11 September 2001 events shed, however, a crude light on the need to speed up work on these measures and triggered the adoption of additional measures designed to prevent the abuse of financial systems for financing terrorist activities. Among the various international efforts in this area, the following can be mentioned in particular:

- The mandate of the *Financial Action Task Force* was expanded beyond the field of money laundering to include combating terrorist financing. The Task Force held an extraordinary plenary session on 29-30 October 2001 during which eight new recommendations were developed to deter misuse of the financial sector by terrorists. It is most likely that these eight additional recommendations will soon be added to the 40 recommendations in the set of 12 international standards that have been highlighted by the *Financial Stability Forum* as key for sound financial systems. They will also be included in the assessment methodology which is presently being drafted by the *IMF* for inclusion into the reports on observance of standards and codes ("RSCs") (this methodology is due to be completed by end October 2002).
- Another standard setting body that added its voice to condemn terrorist financing is IOSCO which announced on 12 October 2001 the creation of a special project team that would in particular look into issues relating to the sharing of information between competent authorities and to the identification of clients of securities firms. It is not unlikely that other standard setting bodies will join in the effort.
- Another very important development is *United Nations Security Council Resolution 1373* that was unanimously adopted a few days after the terrorist attacks in New York and provides that all States shall prevent and suppress the financing of terrorist acts.

On the national level, the competent authorities of a great number of countries took the necessary measures to ensure the freezing of funds and other financial resources of the Taliban of Afghanistan. Certain countries also adopted specific national legislation; particularly noteworthy is the *USA Patriot Act* (the *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*) which contains, among other measures, amendments to the anti-money laundering provisions of the *Banking Secrecy Act* which are intended to make it easier to prevent, detect and prosecute international money laundering and the financing of terrorism. Among its provisions, the requirement that foreign banks maintaining correspondent accounts with a financial institution in the US designate an agent to accept service of legal process with regard to the account concerned has been perceived outside of the USA as a means to enlarge the territorial application of US law.

One can hope that the spirit of co-operation and realisations of international interdependence arising out of the efforts to combat terrorist financing will lead to increased coordination in developing new laws, not only in this area, but across the spectrum of Monetary and Financial Law.