INTERNATIONAL TRADE IN FINANCIAL SERVICES

EXECUTIVE SUMMARY

An important services export

Financial services are a major international export. Around $469billion in such financial services were traded cross-border in 2019, with hundreds of billions more supplied through financial services businesses established and authorised in markets outside their home jurisdiction. These trade flows support the basic financial infrastructure of markets around the world, sustain deep and dynamic capital markets, and finance trade and fund investments.

Liberalisation, regulation and cross-border trade

The case for open trade in financial services is no different from the case for open trade in general. Access to foreign suppliers alongside domestic ones can create new competition and choice and push down costs. It provides domestic firms and households with a wider range of services and encourages domestic firms to innovate and compete. Financial services play an important facilitative role in the wider economy, and foreign firms can bring new capital and sophisticated skills that benefit the importing economy.

To liberalise trade in financial services is not to deregulate the supply of these services. It is to allow and facilitate supply by foreign providers alongside domestic ones on equal terms. Nevertheless, it must be recognised that financial services can raise unique challenges for cross-border supply because it is generally a highly regulated activity. Many states have responded to this challenge by requiring local establishment and local authorisation for most financial services trade. There are, however, also a range of approaches that have been adopted to support cross-border supply, especially by markets that want to facilitate a wider choice of imports than may be available when full local establishment is required.

These include models that empower defined categories of qualified local consumers to choose foreign providers and models that recognise the regulatory standards of an exporting jurisdiction to be as robust as those of the importing jurisdiction. The UK is one of a number of jurisdictions, including the US and Australia, that have sought to develop the potential of these recognition models.

Defining openness in trade in financial services

A trade policy for financial services is therefore the sum of a number of things. These include:

- How states facilitate and regulate cross-border access to their market;
- How they regulate investment via commercial presence by foreign financial service providers;
- The treatment they grant to foreign financial services firms, such as banks, once they are established alongside domestic ones, including the implications of their domestic regulatory approaches to professional mobility, data transfer and back and middle-office functions for firms that are part of international groups;
- The extent to which they align their law and practice with international financial regulatory principles, and with the law and practice of their key trading partners; and how and when they defer to, or recognise, the standards of others as comparable to their own.

In each of these cases, openness to trade in financial services can be defined by reference to a number of core principles: the application of non-discrimination between foreign and domestic suppliers; the value of thoughtful approaches to the balance in host and home state requirements between trusted partners; transparency and proportionality in regulation and supervision, and robust and collaborative mechanisms for regulatory cooperation.

The policy toolkit for trade in financial services

There are two basic categories of policy tool. The first are strategies for encouraging openness, convergence and best practice in regulation in the jurisdiction's key trading partners. These include the jurisdiction's own approach as an importer, a wide range of bilateral cooperation and recognition (or "deference") frameworks and the process of setting financial services standards at the multilateral level. The second are mechanisms for 'locking in' this practice in formal international agreements. The first fall under the broad heading of regulatory diplomacy. The second are the jurisdiction's network of Free Trade Agreements (FTAs) and the WTO framework.

TOOL	KEY FEATURE
Regulatory diplomacy and unilateral reform	Regulatory diplomacy that targets improved market access and operating conditions in foreign markets is probably the single most important channel for delivering practical opportunities for UK exporters. This will generally be done by supporting and encouraging domestic reform and engaging with domestic regulatory change from key trading partners. Examples in the case of the UK include: the UK-China economic and financial dialogue (EFD); PRA/FCA supervisory cooperation with key peer supervisors and formal and informal regulatory dialogues between the UK and key partners.
Multilateral alignment on standards	Work on multilateral standards convergence can have a powerful effect in aligning the basic approaches of jurisdictions at an upstream level. Examples include UK engagement through key standard-setters such as the Financial Stability Board (FSB); the Bank of International Settlements and Basel Committee and the International Organization of Securities Commissions (IOSCO)
Formal bilateral cooperation frameworks	Channels of regulatory and supervisory cooperation can be underpinned by formal agreements that create structured permanent dialogues, establish protocols for cooperation and provide a basis for data sharing and other forms of collaboration. These can have a particular value in areas of rapid technological change such as cybersecurity, AI and financial technology. Examples include the UK-Switzerland Global Financial Partnership and the range of 'Fintech Bridges' the UK has established with key partners.
Recognition and deference frameworks	Recognition of, or deference to, the standards or supervisory actions of peer jurisdictions can be an important way of facilitating both imports and exports of financial services. Such determinations can be extended unilaterally or codified in bilateral frameworks. Examples include a wide range of UK market infrastructure and prudential equivalence determinations: the US-UK Covered Agreement on Reinsurance and the Bank of England-CFTC MOU on supervisory deference.
Free Trade Agreements (FTAs)	FTAs are a unique opportunity to 'lock in' national treatment and market access frameworks and regulatory best practice from trading partners. This creates certainty for exporters and can establish 'gold standards' in areas such as transparency and proportionality in regulation. FTAs can also be used to establish frameworks for regulatory cooperation and collaboration.
Multilateral bindings	Like FTAs, the key role of the WTO and the General Agreement on Trade in Services (GATS) framework is to deepen binding commitments to open trade in financial services and good regulatory practice. While the WTO framework in this area is unlikely to evolve materially in the years ahead, the UK should remain an advocate of action at this level, including through revived initiatives such as the Trade in services Agreement (TISA). Current work on digital trade and e-commerce is also relevant to financial services.

UK FINANCE RECOMMENDS THAT THE UK AUTHORITIES ACT ON OUR REPORT TO:

1. Develop a comprehensive regulatory diplomacy strategy for financial services.
2. Continue to play a leading role in setting international financial services standards.
3. Build a network of formal platforms for regulatory and supervisory cooperation.
4. Pioneer the innovation and expansion of cross-border trading models based on recognition.
5. Use a new set of FTAs to lock in UK market access for financial services in key markets.
6. Champion a range of WTO-level initiatives that will support trade in financial services.
7. Sustain the UK's openness to imported financial services.