UK FINANCE

INTERNATIONAL TRADE IN FINANCIAL SERVICES

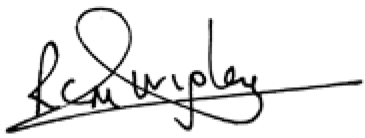
Defining trade policy for banking, payments and related financial services

PREFACE

UK Finance has pleasure in publishing this contribution to the understanding of trade and market issues as regards banking, payments and related services (and, indeed, financial services more generally). As the representative trade body for firms doing banking, payments and related business in and from the UK, we take a special interest in maximising the growth and wider social benefits that open trade can bring, including trade in the services that accompany and support global financial flows.

The intended readership for this report is all those who share our interest in trade and market access for financial services. As the UK hosts the world's most international financial centre we hope that our report and the recommendations it entails will be of particular interest to UK policymakers.

I would like to thank the principal authors of the report: Stephen Adams, Senior Director of our advisers, Global Counsel, and our own Director of International Affairs, Angus Canvin. Thanks are also due to Clifford Chance and colleagues in UK Finance for their contributions.



Bob Wigley

TABLE OF CONTENTS

1. 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.

This report

This report examines trade policy for banking, payments and related financial services. Section 2 reviews the scale and structure of international trade in financial services and the policy case for it. Section 3 of this report addresses the relationship between liberalisation and deregulation and the key question of trading highly regulated services between jurisdictions. It considers a range of approaches that have been developed to sustain the necessary standards of regulatory integrity while facilitating cross-border supply of key services.

Section 4 of this report proposes a definition of 'openness' for a wide range of key areas of regulation and practice. It develops a range of general approaches that can guide policymakers in setting out a trade policy for financial services that is robust on prudential and conduct standards but open to foreign competition. Central to this is the principle of national treatment – the principle that importers should be able to compete against domestic firms on the same terms. Section 5 of this report turns to the policy tools that can be used to deliver these aims.

2. THE BENEFITS OF TRADE IN BANKING, PAYMENTS AND RELATED FINANCIAL SERVICES

The case for international trade in banking, payments and related financial services[1] is no different from the case for open trade in general. Banking, payments and related financial services are important in any economy because they support activity in every other part of economic life: holding and protecting money for customers, channelling savings into lending to households and businesses, providing payment services, facilitating market-based finance (e.g. to raise capital for business) and providing a range of financial risk management tools for companies.

Managed carefully and well, liberalisation of trade in banking, payments and related financial services deepens the capacity of an economy to provide such services to the public sector, companies and households. This can be seen as happening in two basic ways. The first is in expanding the choice of service providers available in a market, lowering the cost of those services and improving their quality. Allowing foreign financial services firms to establish in a domestic market alongside local ones, or to sell services cross-border, can bring new competition, choice and capital to domestic markets. These benefits can make an important wider contribution to economic growth and development by deepening the capacity of the economy to fund and support economic activity.

The second is in deepening the capacity of the market to provide and support an increasing level of financial services sophistication. Financial services markets tend to deepen and develop in parallel with the depth and sophistication of the economy they serve. This is a mutually reinforcing process in which basic banking services are complemented by capital markets and then the derivatives markets built on these markets. This market evolution widens the source of capital available to companies and the sophistication of risk management tools available to them when they trade, borrow and invest. Where it is undertaken with markets whose firms already support these sophisticated activities, foreign participation can play a useful role at each stage of this market evolution with capital, technology and skills.

These two benefits comprise the basic case for financial services liberalisation. The importing market obtains access to additional sources of capital and choice to support the local economy. It also exposes its domestic industry to new technical, technological and managerial expertise, new products and firms with experience complying with global standards. These benefits spill over quickly into the domestic market.

1 Services characterised as financial services in this report include: acceptance of deposits; lending of all types; financial leasing; payment and money transmission services; guarantees and commitments; trading for own account and for customers of money market instruments, foreign exchange, derivatives, exchange and interest rate instruments, transferable securities and other negotiable financial instruments and assets; participation in securities and debt issuance and linked services; money-broking; settlement and clearing services; financial data processing or transmission; advisory and auxiliary services to any of the above.

Policymakers seeking to tap into such benefits have two basic models of international trade[2] in financial services to work with:

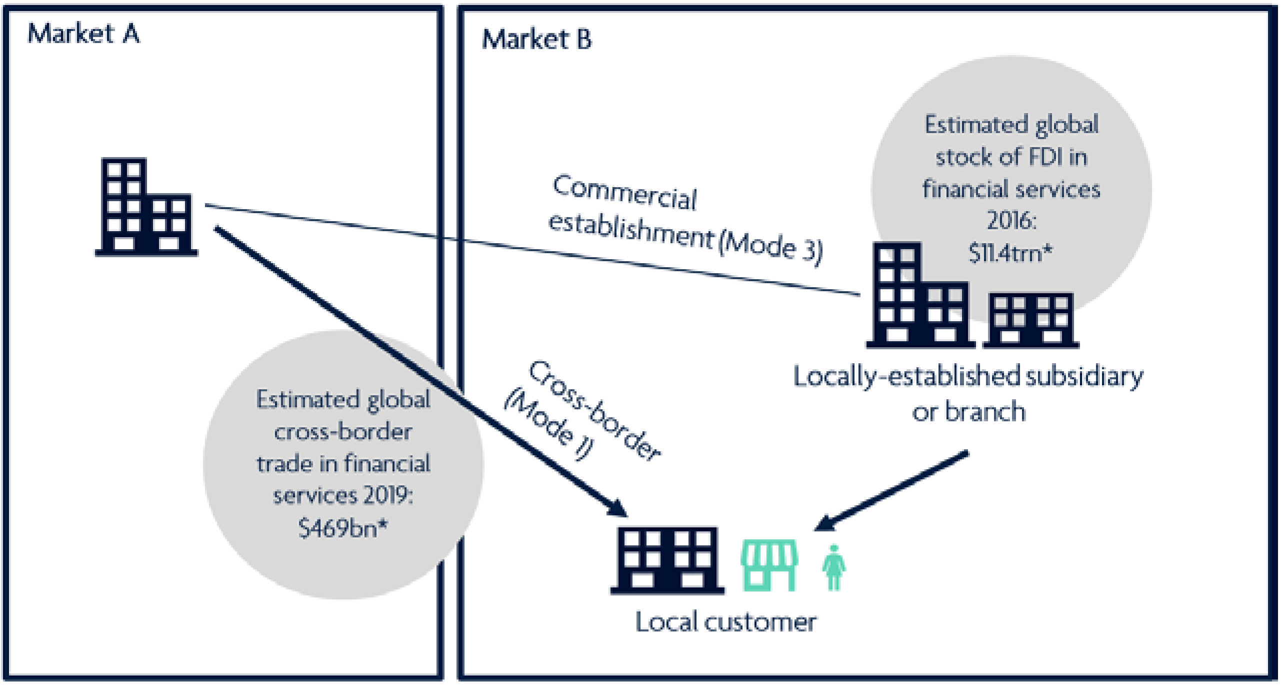
- **Trade through a local commercial presence.** In this model, services are sold through a local establishment, such as a subsidiary or branch, established in the importing country by the financial services business of the exporting country. Creating rights for foreign firms to establish and compete alongside domestic ones is the basic way of bringing more choice, capital and competition to a domestic financial market. It allows foreign firms access to local customers on the same terms as domestic firms. It gives domestic regulators comfort that foreign firms are operating within their direct supervision. However, as discussed in greater detail below, it makes trade conditional on the economic feasibility of full commercial location in the importing market.

