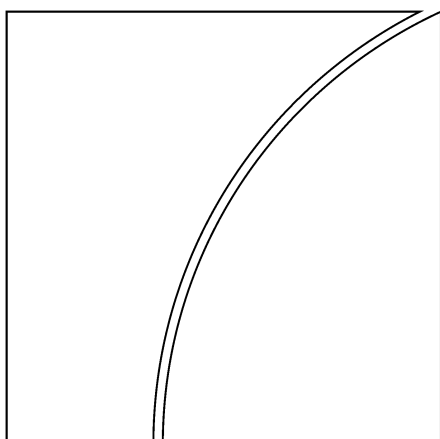


Basel Committee  
on Banking Supervision



**Management and  
Supervision of  
Cross-Border Electronic  
Banking Activities**

July 2003



BANK FOR INTERNATIONAL SETTLEMENTS



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# **Management and Supervision of Cross-Border Electronic Banking Activities**

## **Executive Summary**

The purpose of this paper prepared by the Electronic Banking Group (EBG) of the Basel Committee on Banking Supervision is to express supervisory expectations and guidance as to banks carrying out cross-border electronic banking activities, as well as to their home and host supervisors.

This paper has two main areas of focus. The first is to identify banks' risk management responsibilities with respect to cross-border e-banking. This discussion supplements the Basel Committee's Risk Management Principles for Electronic Banking (July 2003) by stressing the need for banks to integrate cross-border e-banking risks into the bank's overall risk management framework. It contains refinements to the risk management principles concerning the responsibility of banks to conduct appropriate due diligence and risk assessment, provide adequate disclosures, and establish an adequate ongoing risk management oversight process prior to engaging in cross-border e-banking.

The second objective is to focus attention on the need for effective home country supervision of cross-border e-banking activities as well as continued international cooperation between banking supervisors regarding such activities. This is essential to promote safe and sound cross-border e-banking without creating undue regulatory burden or impediments to banks' use of the Internet delivery channel to meet customer needs. Discussion on such an issue identifies the role and responsibilities of the home country banking supervisor and of local supervisors. Home country supervisors should satisfy themselves that their banks' due diligence, risk management, and disclosure policies and practices are adequate for the intended cross-border e-banking activities. Further, in the exercise of their supervisory responsibilities, local banking supervisors should consider the facts and circumstances of the cross-border e-banking activity with local residents and the effectiveness of home country supervision before making a determination as to whether they need to take action in the role of a local supervisor, and the nature of such actions.

The Committee recognizes that the EBG's work to promote enhanced management and supervision of e-banking activities deals with cross-border supervisory issues that are not unique to e-banking and need to be explored with other groups both within and outside the Committee. Specifically, the EBG has worked closely with the Committee's Cross-Border Banking Group to address cross-border e-banking supervisory issues. It will continue to do so as issues emerge, given the evolution of the Internet banking delivery channel, with the goal of ensuring a consistent supervisory approach to cross-border banking whether it is conducted through a physical distribution channel or over the Internet.

# Management and Supervision of Cross-Border Electronic Banking Activities

## Introduction

1. Banks have used electronic channels for years to communicate and transact business with both domestic and international corporate customers. With the development of the Internet and the World Wide Web (WWW) in the latter half of the 1990s, banks are increasingly using electronic channels for receiving instructions and delivering their products and services to their customers. This form of banking is generally referred to as *electronic banking (e-banking)* or *Internet banking*,<sup>1</sup> although the range of products and services provided by banks over the electronic channel vary widely in content, capability and sophistication.<sup>2</sup>

2. Banking strategies and business models are still evolving to take advantage of the Internet delivery channel. The open, ubiquitous and automated nature of the Internet implies that neither geography nor time pose significant barriers between banks and their e-banking customers. Consequently, while most banks offer their e-banking products and services exclusively to their home market and to foreign markets where they have local licensed banking establishments, a number of banks also have begun to conduct *cross-border e-banking* activities; that is, the provision of on-line banking products or services remotely from one country to residents in another country.<sup>3</sup>

3. To date, cross-border e-banking has not developed as rapidly as domestic e-banking in most countries. This is due in large part to customers' perceptions regarding the safety and security of e-banking transactions with foreign institutions as well as banks'

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<sup>1</sup> For the purpose of this Paper, the *Internet* includes all related web-enabling technologies and open telecommunications networks ranging from direct dial-up connections, the public World Wide Web, cable, and virtual private networks. *Electronic banking*, or *e-banking*, is defined to include the provision of retail and small value banking products and services through electronic channels as well as large value electronic payments and other wholesale banking services delivered electronically. This Paper is not intended to encompass large payment inter-bank transfer systems.

