

## WTO Negotiations on Financial Services

*Summary: The forthcoming Hong Kong WTO Ministerial Conference makes it opportune to assess the WTO negotiations on financial services. The GATS provides a framework for progressive trade liberalisation of financial services. The EU's FSAP can position the EU as a forceful advocate of the benefits of financial services liberalisation. Industry in Europe has tabled detailed Model Schedules outlining concrete steps needed to secure a substantial quality result. Now that the Doha Round has picked up momentum, a good outcome on financial services must be secured for both developed and developing countries.*

### Introduction

The Ministerial Conference of the World Trade Organisation (WTO) in Hong Kong on December 13-18, 2005 will meet at a crucial juncture in the current Doha Development Round of multilateral trade negotiations due to conclude in late 2006. Securing a win-win outcome on the dynamic economic sector of services, including financial services, is an important goal. There is a wide global academic consensus that commercially meaningful commitments to liberalise trade in services would considerably boost economic growth and jobs in both developed and developing countries. Financial services are particularly important since the sector plays a key enabler role in facilitating the development of so many other areas of economic activity, manufacturing, infrastructure as well as other services sectors.

The European Union has a vital interest in the negotiations on financial services. Good self-sustaining jobs in our societies depend upon the ability of firms successfully to embrace global competition. Access to finance and a wide range of innovative financial products on competitive terms is a crucial aspect of capacity to compete. Increasingly, European financial institutions compete across international borders and daily they seek to be more active in emerging markets. The drive to eliminate inefficiencies and barriers to growth through implementation of the EU's Financial Services Action Plan (FSAP) will do much to modernise Europe's financial sector. But it also equips the EU better to compete globally and to be a forceful advocate for more global modernisation and liberalisation of financial services.

Developing countries too have a vital interest in services. Developing country services sectors are growing strongly, especially in the more dynamic economies. Many have services sectors in which they enjoy comparative advantage and they too seek non-discriminatory access to other countries markets. The financial sector – banking, insurance and securities - is crucial to development plans. Modern financial services are increasingly required in developing country economies. Innovative products and services are needed so as better to manage risk and to reduce the cost of capital. Sound regulation and resilient capital markets are required to develop more fully fledged financial infrastructures so that the overall economy can function more efficiently.

### The WTO, the GATS and Financial Services

The General Agreement on Trade in Services (GATS), which provides the framework for WTO negotiations on financial services, aims at negotiating a legally binding set of commitments to enhance predictability and provide transparency in a process of progressive liberalization.

Trade in financial services, as in other services, is defined in terms of four modes of supply:

1. **Cross-border supply**, whereby, for example, domestic consumers take a loan, purchase securities, or take insurance cover from a financial institution located abroad;
2. **Consumption abroad**, whereby consumers purchase financial services while travelling abroad;
3. **Commercial presence**, whereby a foreign bank or any other financial institution establishes a branch or subsidiary in the territory of a country and supplies financial services; and
4. **Movement of natural persons**, whereby natural persons supply a financial service in the territory of a foreign Member country.

The GATS framework consists of: (i) rules and obligations specified in the Agreement; (ii) annexes on specific sectors including an annex on financial services; and (iii) national schedules of market access and national treatment commitments and lists of MFN exemptions. The most important of the general obligations under the GATS are MFN (most-favoured-nation) (Article II) and transparency (Article III). Specific obligations are related to market access and national treatment (Articles XVI and XVII, respectively). They apply only to services that are inscribed in the Schedules of Commitments of countries where specific commitments on market access and national treatment are listed in the form of limitations or measures applicable. Article XVIII offers the possibility for countries to inscribe additional commitments. Some countries have made their specific commitments in accordance with the Understanding on Commitments in Financial Services, an optional text containing a “formula” approach to the scheduling of commitments.

In addition to the provisions of Articles XVI, XVII and XVIII, specific commitments in financial services are made in accordance with the Annex on Financial Services that complements the basic rules of the GATS. Paragraph 2 (a) of the Annex recognizes that countries may take measures for prudential reasons, including for the protection of investors, depositors, policy holders and for preserving the integrity and stability of the financial system. Such measures shall not be used as a means of avoiding a country’s commitments or obligations under the GATS.