- **Cross-border trade.** In this model, rights to contracts cross-border are created in domestic regulations that allow domestic firms and individuals to buy regulated services directly from firms in the exporting jurisdiction. As well as increasing the choice available to domestic firms and individuals, this allows service providers to consolidate operations in one or more locations (business "hubs", such as those that form international financial centres). This brings customer benefits in the form of deep pools of both commercial and regulatory expertise, economies of scale and liquidity. It also provides opportunities for export that may be uneconomic or less commercially feasible if commercial establishment and full domestic licensing is required in every market of operation, especially if those markets are small. It also allows domestic firms and individuals access to financial services that they may need for their own activities abroad and that domestic financial services providers may be unable to provide, such as the maintenance of foreign bank accounts needed to service overseas payments or receipts, mortgages of foreign real estate, or insurance of foreign assets. However, this model raises its own challenges related to the protection of domestic firms and individuals when they procure regulated services from outside of their jurisdiction. This is considered in detail in the next section.

As policymakers have recognised the value of financial services trade, we have seen the steady development of liberalisation in both of these models of financial services trade. This is especially the case in commercial presence frameworks for financial services over the last three decades. It is now commonplace in both emerging and developed economies for foreign financial services firms to be granted at least some rights to establish a local presence alongside, and to compete with, local firms. National authorities have often encouraged such investments as sources of capital, skills and competition. The WTO/UN International Trade Centre (ITC) estimates that the stock of foreign investment in financial services globally was around $11.4trillion in 2016, up from $9.1trillion in 2013.[3]

2 The cross-border and local commercial presence trade models described here are often described in WTO General Agreement on Trade in Services (GATS) nomenclature as Mode 1 and Mode 3 respectively

3 https://www.investmentmap.org/potentialInvestor.aspx . The most recent totals in the ITC data set are for 2016, but they are representative.



**WTO/UN International Trade Commission 2020*

FIG 1: TWO MODELS OF FINANCIAL SERVICES EXPORTS

Cross-border trade in financial services is also substantial, although much smaller than the volume of services traded through commercial establishment. As supply chains have globalised, foreign investment has grown and global trade has intensified, global trade in the financial services that support this has also deepened and markets have developed with the support of internationally minded regulatory authorities. The ITC estimates that around $469billion in such financial services were traded cross-border in 2019.[4]

Behind the headline data for financial services, trade is a dense network of supporting services and functions. For the purposes of this report, 'trade' in financial services goes beyond the provision of finance or the delivery of a financial service, such as bank account and payment services lending commitments, risk management, underwriting, asset management or advice. It also includes all the ancillary and support services (including 'middle office' and 'back office' services) that assist, or are necessary to the provision of, these financial services. This report will also cover these ancillary or support services.

4 Financial services here combines insurance, pensions and financial services in the ITC data. https://www.intracen.org/itc/market-info-tools/statistics-import-service-country

3. PUBLIC POLICY AND TRADE IN BANKING, PAYMENTS AND RELATED FINANCIAL SERVICES

Any approach to international trade in financial services must recognise that financial services are regulated and supervised in a particularly rigorous way. This reflects the unique role that they play in an economy and society. Typically, financial services regulation will pursue a set of common public policy objectives:

- The preservation of financial stability through effective prudential regulation of banks and market infrastructure;
- The protection of consumers, investors or other parties exposed to potential harm; and
- The maintenance of the integrity of financial markets through strict oversight of standards of business and the effective reach of regulation and supervision.

Often states will add a competition policy objective, so that financial services regulation should also promote plurality of supply of banking and other financial services through competition.[5] All of these policy objectives can be impacted by trade policy choices.

These aims recur in some form in almost all jurisdictions. This commonality of core aims across most financial service markets is a useful potential frame for trade in financial services. It provides a common set of aims in international standard setting, which in turn can help ensure that domestic regulations are aligned in their intent and approach across markets, even if they differ in detail. This broad alignment can in turn support the use of regulatory recognition or deference between regimes that are pursuing common standards and goals. These are discussed in detail in Section 5.

3.1. What liberalisation of financial services trade is not

In this context, it is important to recognise what the liberalisation of trade in financial services does not imply or require. Firstly, it does not require 'deregulation' in the sense of weakening the regulatory requirements of firms or lowering of prudential standards.[6] 'Liberalisation' concerns the right of foreign providers to provide services to customers in a local market on a 'national treatment' basis - meaning terms no different in their effect from those applied to domestic suppliers. It should not affect the prudential and conduct standards to which they are held when they do so, so long as they meet this basic test of non-discrimination. Indeed,

5 Effective competition is central to the ability of markets to meet consumers' needs in terms of choice, price, quality and value for money. This objective is potentially furthered when trade policy measures add non-domestic competition.

6 In this paper, references to regulatory barriers acknowledge the legitimate and necessary role played by prudential and conduct regulation in many areas of financial services. High regulatory standards can in fact be an incentive for financial services trade and investment. Where this report advocates adaptations to regulation is where they are discriminatory between foreign and domestic providers, breach WTO norms in other ways, or where they impose costs in a way that is duplicative and could be addressed without compromising prudential or conduct standards. The OECD Services Trade Restrictiveness Index is a useful guide to some of the more common regulatory barriers to financial services trade via commercial establishment in this respect. The STRI covers barriers in commercial banking (here) and insurance (here).

financial services trade liberalisation does not involve the specific choices of local regulators and supervisors at all, except to the extent that they shape the terms on which foreign firms may access a local market, and the extent to which they are treated the same as domestic firms when they do so. However, as we discuss below, policymakers have to make more complex choices when deciding how to facilitate cross-border trade as national treatment in many cases may effectively prevent that trade.[7]

Secondly, the liberalisation of financial services investments is distinct from the question of the access of portfolio investors to local securities and linked concerns about 'hot money'. Commercial establishment is a variant of fixed direct investment that involves a substantial and economically material commitment to the market of import, with significant obligations in terms of local authorisation and regulation. Investors of this type overwhelmingly invest with long-term intentions to serve the local market. The issue of liberalisation of commercial establishment for financial services is separate from the question of cross-border portfolio investment flows.