<sup>2</sup> E-banking, whether domestic or cross-border in nature, can be broadly categorized into three levels: (i) *basic information web sites* that just disseminate information on banking products and services offered to bank customers and the general public; (ii) *simple transactional web sites* that allow bank customers to submit applications for different services, make queries on their account balances, and submit instructions to the bank, but do not permit any account transfers; and (iii) *advanced transactional web sites* that allow bank customers to electronically transfer funds to/from their accounts, pay bills, and conduct other banking transactions on-line. This Paper focuses specifically on the latter two categories of web sites that allow for transactional e-banking and not just the on-line provision of information about banking products and services.

<sup>3</sup> Many international banks provide e-banking products and services to their customers in different countries through the web sites of their licensed bank branches or banking subsidiaries in those countries. Such e-banking activity is strictly an extension of their existing international banking business to include the Internet delivery channel in their respective local markets. Accordingly, these e-banking transactions are local transactions subject to the law and jurisdiction of that country. The focus of this paper is on the provision of e-banking products or services remotely from one country to residents in another country where the banks does not already have a licensed banking establishment.



concerns regarding the uncertainties that exist with respect to national jurisdiction, choice of law and consumer protection requirements for cross-border e-commerce transactions.<sup>4</sup>

4. However, industry participants and banking supervisors recognize the potential for an increase in cross-border e-banking relationships and transactions in the coming years for two main reasons. First, as the acceptance of e-banking services continues to grow in many countries, banking customers are more likely to use the Internet to access banking products that meet their needs, with less regard for country of origin. Second, continued technological innovation will facilitate banks' ability to use the electronic delivery channel to broaden their targeted customer base in both existing and new markets without as much reliance on physical presence and the significant investment that it entails.<sup>5</sup>

5. As these market opportunities, coupled with competitive pressures, provide impetus for the development of cross-border e-banking on a broader scale, it is important that banks contemplating such activity recognize and manage the associated risks in a safe and sound manner. Although these risks are not new, cross-border e-banking can increase certain banking risks such as strategic risk, reputational risk and operational risk and expose a bank to country risk.<sup>6</sup>

6. Further, given the continued evolution of developments affecting issues of legal jurisdiction and choice of law considerations with respect to cross-border e-commerce, banks that engage in cross-border e-banking may face increased legal risk. Specifically, unless banks conduct adequate due diligence they run the risk of potential non-compliance with different national laws and regulations, including applicable consumer protection laws, advertising and disclosure laws, record-keeping and reporting requirements, privacy rules and anti-money laundering laws in foreign jurisdictions. Complicating this challenge are the existing general legal uncertainties over which country's law applies to cross-border e-commerce activities and, in turn, the respective roles and responsibilities of home country and local authorities for Internet-based transactions with local residents. While some of these uncertainties pre-date the development of the Internet and affect traditional cross-border banking services, the use of the electronic delivery channel facilitates the offering of cross-border banking services and thus increases the challenges. These differences will likely continue to exist over the next years.

7. While bank supervisors are not in a position to address legal issues of jurisdiction and choice of law of different nations, the Basel Committee does recognize the essential role of effective supervision of cross-border banking activities by the home country supervisor in cooperation with local supervisors of countries within whose borders the subject bank

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<sup>4</sup> For a more detailed discussion of these factors, see BIS Paper No. 7 *Electronic Finance: A New Perspective and Challenges* (November 2001), and OECD Paper *Electronic Finance: Economics and Institutional Factors* (November 2001).

<sup>5</sup> It is very likely that generalized acceptance of e-banking is only a matter of time as retail customers get more accustomed with the on-line distribution channel, technologies improve and address customers' concerns regarding security and banks convince their customers to move to online banking through active marketing. In addition, retail customers have accepted other technological evolutions over the past years as the added convenience and cost-effectiveness becomes apparent although this may have taken longer than initially expected (ATMs being an example). However, although growing acceptance is likely, the length of the transition period before general acceptance is reached is uncertain. The pace of such acceptance may also vary between jurisdictions.

<sup>6</sup> These risks are encompassed by the eight risk categories identified in the Basel Committee's *Core Principles for Effective Banking Supervision* (September 1997); that is, credit risk, country and transfer risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk and reputational risk. The *Core Principles* are available on the BIS website at <http://www.bis.org>.

operates. The need for effective home country supervision of cross-border banking has been reinforced over time since the Basel Concordat was agreed upon, by the emergence of increasingly large and complex banking organizations with numerous branches and subsidiaries spread around the world. Moreover, financial conglomerates active in several financial sectors have also emerged. The Committee views the role played by effective home country supervision to be even more crucial when considering cross-border e-banking activities, given the possible absence of a physical banking presence in the local jurisdiction.