### **Barriers to Financial Services Supply**

Notwithstanding the growing demand globally for modern financial services and innovative products and services, many countries maintain outmoded laws, regulations or administrative restrictions which prevent users of financial services from efficiently accessing these services from foreign suppliers or prevent foreign suppliers of financial services from meeting this growing demand. These (often discriminatory) barriers can apply across the board to all financial service sub-sectors, banking, insurance and securities or they may more specifically affect a particular sector or product or service. Some of the main categories of barriers encountered include:

- restrictions on a company’s choice of form for its business entity (e.g., branch, corporation, joint venture) as well as limitations on majority foreign ownership or control of a local entity;
- quantitative restrictions on business activities, such as quotas on the number of licenses or branch offices, or an “economic needs” test based on a government’s assessment of the need for additional suppliers;
- barriers to expansion of business lines or services, including unnecessarily long and cumbersome approval processes for new products;
- prohibitions and limitations on the right to establish a commercial presence;
- unnecessary limitations on cross-border access, including the right to promote and sell financial services to institutional and other qualified investors across borders;
- non-transparent, burdensome, and discriminatory licensing requirements and procedures; and
- restrictions on the movement of key professional, technical, and managerial personnel necessary to facilitate cross-border supply or establish and maintain a commercial presence abroad.

### **The Industry Response**

The financial services industry welcomes the opportunity afforded by the WTO Doha Development Round to eliminate the barriers to doing business, to improve transparency of regulation, and to increase legal security through binding commitments on financial services in the WTO. Each of the sub-sectors – banking, securities and insurance – have developed Model Schedules of WTO commitments which in their view would assist WTO members to schedule their commitments on financial services in a manner that will have the most effective commercial impact. The insurance industry was the first to formulate a draft Model Schedule a number of years ago. The European Banking Federation also supports a Model Schedule for the banking industry. More recently, the global securities industry has published a detailed Model Schedule and associated documentation describing the underlying principles and the economic case for trade liberalisation in capital markets related services. The Model Schedules represent the industry view of global best practice and they serve as a useful template for WTO negotiators when seeking to assess requests and offers made during the Doha Round bilateral request/offer process of negotiation among WTO members. A WTO member that seeks to be in conformity with these schedules will put itself on the map as a jurisdiction

where the industry can be truly effective in doing business and provide services to users in a manner that will promote investment, modernisation, economic growth and jobs.

The industry proposals are intended particularly to encourage the more developed emerging markets to improve market access conditions and to bring their domestic regulatory practices into line with international best practice. Generally speaking the developed country markets have regulatory regimes that are consistent with the principles underlying the Model Schedules although as usual in matters of trade or market liberalisation there are always a number of issues where individual countries could review and correct.

The industry understands that the Round as a whole has to provide a set of balanced benefits to developed and developing countries alike and that good quality services commitments are of interest both to developing and developed countries. Not all developing countries may yet be in a position to undertake immediately full commitments in all aspects of financial services; indeed, in some jurisdictions questions of regulatory capacity arise and developed countries may need to provide improved technical assistance to strengthen such capacity. The GATS framework is sufficiently flexible to accommodate phasing in of commitments over transition periods. The industry fully acknowledges the right of regulators recognised in the GATS Annex on Financial Services to intervene on legitimate and non-discriminatory prudential grounds in order to safeguard financial stability or to protect users and investors.

#### **The EU Can Play a More Active Leadership Role**

The bulk of media and political attention within the EU on the WTO negotiations has tended to focus defensively on agriculture and textile protection. But does this focus on agriculture and textiles not ignore the far more significant economic potential of services, including financial services, in which EU countries have enormous comparative advantage and where growth and jobs could be greatly boosted? So far, the WTO negotiations on services have yet to pick up real momentum. Although the negotiating framework has been established, the request/offer process has yet to produce a harvest of commercially meaningful results. With the selection of Pascal Lamy as the new WTO Director General, the political momentum behind the Round as a whole is gathering pace. Much work has been done on trade in agriculture and goods; it is time to give serious attention now to the EU's offensive interest on services, and financial services in particular.

Over the summer period, the EU negotiators have worked hard to bring more focus to the services request/offer process and recently they have floated in Geneva ideas on "complementary approaches" intended to give renewed momentum to the negotiations. However laudable the intention, there is a risk, nonetheless, that these ideas developed at working level within the Commission aimed at increasing the quantity of offers from our trading partners may not lead to quality results in the form of offers that are commercially meaningful. Industry and the European economy require a substantive result on financial services from the Doha Round and would be greatly disappointed at a weak outcome.

This suggests that it is time for more engagement in the financial services negotiations at political level. Commissioners Mandelson and McCreevy have indicated their desire to get a substantial result on financial services. Members of the European Parliament, who follow trade or financial services, and who will be represented in the EU delegation at the WTO Ministerial Meeting in Hong Kong, can do much to put a stronger focus on financial services and to ensure that the EU interest in securing a high quality outcome to the Doha Round on financial services is fully accommodated in the negotiations.

#### **Conclusion**

- The Doha Round is gathering momentum but negotiations on financial services lag.
- Europe has a vital interest in the services negotiations, including financial services.
- Industry has tabled detailed proposals in the form of Model Schedules.
- EU negotiators need to bring more focus to the financial services negotiators.
- Now is a good time to engage the political level more closely in the negotiations, including members of the European Parliament who follow financial services and trade policy.

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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