3.2. The problem of regulation and cross-border trade

Regulators and supervisors rightly protect their prerogatives under their financial services' regulatory regimes very carefully. Are these prerogatives compromised by international trade in financial services? Where foreign firms are established locally and are exporting through commercial establishment, the question does not arise. They are subject to local authorisation requirements and supervised the same way as domestic firms. Whatever standards local supervisors and regulators apply to domestic firms are applied to them also. Policymakers have often preferred to simply require that foreign firms seeking to export financial services must establish and be authorised in their market, and thus subject to their domestic regulation.

This has the attraction for regulators of direct oversight of the firms operating in their market. However, it also has the disincentive of duplicative costs for exporting firms unable to operate directly from their home market. For large markets, these costs may be outweighed by the benefits of market access, but for small markets, they can potentially act as a disincentive for exporters and thus restrict the availability of imported services. Measures to improve access for, and eliminate discrimination against, foreign financial services providers in host markets are thus a central part of any trade policy for international financial services focused on commercial establishment. But this will often need to be complemented with a focus on pushing down duplicative costs associated with full commercial establishment in order to ensure that it is an economically feasible and attractive option for exporters if cross-border access is not available.

Where regulators do want to widen the scope for cross-border contracting for their firms and households they must address more complex issues. In this model the exporting firm is outside the jurisdiction of the importing one.

7 By requiring, for example, that any firm be locally established and authorised in order to provide a service.

Global jurisdictions seeking to facilitate trade and widen access to services for their local customers have approached this problem in a range of ways:

- **Recognition-based approaches** that acknowledge standards in a foreign country as being adequate to allow domestic customers – generally wholesale or sophisticated financial services consumers – to be supplied from authorised firms in that market. This addresses the concern that the exporter should be held to the similar standards as local firms, for reasons of competitive fairness and prudential and conduct integrity.

- **Informed customer models,** in which defined types of customer purchasing financial services from a supplier abroad are judged to have (or expected to acquire) adequate knowledge to determine their needs and select appropriate providers and their activities are either explicitly permitted or deemed unregulated. These models can include frameworks such as the UK's Overseas Persons Exclusion framework discussed in Box 5 below.

- **Intermediated services models**. Some jurisdictions also provide exemptions to allow foreign firms to deal with local clients or counterparties where a local firm is involved as intermediary to ensure the application of local customer protection rules and local reporting and record-keeping requirements. This is the basis of the 'with or through' exemption and rule 15a-6 of the 1934 Securities Exchange Act in the US. Under this rule, a foreign firm can deal with local customers if a local firm is involved in the transaction in a way which delivers the application of local customer protection and reporting.

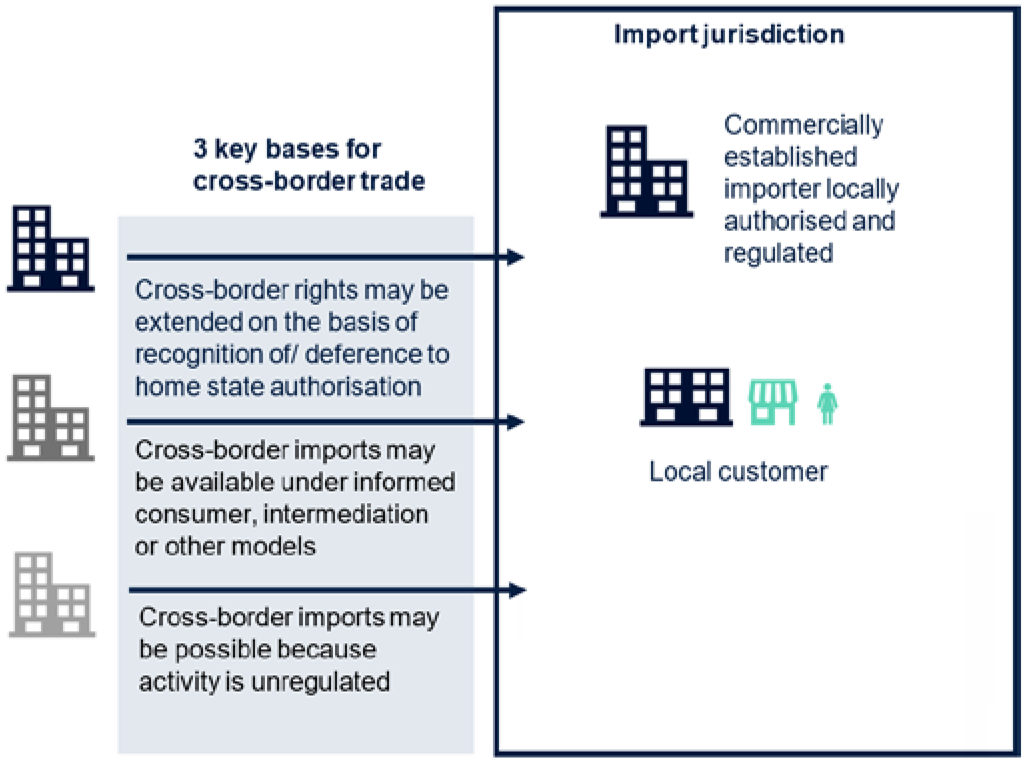


FIG 2: IMPORTING FINANCIAL SERVICES ACROSS THE REGULATORY PERIMETER

In addition, many jurisdictions accept that it would be unduly restrictive only to allow domestic firms and individuals to purchase foreign financial services from recognised foreign firms or under the conditions of an informed customer exemption where they are acting on their own volition and their business is not being actively solicited. Thus, many jurisdictions allow domestic firms and individuals to purchase foreign financial services on a reverse solicitation basis.[8] There are other examples in Ireland where regulators allow foreign banks to provide some cross-border banking services in a limited way without triggering local licensing requirements, for example the MiFID Safe Harbour.[9] Others provide more limited exceptions, for example, to allow foreign firms to continue to provide financial services to clients that have relocated to their territory.

These kinds of exceptions are essentially pragmatic. If a country has a complete firewall against unrecognised foreign firms, or only allows informed customers to access foreign financial services from unrecognised firms, individuals and others may simply be unable to do things that they would expect to be able to do e.g. buy property abroad or move to a new country while maintaining financial links with their country of origin.

3.2.1. Recognition

Recognition-based models all in some way involve local supervisors allowing forms of cross-border trade on the basis of their trust and confidence in the regulatory, supervisory and enforcement standards in the exporting country. These approaches go by a wide range of names, including 'deference', 'equivalence', 'substituted compliance' and 'mutual recognition'. What they all have in common is the recognition by one state that the regulatory and supervisory standards, and in some cases the intent and form of specific rules, in another are sufficiently aligned with its own to allow them to be relied on for a range of purposes, such as calculating the regulatory capital requirements linked to cross-border exposures or allowing cross-border contracting by firms from that jurisdiction in defined areas.