8. Accordingly, the home country banking supervisor is expected to ensure that its supervisory program encompasses its banks' cross-border e-banking activities and that it focuses properly on the bank's risk management responsibilities, including due diligence, risk assessment and disclosure which are discussed in this paper. Effective home country supervision, coupled with appropriate co-operation between home country and local banking supervisors, will facilitate the ability of banking supervisors to fulfil their respective roles and responsibilities with respect to cross-border e-banking activities conducted by foreign banks with local residents.<sup>7</sup>

9. Accordingly, the purpose of this paper is twofold:

- (a) To identify banks' risk management responsibilities concerning cross-border e-banking. Discussion on this topic supplements the Basel Committee's *Risk Management Principles for Electronic Banking*<sup>8</sup> by stressing the need for banks to integrate cross-border e-banking risks into the bank's overall risk management framework. Part I of this paper specifically provides refinements to the risk management principles concerning the responsibility of banks to conduct adequate due diligence and to ensure appropriate disclosure to potential bank customers prior to conducting cross-border e-banking activities.
- (b) To focus attention on the need for effective home country supervision of cross-border e-banking activities as well as continued international cooperation between banking supervisors regarding such activities. Such a focus is essential to promote safe and sound cross-border e-banking without creating undue regulatory burden or impediments to banks' use of the Internet delivery channel to meet customer needs. Part II of this paper discusses the key role and responsibilities of the home country banking supervisor and possible considerations for local supervisors.

## Defining Cross-Border E-Banking Activities

**Definition:** For the purpose of this paper, *cross-border e-banking* is defined as the provision of transactional on-line banking products or services by a bank in one country<sup>9</sup> to residents of another country.

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<sup>7</sup> The supervisory challenges presented by cross-border e-banking are discussed in detail in *Cross-Border Electronic Banking Issues for Bank Supervisors* contained in Basel Committee Paper No. 78, *Electronic Banking Group Initiatives and White Papers*, (October 2000).

<sup>8</sup> See Basel Committee for Banking Supervision, *Risk Management Principles for Electronic Banking* (July 2003), available on the BIS website at <http://www.bis.org>.

<sup>9</sup> For the purpose of this document, a country may also refer to a jurisdiction when there is more than one jurisdiction in a country, such as in China.

10. This definition of cross-border e-banking does not seek to address legal questions concerning the authority of a local jurisdiction to require a local banking license or to apply local laws to a foreign entity engaged in cross-border e-banking activities in that country. It also is not intended to address the substantial variations that exist in national definitions of “banking” activities or to address banking regulations and licensing criteria used for determining whether local activities conducted by a foreign entity trigger the need for a local banking license.

11. The Committee recognizes that under local regulation in many jurisdictions, a foreign bank that falls under local bank licensing requirements must actually establish a physical presence in the country and use such an establishment to engage in banking transactions (such as taking deposits or making loans) with local residents. However, under the regulations in some jurisdictions, the local supervisors may allow a foreign bank to obtain a local bank license when it delivers e-banking products and services in the local market without necessarily imposing a local physical presence.<sup>10</sup> Developments in jurisdictional law or international agreements could conceivably permit greater convergence in licensing practices some time in the future. In addition, the Committee recognizes, more generally, that laws in the area of cross-border e-commerce, including e-banking, are still evolving.

12. Accordingly, in order to encompass the range of national regulatory approaches but still afford a pragmatic definition of cross-border e-banking for the purpose of applying the risk management principles set forth in this paper, cross-border e-banking is defined as the provision of transactional on-line banking products or services by a bank in one country to residents of another country.<sup>11</sup>

13. Fundamentally, the Committee believes that the degree of necessary bank due diligence, risk assessments and ongoing risk management responsibilities, as well as the extent of a banking supervisor’s interests, should be predicated on a determination that the bank’s e-banking products or services are being *directed* at residents of another country. Consequently, the definition of cross-border e-banking purposefully excludes situations limited to the general provision of product or service information on a bank’s Web site, unless a reasonable determination can be made that the bank’s Web site is directed cross-border at foreign residents.

14. Banks as well as banking supervisors may find certain qualitative and quantitative indicators useful in determining whether e-banking activities are directed at the residents of a foreign country and, in turn, whether the risk assessment, due diligence, and disclosure principles set forth in the following section of this paper are applicable. Annex I contains a discussion of possible approaches in this regard.

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<sup>10</sup> It also should be noted that under the “European Passport” procedure of the European Union (EU), based on mutual recognition, cross-border retail e-banking services can be offered in Europe through a largely simplified licensing procedure. In essence, the foreign entity is authorized to operate in the foreign jurisdiction because both countries are members of the EU. Their licensing requirements are deemed to be equivalent, have been recognized as such by all EU members and the host country authority has not opposed the foreign bank’s application to deliver such services as notified by the home country supervisory authority.

<sup>11</sup> This definition would include situations where a foreign bank provides e-banking products or service to residents in a foreign country from (i) a location in the bank’s home country, or (ii) an “onshore” physical establishment in another foreign country. These situations may or may not be subject to a bilateral home and host country supervisory relationship as contemplated by the Basel Concordat. See Part II for a further discussion of these issues.