Many large sophisticated financial services jurisdictions have some form of arrangement of this kind, including the UK, the US, Australia, many individual EU member states and the EU itself. They cover a wide range of applications, including permissions to contract cross-border in areas such as corporate lending, the trading of securities and other services generally provided between financial services professionals. They are considered in more detail in Section 4, below.

At the heart of all of these approaches is an important proposition that has central relevance for international trade in financial services. This is the proposition that different jurisdictions, with their own autonomous approaches to the regulation and supervision of financial services markets, should nevertheless be able to agree that their approaches

8 Reverse solicitation frameworks permit customers to choose to be supplied by a supplier not regulated in their jurisdiction provided they have done so on an unsolicited basis and solely on the basis of their own judgement of any risk involved. This reflects the fact that in many cases, and especially in retail financial services, the act of marketing a service is the point at which it becomes a regulated activity and local licensing obligations are triggered.

9 Regulation 5 of the European Union (Markets in Financial Instruments) Regulations 2017 (S.I. 375/2017)

are sufficiently aligned in intention and outcome as to be treated as comparable or sufficiently consistent. Where accepted, this proposition potentially provides a valuable set of tools for addressing the challenge of how to deepen international financial services trade, including where there are carefully guarded regulatory prerogatives in which the integrity of domestic regulation is paramount.

Such approaches can be based on a wide range of criteria and can be designed and implemented unilaterally or in the framework of a negotiation between jurisdictions. Importing state public authorities will generally more readily defer to the regulation of the exporting state where both states' regulation derives from common global standards. In this respect, the development of a detailed and sophisticated global prudential rulebook under the auspices of the Basel 3 process[10] since 2009 has established a natural baseline for determining the basic alignment of regulatory approaches to banking between jurisdictions. The more prescriptive the international standard – and elements of Basel 3 are highly prescriptive – the easier in principle it is for jurisdictions to assume a common supervisory baseline.[11] The G20 group of nations and IOSCO have formally endorsed the principle of deference as valuable in encouraging financial services trade.[12]

Beyond this baseline, approaches to recognition need to be calibrated to the kinds of services being provided cross-border, and to whom. For example, the cross-border provision of retail banking services raises issues of alignment in areas such consumer protection regulation that are less relevant in wholesale services provided to sophisticated counterparties such as institutional investors, large companies, banks and governments. Section 5 below looks in more detail at some of the approaches that states have taken to these choices.

3.2.2. The trust question

The question of trust is central to these models. Recognition frameworks cover not just close comparisons of the legal and regulatory regimes of a trading partner but more qualitative elements of trust and confidence in the approaches of supervisory peers from the other market. The only way that such trust can be developed and maintained is through close cooperation, frequent interaction and developed protocols for information sharing and transparency.

Fora for regulatory coordination and supervisory cooperation are key to promoting this trust between financial services regulators and supervisors.

10 The FSB, BCBS and IOSCO are the three principal global standard setters for financial services regulation and supervision. There are other international bodies, such as the Financial Action Task Force (FATF), which sets standards on financial crime (such as to tackle money laundering and terrorist financing).

11 The fact that the Basel Committee itself conducts assessments of implementing jurisdictions provides a useful objective benchmark for comparison across jurisdictions. These assessments are used by the IMF in its own Article IV and financial stability assessments. The World Bank promotes compliance with the Basel standards as its core framework for developing financial stability in emerging and developing markets.

12 The G20 Leaders noted in their November 2014 Declaration, "We encourage jurisdictions to defer to each other when it is justified, in line with the St Petersburg Declaration." See, G20 Leaders Communique, November 2014, Brisbane, available at https://g20.org/wp-content/uploads/2014/12/brisbane_g20_leaders_summit_communique1.pdf. The International Organisation of Securities Commissions (IOSCO) has subsequently elaborated global standards for deference: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD659.pdf

"Regulatory dialogues" between states[13] and other such formal groupings of the relevant public authorities and agencies involved in financial services regulation and supervision[14] can build such trust. So too do the 'supervisory colleges' created by global supervisors to oversee the global activities of large banks and the mechanisms created both in and outside of the G20 framework for encouraging cross-border regulatory cooperation on the potential recovery and resolution of failing banks with operations in multiple jurisdictions.

Recognition models generally need to build on these mechanisms of individual firm supervision with deeper links between regulators and supervisors that focus on developing common and compatible approaches to overseeing financial markets and developing and evolving rulebooks. Such cooperation is considered in Section 5 below. Taken together, the various forms of international regulatory and supervisory cooperation and convergence in financial services over the last two decades have created a useful and valuable platform for considering how to use recognition models to deepen the possibilities for trade in financial services, both in the treatment of locally-established foreign firms and for cross-border contracting. Such models are based on the key assumption that trade in financial services must not erode or compromise commitments to market integrity, financial stability or consumer protection – and demonstrate how this might be done.

However, as noted above, recognition remains only one tool. In practice many states combine the use of recognition models with other approaches to facilitating cross-border trade in financial services, recognising that there are limits to the effectiveness of such models in addressing the practical issues faced by businesses and individuals that need to access foreign financial services firms. Even the combination of recognition and informed customer approaches can leave many areas in which legitimate forms of cross-border contracting can remain complex or impossible. Innovative and thoughtful jurisdictions have to draw on a wide range of tools. The remainder of this paper considers what such models and other supportive policy tools and complementary approaches might aim to achieve for local financial services customers and the foreign firms that serve them.

13 Such as those established in several FTAs, most recently the UK-Japan Comprehensive Economic Partnership Agreement. See Annex 8A here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/929193/CS_Japan_1.2020_UK_Japan_Agreement_Comprehensive_Economic_Partnership__v3.pdf

14 Such as the US-UK Financial Regulatory Working Group established in 2018.

4. DEFINING OPEN TRADE IN BANKING, PAYMENTS AND RELATED FINANCIAL SERVICES

What makes for open trade in banking, payments and related financial services? Such trade might be characterised as a framework in which customers have equal access to products and services provided by foreign banks or financial institutions alongside domestic ones, to the greatest extent that this is compatible with the integrity and effectiveness of domestic financial regulation and supervision.

In such a framework the needs of customers for greater choice and competition and the prerogatives of regulators are balanced against each other: trade liberalisation requires the importing or host state to recognise that the benefits of free trade in financial services, such as the economic gains from greater choice and competition in financial markets, can be delivered without undermining the legitimate public policy objectives that underpin their regulation and supervision of financial services. Liberalisation does not come at the expense of domestic standards, or with the requirement for deregulation.

Such a definition deliberately does not distinguish between trade cross-border (e.g. from a hub) or through a local commercial presence (e.g. via a branch or subsidiary). However, meeting the test it sets clearly raises different questions for the two different forms of commerce. This section explores this balance in greater detail in a range of key areas for financial services trade, from rights of local establishment for subsidiaries and branches to the conditions that might be created for cross-border trade. It also considers flanking areas which underpin trade, such as the right to temporarily locate professionals in the export market and the importance of supporting forms of digital commerce and data processing that are increasingly integral to financial services.

4.1. Rights of establishment

Although technology is rapidly changing the geographical scope for providing services cross-border, the ability to co-locate alongside customers inside their regulatory jurisdiction (by establishing a local branch or subsidiary, for example) is always likely to remain important for most financial services exports, especially in the market for retail financial services. This dynamic is strongly reinforced by regulatory preferences and prerogatives. In retail services, local authorisation and direct local supervision are often seen as a necessary condition for contracting with local customers and households.

This means that the key issues for financial services exporters are often closely linked to the inward investment regimes of trading partners, and the conditions under which foreign firms can own and operate local banks, capital markets businesses and related services. These conditions vary widely from market to market globally. Within the membership of the WTO there is a spectrum of openness in investment regimes for banking and financial services that ranges from almost completely closed to foreign establishment to very open. The UK is among the most open markets in the world for commercial establishment in financial services, a fact reflected in the incredibly diverse range of foreign firms operating in the UK.

In reviewing inward investment frameworks for banking and capital markets, the key issue for exporters are generally the extent to which it is possible for foreign firms to own local banks or other local financial institutions. Ideally firms will have the right to wholly own, or at least control, banks and capital markets businesses in export markets. Where this is not possible, foreign firms should be permitted majority ownership and control of locally established firms. The alternative of minority ownership can in some cases leave exporting firms vulnerable to compromising arrangements with local partners, and without full control of the prudential management of the firms they own and run. Banks and financial institutions should not be subject to foreign ownership caps and should be free to choose the form of legal entity appropriate to their investment and should not be compelled to enter into joint ventures.

It is also important that the rights to establish and own local banks or other financial services firms is not compromised by unreasonable conditions on that ownership. These can include obligations to employ local nationals as directors or senior managers, use local suppliers, meet local lending targets or allow the transfer of proprietary technology or intellectual capital. There should also be no restrictions on the free operation of the market they are part of that act as de facto checks on foreign participation – such as quotas on the number of banks or firms permitted to operate in a region or segment.

4.2. The importance of 'national treatment'

Once established, financial institutions should be subject to treatment no different from that applied to local banks in the same circumstances. This principle of 'national treatment' is deeply embedded as an ideal in much WTO law,[15] but it has much wider application as a general guiding principle of liberalisation. It requires that firms legally established and authorised in a foreign market should be treated the same as local firms. While regulators and supervisors should be free to vary supervisory terms in a way that reflects their prudential judgements, such practice should not discriminate between foreign and domestic banks or financial institutions established and operating in the same way.

This should cover all aspects of their regulation, including prudential and conduct supervision, rights to establish local branch or sales networks and the requirements imposed on their corporate governance, data handling or any other aspect of business. It should also apply with respect to access to payment and clearing systems and to official funding and refinancing facilities available in the normal course of business. Such commitments should also be 'dynamic' with respect to financial innovation, guaranteeing that as new financial products and services

15 However it should be noted that in services, unlike in goods, national treatment under WTO law applies only once members commit to extend it, not as a general principle. This is why securing national treatment commitments from trading partners in FTAs or other binding agreements is an important element of trade policy for financial services. See Box 1 and Section 5 below.

are authorised for a market, both under existing regulatory frameworks and any new ones, foreign firms are permitted to adopt or deliver them in exactly the same way as domestic businesses.

A linked principle should also apply with respect to other foreign banks or financial institutions operating in the same market. Where they are covered by the same access arrangements and conducting the same forms of activity, they should be extended the same terms of regulation and supervision. This principle is often described in WTO practice as a 'most favoured nation' (MFN) approach, and it should be a basic element of financial market regulation and a state's inward investment regime.

BOX 1: MARKET ACCESS AND NON-DISCRIMINATION COMMITMENTS IN TRADE AGREEMENTS

One of the valuable roles played by financial services trade rules in both the GATS framework and bilateral trade agreements is to establish some core principles of non-discrimination and market access for the governance of the investment and regulatory framework of a trading partner in financial services. These provide a basic benchmark that can encourage and shape reform in a trading partner and once these principles have been fully adopted, they can provide an important guarantee for ensuring that frameworks do not discriminate between foreign and local financial institutions both for current practice and for future regulation or regulatory conduct.

In this spirit, the GATS framework encourages countries to make 'commitments' to non-discrimination and open access. Most FTAs adopt a similar approach. There is an established toolkit for such commitments in both the GATS framework and in bilateral trade agreements:

- Most favoured nation treatment commitments can be used to ensure that firms legally established and authorised in a foreign market should be subject to 'most favoured nation treatment', meaning that they should be accorded treatment no less favourable than the most favourable treatment accorded to other foreign providers of the same type and profile in an export market. Unlike national treatment and market access commitments, which apply only when a country has formally adopted them, the MFN commitment is a general obligation in the GATS.

- Market access commitments can be used to restrict the use of quotas or caps with respect to local contracting, employment or output, economic needs tests or local ownership requirements attached to the right to establish authorised entities for the provision of financial services in a market. The list of restricted measures should be based on the terms of GATS XVI,[16] but customised and refined as required to ensure that tests, caps or quotas of any kind and measures such as data localisation or technology transfer obligations do not act as de facto checks on foreign firms participating in local markets.

- National treatment commitments can be used to ensure that foreign firms are treated no different from local firms of the same type and profile in the conduct of supervision or any other regulatory treatment. This should cover all aspects of their regulation: prudential and conduct supervision, rights to establish local branch or sales networks, access to payments systems and market infrastructure and the requirements imposed on their corporate governance, data handling or any other aspect of business. National treatment should extend to new financial services, with foreign firms automatically eligible to provide new financial services approved for the market on the same terms extended to domestic firms.

- Performance requirements commitments can be used to restrict the use of performance tests to constrain or limit the freedom of foreign firms to establish and operate locally. These might include obligations to employ a defined quantum of local managers or directors, use local suppliers, achieve a defined level of local credit creation, achieve regional or local targets with respect to lending or commercial presence, or transfer technology or other assets to local providers. They can also be used to prohibit the linkage of authorisation with data requirements such as localisation.