## Part I: Risk Management of Cross-Border E-Banking Activities

15. The Basel Committee's Electronic Banking Group issued its first comprehensive paper on risk management and supervisory issues arising from e-banking developments in October 2000.<sup>12</sup> That initial paper assessed the major risks associated with transactional e-banking, namely strategic risk, reputation risk, operational risk (including security and legal risks), and credit, market, and liquidity risks.<sup>13</sup> In that paper, the EBG also noted the existence of additional risk management issues in the area of cross-border e-banking.

16. Subsequently, the Committee released the EBG's *Risk Management Principles for Electronic Banking* in May 2001. That paper set forth essential risk management principles on e-banking in three broad areas: (1) board of directors and management oversight, (2) security and operational risk controls and (3) legal and reputation risk management. The EBG also noted that a key element of the board and management oversight process is the establishment of appropriate risk assessment, due diligence and ongoing risk management processes for any contemplated cross-border e-banking activities. Based on further input from the banking industry and supervisory community, the EBG saw the need to establish two additional risk management principles that stress the importance of risk assessment, due diligence, ongoing risk management and transparency for banks considering cross-border e-banking activities.

**Principle 1: Prior to engaging in cross-border e-banking activities, a banking institution should conduct appropriate risk assessment and due diligence, and establish an effective risk management program for such activities.<sup>14</sup>**

17. Before a bank initiates cross-border e-banking products and services, bank management should conduct appropriate risk assessment and due diligence to ensure that the bank can adequately manage the attendant risks. The bank must also comply with any applicable laws and regulations. This includes the laws and regulations of the bank's home country as well as those of any foreign country that may assert jurisdiction over e-banking services that are directed at its residents. Further, the bank should ensure that it has an effective and ongoing risk management program for its cross-border e-banking activities.

18. Initial risk assessment, due diligence and ongoing risk management considerations should include, but are not limited to, such factors as country risk, compliance risk, regulatory requirements, local business practices, accounting standards and the legal environment, as well as the operational, security, privacy, and customer service challenges presented by the online delivery of banking products and services to foreign customers.

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<sup>12</sup> See "Electronic Banking Group Initiatives and White Papers"(October 2000)

<sup>13</sup> The EBG's conclusions were based on input from the bank supervisory community and the outcome of Roundtables organized between EBG members and representatives from the banking industry and e-banking service providers in North America, Europe and Asia-Pacific. The EBG concluded that emergence of e-banking did not raise new risks not already identified by the previous work of the Basel Committee. However, the EBG noted that the very nature of the Internet delivery channel for banking products and services does increase and modify some of these traditional risks, thereby influencing the overall risk profile of banks engaged in e-banking activities.

<sup>14</sup> This principle is a refinement of Principle 1 contained in the EBG's *Risk Management Principles for Electronic Banking* (July 2003), which states: "The Board of Directors and senior management should establish effective management oversight over the risks associated with e-banking activities, including the establishment of specific accountability, policies and controls to manage these risks."

19. One of the major risks associated with cross-border operations is failure, whether inadvertent or otherwise, to comply with applicable foreign (and therefore possibly less well known) laws and regulations, and uncertainty over how “choice of law” principles can be applied in an e-commerce context. Banks should recognize that substantial differences might exist between jurisdictions with respect to bank licensing, supervisory and customer protection requirements. Also, a bank’s due diligence reviews should recognize that local authorities other than bank supervisors may decide to exercise oversight on issues pertaining to the bank’s activities with local residents. Such authorities may include the central bank, consumer protection authorities, investment services regulators, or authorities responsible for preventing financial crime. The differences in licensing and other requirements in various jurisdictions, and the uncertainty with respect to how choice of law principles are applied could increase the complexity and cost of the bank’s due diligence.

20. A bank could be expected to define and generally mitigate its due diligence obligation by posting on its Web site a conspicuous disclaimer that limits its on-line product and service offerings to only the residents of specified countries. This type of disclaimer should be made in conjunction with the need for the bank to be transparent relative to its intentions (see *Principle 2* below). However, the bank should also recognize that the legal effect of such a disclaimer might be somewhat uncertain. In addition, its value may vary between jurisdictions, particularly if the disclaimer is not backed up by appropriate policies and internal controls that ensure that the bank does not inadvertently conduct e-banking business with residents of an excluded country.