Unlike in the GATS, commitments taken by trading partners in UK bilateral agreements covering these disciplines on limitations on market access and discriminatory treatment should be general commitments, to which only stated and agreed exceptions are permitted. In such an approach, **general** commitments on market access, performance obligations and national treatment can be taken as applying to all activities in scope unless explicitly excluded.[17]

16 Article XVI of the General Agreement on Trade in Services (GATS) defines a wide range of prohibited measures that might restrict the freedom of foreign firms to establish in a domestic market including numerical quotas on suppliers, caps on the total amount of contracts, customers, or volume of services permitted and restrictions on forms of legal entity available to inward investors.

17 In trade policy jargon, such an approach is usually described as a 'negative list'. Its core implication is that non-discrimination is applied as a general principle unless explicitly denied in a specific case. The opposite 'positive list' approach only guarantees what is explicitly stated in a schedule of commitments.

Exclusions should be defined as much as possible at the level of individual and specific non-conforming measures,[18] rather than general prerogatives to maintain restrictive or discriminatory measures both in their current and any future chosen form.

- Such an approach has a number of key benefits both for firms and for negotiators:

- It **binds as much actual applied access and treatment as possible at entry into force of an agreement**, rather than simply limiting bound access to a series of explicit commitments.[19]

- It **crystallises residual market protection** in lists of reservations. While these require careful navigation by businesses in determining the actual value of general commitments, they have the considerable value of confirming that any area or aspect of supply not explicitly excluded from commitments is included.

- It has a **built-in ratchet effect**, because it ensures that, unless additionally specified, if a measure covered by an exception is removed, it cannot be replaced. This also ensures that it is not always necessary to update the text of an agreement to secure new rights as regulatory frameworks evolve or new services emerge. The use of special 'general' reservations to counteract this ratchet effect should be as limited as possible.

18 These should be specified by reference to their location in a particular piece of domestic law or regulation.

19 An explanation of 'bound' and 'applied' access is given in Box 9, Part 5 of this report

4.3. Branching rights

As well as rights to establish authorised subsidiaries, exporters should have the right to provide services through a branch. This choice provides scope to establish in an export market, subject to local authorisation and supervision, but at a level of cost lower than full subsidiarisation. While this may not be appropriate for banking or financial services operations of high levels of complexity, scale or prudential importance, for most others it provides a valuable route to market and in many cases a first step to full local establishment. Like full establishment rights, branching rights should be extended on a national treatment basis and on the basis of equality of treatment between foreign suppliers subject to the same market access regime. This is important, because discriminatory treatment of foreign branches in areas such as their capacity to serve local retail customers, are a recurrent feature of many markets.

Moreover, branch treatment is one area where the scope for duplicative supervisory requirements is high, because a branch is regulated and supervised simultaneously by its host jurisdiction and through its foreign parent. Such duplication can act as an implicit trade barrier. While some form of dual oversight is necessary, it nevertheless creates scope for overlapping or even contradictory requirements or obligations that could potentially be limited or mitigated through close supervisory cooperation, at least where branches remain below a defined scale and offering a defined set of services.

Such duplication is most likely in:

- capital requirements;
- liquidity requirements;
- crisis management or resolution protocols;
- risk management functions or similar;
- obligations to participate in investor or depositor protection regimes.

The attempt to rationalise such duplications should not be seen in any way as weakening conduct or prudential standards. Branches should remain subject to the appropriate level of host state discretion and oversight. The scope for disapplying prudential requirements should extend only to areas where the host state is able to defer to home state regulation and supervision on the basis of its adequacy or comparability. While such approaches may not be appropriate for the provision of retail services such as deposit-taking, they should be practicable for defined forms of wholesale service. Such prudential recognition/deference can be integrated into general branch treatment frameworks, but it has also been elaborated in a preferential form, as in the 1993 EU-Switzerland agreement on direct non-life insurance (see Box 2).

BOX 2: RECOGNITION IN BRANCH TREATMENT FRAMEWORKS – EU/SWITZERLAND

The EU-Switzerland agreement on direct non-life insurance[20] (1993) was designed to deepen and simplify the trade in direct (non-life) insurance between the European Community and Switzerland. It did so by establishing a preferential branching regime between the two sides that relaxes formal and reporting requirements for branches and provides for a greater degree of deference to home supervisors for branch oversight than is the norm for EU third country regimes.

The agreement is based on a parallel set of common commitments on the conduct of insurance regulation, including solvency calculations, that in essence represent a recognition by the two sides that their regimes are sufficiently comparable to be treated as having the same supervisory effect. The agreement includes an 'off-ramp' clause that allows branches authorised under the agreement a year to seek alternative third country authorisation in the event of the agreement being denounced by either side.

20 See Treaty text here

4.4. Delegation, data transfer and other forms of intra-group operations for established banks

The principle of seeking to minimise duplicative requirements for foreign firms operating in a host market has potentially wider applications outside branching arrangements. It potentially applies to a range of operations between entities in two trading jurisdictions.

The GATS rightly recognises that it is not the obligation of WTO members to compensate foreign firms for the inherent challenges or duplicative costs of operating outside of their parent (or home) jurisdiction. It is nevertheless important to recognise that because the regulatory costs of providing financial services are generally high, providing services across multiple markets can easily involve a high and costly level of duplication in areas such as capital adequacy or risk management activity.

These duplicated costs can easily impact or erode the economic feasibility of competing to provide services simultaneously in multiple jurisdictions. While this is not a reflection of protectionism, it can have the effect of reducing the scope for investment and trade. Measures that allow for the rationalisation of functions between entities of the same group can play an important role in lowering the duplicative costs created by trade.

This might include:

- the ability to delegate defined functions from the host market back to the home market as part of a rationalisation of activity, subject to minimum requirements for the supervision of those activities in the home market;
- the ability for a local subsidiary to enter into transactions for risk management purposes with its foreign parent under exceptions from large exposures or concentration risk requirements for transactions within a group subject to foreign consolidated supervision recognised by the subsidiary's state as providing adequate protection to its prudential policy/financial stability objectives;
- the rationalisation of regulatory reporting or similar requirements feasibly dealt with through information sharing between supervisors and regulators in colleges or similar;
- the explicit rights to move financial data out of a market of import and the ability to consolidate personal data storage across the home and host market (subject to the requisite data protection protocols) – see Box 3.

BOX 3: RECOGNITION IN PERSONAL DATA TRANSFER REGIMES – AUSTRALIA AND THE EU

The provision of banking services often requires the collection, processing and storage of personal customer data alongside a huge range of other market and financial data. The ability to move such sensitive customer data between international operations is often important for allowing a global service provider to serve a customer in multiple jurisdictions, or to allow the rationalisation of its processing at a single point. However, the transfer of such sensitive data between countries requires high levels of data protection.

Regulators around the world have taken varying approaches to this problem, but many have introduced the concept of recognition into their legal frameworks in various ways.

- Transferring personal information from Australia is regulated by a range of data protection laws, the most important of which is Australian Privacy Principle 8. This principle limits the liability for failings in data protection only where the transfer is to a recipient subject to a data protection regime "at least substantially similar" to that of Australia. However, the Australian authorities do not maintain a list of such jurisdictions, and it is for Australian companies to make this judgement themselves aware that they can be subject to audit by the Australian data protection authorities (e.g. by obtaining legal advice about the recipient jurisdiction).
- The EU operates a more prescriptive system, under its new General Data Protection Regulation (and its predecessor) in which a list of 'adequate' countries is maintained by EU authorities on the basis of an audit of the third countries' data protection regimes.

Under both models, where the recipient jurisdiction is not 'substantially similar' or 'adequate', the data exporter must either put in place additional safeguards to protect the data or else must obtain the consent of the individual. Again, the Australian model provides firms more flexibility, though less certainty. Under EU law, pro forma clauses are set by EU authorities for data exporters to include in contracts with data importers as the primary means of protecting transfers, while in Australia regulatory *guidance* states that enforceable contracts are "generally expected" and lays out *recommended* contract content. Similarly, EU criteria for valid consent are more prescriptive.[21]

In all of these areas, as with the treatment of branches, the aim should be to lower the costs of group operations across two markets to the greatest extent consistent with prudential soundness. As with branching rights, the use of prudential recognition can play an important role in determining the adequacy of home regulation and supervision required for relaxed local requirements and deference to the home state regime.

21 It should also be noted that the 'Shrems II' decision of the Court of Justice of the European Union suggests that data exporters need to perform a risk assessment in addition to using the pro forma contractual clauses, though regulatory guidance on this matter is yet to be finalised.

4.5. Rights to contract across borders

As noted above, the right to contract the supply of financial services cross-border raises some of the most difficult questions for financial services trade. Because the supplier is outside the regulatory jurisdiction of the consumer, supervisors and regulators inevitably require a high level of reassurance that they are not increasing risks to financial stability or consumer protection. The increasing technological feasibility of providing banking and other regulated financial services online and remotely has far outpaced the development of regulatory policy designed to accommodate such new capabilities.

Nevertheless, many jurisdictions do maintain frameworks for cross-border contracting of some kind, in defined circumstances. Most WTO members will generally allow their consumers to procure financial services from abroad on an unsolicited basis, and this right is codified in the GATS Understanding on Commitments in Financial Services and is reiterated in many bilateral trade agreements.

Other states allow informed customers to access foreign financial services. For example, the UK OPE regime (see Box 5 below) which, among other things, allows foreign firms to provide securities, derivatives and certain other services to a range of UK-based clients, is considered to be able to select financial services suppliers and to judge and manage the associated risks. Some jurisdictions do not regulate certain activities, such as corporate lending or 'spot' foreign exchange services, which can thus provide scope for such activity to be conducted cross-border simply because it is not captured within the importing (or host) market's regulatory 'perimeter'.

BOX 4: DIFFERENTIATING BETWEEN TYPES OF USER OF SERVICES IN CROSS-BORDER TRADE

Cross-border frameworks for trade in financial services sometimes differ from conventional frameworks for trade in an important way: they make the nature of the consumer of the service a key factor in whether trade is permitted. For example: the UK OPE system widens rights for cross-border contracting only to financial professionals in the UK (see Box 5, below). The EU-Canada FTA creates new potential cross-border trading rights for portfolio management services, but only for professional investor users.

This differentiation between types of customer reflects the regulated nature of financial services and makes a distinction above all between professional and qualified users of wholesale financial services, and retail customers. The former are sophisticated users of financial services; the latter individuals and households whose level of financial sophistication is generally much lower and for whom the duty of care for regulators is proportionally higher.

Some basic categories of customers might be defined as:

- **Qualified counterparties**. These are large financial organisations, governments, and very large corporates with sophisticated systems of financial risk management.
- **Professionals**: These are investment professionals, qualified to manage financial assets, or private banking clients of a high level of financial sophistication.
- **Small commercial customers**: These are small to mid-sized businesses that might operate cross-border to some degree and value access to certain sophisticated financial services, not least to support this.
- **Retail customers, including individuals and micro businesses**: these are the bulk of banking customers – ordinary users of basic financial services.

This kind of differentiation is a useful tool for developing frameworks that potentially allow policymakers to enlarge cross-border contracting rights for sophisticated users of financial services, while maintaining an 'establishment-only' approach for serving retail customers, potentially complemented by some freedom to select cross-border supply on an unsolicited basis.

For regulated activities, some states have developed a sophisticated approach to assessing the circumstances in which cross-border contracting provides valuable choice and diversity of service to local customers and should therefore be permitted. In parallel, they have developed a range of bases for such rights, generally linked to assessments of the quality of regulation in the home market of firms providing cross-border services. Key here is deference by the host/importing state to the regulation and supervision of the home/exporting state.

The types of customer entitled to take advantage of deference can vary from jurisdiction to jurisdiction. Some of the frameworks place primary emphasis on the type of users procuring a service cross-border; some use the type of product or service as a core criterion. Most of the approaches use a mixture of both. Most are also based on some form of assessment of the quality of regulation in the home jurisdiction of the service provider. Some EU states provide this kind of access in defined areas at the national level, as do the US, Australia and others in defined areas.[22].

Such arrangements may not be appropriate for all forms of banking and capital markets services – many retail services for example, raise particular consumer protection issues when traded cross-border[23]. But the various regimes from around the world emphasise that in areas such as corporate banking, commercial lending, investment management and the trading of securities, such arrangements can materially widen the reach of local users of financial services (e.g. investment professionals and corporates) in accessing financial services in a way that is mutually beneficial to both sides. With the right level of regulator-to-regulator trust and cooperation and/or the right level of alignment between regulatory and supervisory regimes, cross-border contracting by governments, professional or wholesale customers is perfectly feasible and can make an important contribution to the choice and diversification available to sophisticated users of financial services.

An additional factor in designing cross-border trading frameworks for financial services relates to the problem of duplicative requirements. Some cross-border frameworks allow cross-border contracting, but impose local requirements on a supplier as a condition of its provision. These might take the form of licensing, registration, commercial presence or other requirements of varying levels of complexity.

The more substantive and duplicative these obligations are, the greater the likelihood that they will negate the value of cross-border access. For this reason, one of the challenges of designing effective frameworks for cross-border trade in financial services lies in determining how such formal requirements for cross-border provision can be reduced – in general by replacing them with reliance on the home supervisor of the provider, i.e. trade is facilitated by the host/importing state deferring to the regulation and supervision

22 These EU regimes are explored in much greater detail in the UK Finance Report Serving Europe: Navigating the legislative landscape outside the single market (September 2017).