21. As part of its due diligence process, a bank intending to engage in cross-border e-banking activities is expected to consult with its home country banking supervisor in accordance with established home country practices or requirements. This practice, which is quite common in some jurisdictions, is related to the home supervisor’s need to ascertain as part of its supervisory duties the quality of the bank’s due diligence process and, more generally, its risk management capabilities relative to cross-border e-banking activities. Further, banks are strongly advised to consult with appropriate local supervisors in countries where they intend to deliver cross-border e-banking services in order to ascertain any requirements they might be subject to do under local laws.<sup>15</sup>

**Principle 2: A banking institution intending to engage in cross-border e-banking activities should provide sufficient disclosure on its Web site to allow potential customers to determine the bank’s identity, home country, and regulatory license(s).<sup>16</sup>**

22. Before engaging in cross-border e-banking transactions with foreign customers, a bank should ensure that adequate information is disclosed on its Web site to allow potential customers to make a determination of the bank’s identity, home country, and whether it has the relevant regulatory license(s) before they establish the relationship. This information will

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<sup>15</sup> The Basel Concordat and its supplements set forth the expectation that a bank should contact a potential *host* country banking supervisor regarding any intention to establish a *physical* banking establishment in the host’s jurisdiction. In practice, the *home* country banking supervisor is usually contacted first in accordance with established home country conventions and requirements and then, absent an objection by the home supervisor, the potential host country is contacted if the bank decides to pursue its cross-border business plan.

<sup>16</sup> This principle is a refinement of Principle 11 regarding “Appropriate disclosures for e-banking services” contained in the Committee’s *Risk Management Principles for Electronic Banking* (July 2003).

help improve transparency and minimise legal and reputational risk associated with cross-border e-banking activities.

23. Information that should be disclosed by the bank could vary depending on laws, regulations and business customs in the jurisdictions in which the bank operates. However, in addition to the fundamental disclosure elements identified in Principle 11 of the EBG's *Risk Management Principles for E-Banking*, a bank engaged in cross-border e-banking activities, is expected to disclose on its Web site the name of its parent group (if applicable), as well as the identity of the primary banking supervisor(s) responsible for supervision of the parent.<sup>17</sup>

24. Consistent with any decision to limit the availability of its e-banking products and services to residents of a certain country (or countries), the bank should disclose the country (countries) to which it intends to provide e-banking services or, conversely, the countries to which it does not intend to provide its products and services (see also paragraph 20).

## Part II: Supervision of Cross-border E-Banking Activities

25. The Basel Committee's Concordat for the supervision of cross-border banking promotes co-operation between banking supervisors to ensure adequate supervision of cross-border banking activities. The Concordat and its later supplements clearly identify the respective roles and responsibilities of *home* and *host* country supervisors when a bank is subject to effective home country supervision and has a licensed and supervised physical establishment in the host country. With respect to such a bank, it also sets forth principles for supervisory cooperation and sharing of information between home and host country supervisors.<sup>18</sup>

26. E-banking is generally an extension of traditional banking, using the Internet as an electronic delivery channel for banking products and services. Accordingly, in most countries existing banking laws and regulations that are applicable to traditional banking also extend to e-banking activities,<sup>19</sup> and in concept the principles of home and host country supervisory responsibility and cooperation embodied in the Basel Concordat framework apply. However, there are some practical problems when trying to translate the Concordat principles into

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<sup>17</sup> Principle 11 identifies the following six disclosure elements: (1) the name of the bank and the location of its head office (and local offices if applicable); (2) the identity of the primary bank supervisory authority (or authorities) responsible for the supervision of the bank's head office; (3) how customers can contact the bank's customer service centre regarding service problems, complaints, suspected misuse of accounts, etc; (4) how customers can access and use applicable Ombudsman or consumer complaint schemes; (5) how customers can obtain access to information on applicable national compensation or deposit insurance coverage and the level of protection that they afford (or links to web sites that provide such information); and (6) any other information that may be appropriate or required by specific jurisdictions.

<sup>18</sup> See *Principles for the Supervision of Bank's Foreign Establishments* (May 1983), generally known as the "Concordat", and its supplements: *Information Flows Between Banking Supervisory Authorities* (April 1990), *Minimum Standards for the Supervision of International Banking Groups and their Cross-Border Establishments* (July 1992), and *The Supervision of Cross-Border Banking* (October 1996), *Core Principles for Effective Banking Supervision* (September 1997), *Core Principles Methodology* (October 1999), and *Essential Elements of a Statement of Co-Operation Between Banking Supervisors* (May 2001).

<sup>19</sup> The rationale for such an extension is that banking services are supervised irrespective of the medium used to deliver such services insofar as the medium or distribution channel used does not create special risks. Accordingly, some banking supervisors and regulators have also introduced amendments to their laws or adopted new regulations to address specific risks and issues involving Internet security, customer authentication and protection, data privacy and other issues such as technology outsourcing.

specific guidelines when a bank conducts cross-border e-banking activities and does not have a local physical presence. Although prior to the Internet cases of cross-border banking without a physical presence in the local jurisdiction were not unknown, the emergence of an ubiquitous and truly global electronic distribution channel for financial products and services could not have been foreseen when the Concordat was written.

27. During this early evolutionary period of global e-commerce, the issues of legal jurisdiction and choice of law are generally ambiguous. This also applies to the case of cross-border banking services provided over the Internet. Further complicating matters, different jurisdictions are likely to continue to have divergent rules and regulations regarding licensing or other requirements for foreign banks that provide e-banking services to local customers **without** maintaining a local physical establishment in that country.<sup>20</sup> For example, in some jurisdictions, banking supervisors may not have the authority to impose local licensing requirements on banks that provide cross-border e-banking services to local residents. However, supervisors in other jurisdictions may have the authority to do so and thus may require a local license in similar circumstances.

28. In the latter situation, effective home country supervision, coupled with good cooperation among banking supervisors, should largely mitigate the need for prudential intervention at the local supervisory level. Nevertheless, the Committee recognises that even when home country supervision and cooperation are effective and a local banking license is not required, local laws in some jurisdictions may give local supervisors responsibility for ensuring compliance with consumer protection requirements and other non-prudential mandates.<sup>21</sup>

29. In any case, effective home country supervision can mitigate local supervisors' concerns to some extent by ensuring that banks have in place appropriate risk management systems to manage and control the risks involved.

30. The following guidance identifies possible supervisory options to assist banking supervisors in determining their appropriate responses to cross-border e-banking activities at both the home and local banking supervision levels. This guidance builds upon the basic supervisory principles of the Basel Concordat framework. It therefore is predicated on the general presumption that local banking supervisors, when contacted by a foreign bank intending to provide cross-border e-banking to local residents, will first consider whether there is effective home country supervision of the bank's activities before making a determination as to whether they need to take local supervisory action, and the nature of such actions.

#### **A. The Role and Responsibilities of the Home Country Banking Supervisor**

31. The introduction of cross-border e-banking does not change the fundamental responsibility of the home country banking supervisor for ensuring effective oversight of a bank's consolidated risk profile, risk management and capital adequacy. The home country supervisor should assess whether a bank understands the challenges and risks associated

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<sup>20</sup> It should be noted that for years many banks have conducted cross-border banking business with foreign customers, whether via mail, telephones or fax machines, without establishing a physical presence in the foreign country (or countries). Such activity, however, has generally been concentrated in the wholesale markets and has been minimal in the retail banking market.

<sup>21</sup> Issues related to local consumer protection, public disclosure, anti financial crime efforts, access to the local payment system, etc., may be of interest to the local banking supervisor or other local authorities.

with its cross-border e-banking activities as part of its assessment of the bank's banking activities more generally.

32. Good and clear communication of home country supervisory expectations and guidance for managing risks associated with cross-border e-banking activities will help ensure that banks properly conduct due diligence and control risks before they engage in such activities. Thus, home country supervisors should ensure adequate transparency with respect to their supervisory standards and expectations for cross-border e-banking activities. Such transparency will also help provide foreign banking supervisors with comfort that the home supervisory framework includes an adequate focus on ensuring that its banks' cross-border e-banking activities are well managed and adequately supervised.

33. As part of their supervisory function, home country supervisors need to be satisfied that banks under their supervision have adequate processes for identifying and managing risks associated with cross-border e-banking activities, including an effective due diligence process to determine the applicability of laws, regulations, and supervisory standards in both the home jurisdiction and any relevant foreign jurisdictions.

34. Coordination among bank supervisors is also a key element in the supervision of cross-border banking activities. When the home country supervisor is contacted by a foreign supervisor regarding the cross-border e-banking activities of a bank under home country supervision, it should cooperate as appropriate under its applicable laws and regulations.<sup>22</sup>

35. Finally, to the extent that the bank's e-banking data or information are managed offshore or processed by a third party based in a foreign country, the home country supervisor needs to satisfy itself that the bank has access to and controls any critical data or information necessary to adequately manage its e-banking activities. In addition, the home supervisor should ensure that it has sufficient access to such information or data consistent with its supervisory regime and its responsibilities as the primary supervisor of the bank's head office.

## **B. Considerations for Local Banking Supervisors**

36. Given the open nature of the Internet, information regarding e-banking products and services are available around the world as soon as they are posted on a bank's Web site. However, the simple availability of this information does not in itself constitute cross-border e-banking or warrant local supervisory interest (see definition of cross-border e-banking on page 5).

37. Further, when contacted by a foreign bank that intends to provide e-banking services to local residents but does not have a local license or establishment,<sup>23</sup> the local

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<sup>22</sup> It should be noted that not all cases of cross-border e-banking would warrant discussions between home country and local banking supervisors. The scale or type of a bank's cross-border e-banking may not be sufficiently material to trigger supervisory interest on the part of a foreign supervisor.

<sup>23</sup> Local bank supervisors or other authorities may become aware that a foreign bank with no local license or establishment is providing e-banking services to local residents. This can range from a foreign bank conducting cross-border e-banking transactions on a limited basis (e.g., with foreign nationals residing locally or with local residents who have opened accounts with foreign banks while abroad), to one that is openly directing e-banking services to local residents. Situations may also emerge where a foreign *non-bank* entity provides online banking products and services to residents of a foreign country as determined by local banking laws or licensing criteria. See Annex II for more discussion of issues raised by the non-bank e-banking case.



banking supervisor may decide that the activity does not present any local supervisory interest. In situations where the local supervisor concludes that it does have a supervisory interest in the subject banking activity, it should consider:

- (a) Whether the subject cross-border e-banking activities are subject to effective home country supervision;
- (b) Whether there is an existing adequate process for supervisory dialogue between the respective supervisors on the foreign bank's activity;
- (c) The need to discuss with the foreign bank its intentions and plans. It also might discuss with the foreign bank's home supervisor(s) any identified risks or concerns, and explore an appropriate framework for co-ordination and co-operation, if necessary;
- (d) The need to inform the foreign bank of the applicability of any relevant local banking laws, regulations or requirements;<sup>24</sup>
- (e) The need to inform the foreign bank's home supervisor (if any) of how it intends to ensure the bank's compliance with relevant local banking laws, regulations or requirements.

38. A local supervisor's ability to decide whether a foreign bank's cross-border e-banking activity is of local supervisory interest may be to some extent constrained by the local regulatory regime within which the supervisor has to operate. If a situation arises wherein a local bank supervisor determines that a foreign bank with no local presence is conducting cross-border e-banking activities in violation of local laws, regulations or requirements, it needs to consider the following options:

- (a) Informing the foreign bank of any noncompliance with local laws or regulations;
- (b) Informing the foreign bank's home country banking supervisor (if any) of the situation;
- (c) Publicly advising local residents that the foreign bank is conducting cross-border e-banking business in violation of local laws and regulations; or
- (d) Taking any appropriate enforcement actions.

39. With respect to foreign banks that may be conducting cross-border e-banking activities and do not have a home country banking supervisor that provides effective supervision, the local supervisor may wish to explore alternatives in accordance with the existing guidance provided in the Basel Concordat and its supplements. As indicated in that guidance, a local supervisor that licenses a foreign bank that lacks a competent home country supervisor takes on added responsibilities and risks beyond that normal for a host supervisor. Conversely, the local supervisor may attempt to restrict such foreign banks from doing e-banking business with local residents. Annex II of this paper contains more discussion of the issues arising from cross-border e-banking services provided by entities not subject to effective home country supervision.

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<sup>24</sup> This may include communicating to the foreign bank any relevant local disclosure or customer protection rules applicable to the provision of e-banking services to local residents.

## Annex I

### Possible Indicators of Cross-Border E-Banking – Ascertaining an entity's intentions to extend services to local residents

1. As discussed in Part I of this paper, banking supervisors may find it useful to adopt qualitative as well as quantitative indicators to help determine whether a bank's e-banking services are directed at residents of another jurisdiction.
2. Although bank supervisors have the discretion to adopt their own indicators, they might consider the following examples:
  - (a) The type and extent of e-banking activity with local residents;
  - (b) Whether the foreign bank's Web site is presented in the language and/or the currency of the local resident's country. This might indicate the bank's intention to target local residents of a specific jurisdiction but would need in most cases to be supplemented by other indicators;<sup>25</sup>
  - (c) Whether the foreign bank's Web site uses an Internet domain name of a type reserved to or identified with the local market, or otherwise designs its Web site in such a way as either (i) to suggest that it is located in the local jurisdiction, or (ii) to conceal its actual geographic location; and/or
  - (d) Whether the foreign bank advertises or markets its e-banking products or services directly to local residents via channels such as local television, the print media, or direct mailings. Such direct marketing would generally imply that the bank has an intention of doing business with local residents.
  - (e) Whether there are quantitative indicators that could be part of a materiality test.
3. Ideally, qualitative and quantitative indicators should not be automatic in order to allow banking supervisors the flexibility to assess on a case-to-case basis the need to assert a local supervisory interest in cross-border e-banking activities conducted by a foreign institution. Also, no single indicator is self-sufficient to determine whether local residents are being targeted by a foreign bank's cross-border e-banking offerings. Further, supervisors should take care to ensure that indicators relating to language are a contributing but not a sole criterion in any determination that a bank intends to engage or is engaging in cross-border e-banking, if only because several jurisdictions might share the same official language.
4. If supervisors use an indicator approach for assessing cross-border e-banking activities involving local residents, they should consider publicly disclosing their approach so as to promote transparency concerning any local regulatory requirements that may be

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<sup>25</sup> For example, the fact that a Canadian bank's web site is presented in French does not necessarily imply either the intent or the capability to offer its services in France, Switzerland or Belgium. In addition, a web site in French using Euros would not allow banking authorities from France or Belgium to clearly identify if local residents were specifically targeted.

triggered by local e-banking activities by a foreign bank. Such public disclosure will help address current banking industry concerns regarding legal and regulatory ambiguities concerning the Internet delivery channel. In many jurisdictions, such ambiguities are related to a perceived lack of clarity regarding the applicability of local authorisation rules and requirements to cross-border e-banking.<sup>26</sup>

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<sup>26</sup> Such concerns were expressed by a number of international banks that participated in the EBG's roundtables during 2000. These roundtables were held on a regional basis in North America, Europe and the Asian-Pacific region. As an example of such concern, one large multinational bank stated that it had felt obliged to collect over twenty legal opinions as part of its due diligence efforts in an attempt to ensure compliance with the regulations of the various jurisdictions in which it might intend to offer e-banking services.

## Annex II

### Financial Services Entities that Conduct Cross-Border E-Banking Activities without Effective Home Country Banking Supervision

1. Home country supervision of a banking institution and of its risk management capabilities is central to the Basel Concordat. Consequently, home country supervision is also central to ensuring that cross-border e-banking activities are conducted safely and soundly. Specifically, it is the responsibility of the home country supervisor to ensure that its banks have appropriate due diligence, risk assessment and ongoing risk management oversight processes in place prior to providing cross-border e-banking activities.
2. However, problems can develop with cross-border e-banking activities in two main ways with respect to reliance on home country supervision. First, foreign banks may undertake cross-border e-banking activities with local residents without effective home country supervision in the country of incorporation. These risks are compounded if the parent is an unsupervised holding company, a trust holding or a bank that does not have a single parent. If such a situation arises, a local banking supervisor could impose restrictive measures, as provided for under the Concordat.<sup>27</sup>
3. Second, the home country may not require a banking license because of the way in which home country law defines banking. Unlike more traditional distribution channels where the absence of a home supervisor has been relatively infrequent, potential cross-border “e-banking-like” activities by non-bank companies that do not have a physical presence is already becoming common in some e-finance product areas such as person-to-person electronic payments and account aggregation.
4. The Basel Concordat currently deals with the absence of an effective home supervisor by cautioning a potential host supervisor to perform strong due diligence before granting a license. In most instances, a host country granting a license to an entity without an effective home country supervisor is likely to require more information than they would if an effective home supervisor existed. Where a local license is not needed, activity in the local jurisdiction would be subject to neither home nor host supervision.
5. Traditionally, situations in which an unlicensed entity or an entity without effective home country supervision wants to offer banking services to a host country through a local physical establishment have been resolved on a case-by-case basis by either the host country supervisor (a) granting a local license and also imposing additional requirements (e.g. the creation of a local subsidiary) that allows the host supervisor to “ring-fence” the foreign entity’s activities in its jurisdiction and supervise it on a solo basis as a domestic bank, or (b) by refusing to grant a license. These two possibilities are specifically provided for under the Concordat and its supplements.
6. However, with the Internet, the supervisory challenges are exacerbated. In order for a potential host to “ring-fence,” the e-banking services delivered in the foreign country’s jurisdiction would have to be conducted from a local subsidiary as opposed to the parent-

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<sup>27</sup> See BIS paper *The Supervision of Cross-Border Banking* (October 1996) for a discussion of the supervisory issues arising from cross-border operations by banks incorporated in under-regulated financial centres.

company (or an establishment in another country) to ensure that supervision on a solo basis by the host country supervisor remains fully effective. Also, given the virtual nature of the electronic delivery channel, the effectiveness of refusing to grant a local license might have to be closely monitored by the host country in order to prevent the entity from conducting illegal banking activities. In addition, if such activities were exercised illegally, enforcing the law might prove to be more difficult than when banking services are delivered through more traditional distribution channels.<sup>28</sup>

7. With technology facilitating the breakdown of traditional banking services into multiple components and the addition of analytical tools and other capabilities into traditional banking services, more unlicensed non-bank entities are likely to provide bank-like services via the Internet, including those that are extended cross-border. Differences in definitions as to what constitutes a “bank” among jurisdictions will likely be magnified and will increasingly challenge how bank supervisors deal with financial entities with no home supervision.<sup>29</sup>

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<sup>28</sup> In such a situation, if the foreign entity is affiliated or has a correspondent relationship with a local bank that provide it with access to local payments systems such as ATM or ACH systems, the local supervisor may have additional leverage against the foreign entity to promote compliance. Likewise, in instances where a foreign entity conducts cross-border e-banking activities with residents of more than one country, the local supervisors may wish to consult about possible multilateral supervisory leverage that might be brought to bear on the bank (or its home-country supervisor) to ensure compliance with applicable local laws, regulations or requirements.

<sup>29</sup> For example, over time some technology companies offering “e-banking-like” services might relocate into jurisdictions where their specific mix of products and services does not require a banking license just as offshore centres developed previously.