23 However, it should be noted that retail banking services should be available on an unsolicited basis for UK retail customers and UK customers should be free to consume financial services abroad. See section 4.8 below.

of the home/exporting state.

Alongside conventional forms of non-discrimination, in designing cross-border frameworks it is important to consider:

- The scope for exempting cross-border trade from unnecessary licensing or similar requirements additional to those already provided by the home party for the services being offered. Even apparently non-discriminatory requirements can operate as an effective bar to cross-border services because of the practical difficulty of complying with multiple cross-border authorisation regimes and the related national rules that apply to authorised firms;

- The scope for exempting cross-border trade from commercial presence requirements, at least where the supplier is authorised in its home state, and ensuring that commercial presence is not made a condition of cross-border supply rights where such supply is permitted. A requirement to establish a commercial presence, such as a branch or subsidiary can materially impact the commercial viability of the provision of services on a cross-border basis.

- The scope for limiting duplicative rules for cross-border providers. Requirements for cross-border providers that duplicate requirements they already meet in their home market can operate as an effective bar to cross-border services, or raise the cost of such service to the point that it is economically unattractive. However, this commitment should not restrict the right of a host supervisor to require a financial institution to comply with non-discriminatory requirements relating to market integrity, such as rules on reporting of large positions, registration of prospectuses, requirements relating to takeovers or mergers, restrictions on short sales or rules preventing insider dealing, market manipulation or elements of general consumer protection rules.

Such reliefs could be codified in regulatory frameworks for cross-border trade and bound in the formal requirements clauses of bilateral trade agreements, although it is recognised that this is an area of regulatory sensitivity that may not lend itself to binding. They may also be linked to frameworks in which the host/importing state defers to the regulation and supervision of the home/exporting state.

BOX 5: THE UK 'OPE' REGIME

The UK operates a regime for cross-border trade in financial services that has a number of important features. Specified activities are permitted to be carried out without the need to be authorised in the UK in defined circumstances. The UK 'overseas person's exclusion' ("OPE") regime identifies two main circumstances in which an overseas person may contract cross-border with a UK person without having to be authorised in the UK:

- *Transactions with or through UK authorised persons:* When the overseas person is transacting with a firm that is itself authorised in the UK or with other parties in the UK and the transaction is arranged or executed by a UK authorised person. "With or through" is limited to 'transacting' activities (e.g., dealing in securities and derivatives). It does not cover other forms of contracting for financial services e.g. contracting for investment advice.

- *Contracting following a legitimate approach:* When the overseas person contracts with a UK person as a result of an approach to the UK person which was either solicited by the UK person or did not contravene the UK marketing rules. Those rules allow marketing to UK authorised persons and other 'investment professionals' as well as to companies and trusts meeting certain size thresholds, thus allowing overseas persons to provide services under the OPE to a wide range of institutional investors and other wholesale market participants.

These rights apply to a range of services, including arrangements to buy, sell or subscribe to securities or derivatives, advising on investments, operating trading facilities and trading in securities and derivatives as an agent or principal.

The UK OPE regime is not a recognition regime in the sense used in this report. Rather it is based on the principle that authorised intermediaries, investment professionals and larger companies should have the financial sophistication to contract with non-UK persons. The OPE places the onus on these kinds of firms to acquire and apply such expertise. It also recognises that, where an overseas person transacts with other UK investors through a UK authorised firm, the regulatory rules applying to the UK authorised firm should provide adequate protection to the UK investor and meet other UK policy goals.

The interaction between the OPE and the marketing rules also allows the provision of cross-border services in other circumstances that recognise the reality of cross-border activity, e.g. by allowing a foreign firm to continue to provide services to a customer who relocates to the UK. This framework places the customer at the centre of the trade policy, allowing a range of global choices to authorised and sophisticated service users.

The UK OPE regime is complemented by other features of the UK regulatory framework which ensure that the UK is relatively open to cross-border financial services. For example, UK law generally allows UK residents to maintain foreign bank accounts and to access foreign payment services so long as suppliers comply with limited disclosure requirements. The UK does restrict the supply of cross-border credit to consumers, but there are exemptions for some business with high net-worth borrowers, and the UK does not regulate cross-border (or domestic) corporate lending, allowing UK corporates to access a wider variety of financing options. This import regime is an important part of the general UK framework for trade in financial services and should be sustained. It is discussed further in Section 4.8, below.

4.6. Temporary movement of persons and recognition of qualifications

The ability to provide banking or financial services is closely linked to the ability to employ and deploy individuals with the right skills and experience. A bank establishing operations in an export market may need to post experienced staff there for that purpose. A bank selling directly to a customer in a third country may wish to dispatch advisors or other staff to conduct aspects of that service in person. Thus, the freedom to move skilled staff between markets can often be an important prerequisite to realising the full value of market access rights or commitments.

A liberal approach to such temporary movement of professional staff linked to delivering traded services is an integral part of a general policy of market openness. It is in the interests of the host/importing state to develop the financial services skills and experience of the local talent pool and to ensure that customers can always be provided with the capabilities they need. Working with experienced staff from a foreign firm can be very effective in transferring those skills and develop the experience of the local staff.

Similarly, foreign firms in emerging and developing markets have a legitimate (and ultimately self-interested) obligation to help develop the depth and sophistication of the local pool of financial services skills in export markets. However, it is not desirable that this is enforced through restrictions on the temporary posting of foreign staff for the purposes of establishing and servicing investments, which can ultimately hamper and devalue the investments themselves. Even in the UK, the ability to bring investment and banking professionals with experience of markets around the world to the UK supports the UK's role as an international hub.

Commitments to temporary movement for the provision of services should not imply rights to long-term residency or economic migration. Nor should they be seen as removing the obligation to hold the required visas or other forms of authorisation for entry and presence. They should be time-limited, linked to existing senior, specialist or technical roles in an exporting company and delimited to that activity. Such rights should generally provide scope to move staff temporarily to another market for a period of around three years.

For banks and financial services, the most important categories of staff to be covered by such commitments are:

- Senior managers with proprietary knowledge of a firm's risk management or other key operational protocols;
- Senior individuals linked to the key processes of securing establishment in an export market and building key relationships with supervisors, including legal and compliance professionals;
- Senior specialist experts in key aspects of a financial services business such as its information technology systems;
- Sales and relationship management staff visiting a market for periods of short duration for the purpose of marketing approved services or developing relationships with local customers;
- Contractors to firms providing essential services, where the contracted firm has no commercial presence or staff in the market of export;

- Graduate trainees, for whom posting to an overseas operation of a business can be an important part of their professional development.

Market access commitments of the kind above, and the granting of temporary rights to relocate staff, do not remove the necessity for financial services professionals wishing to be temporarily or more permanently located in another market to hold the necessary qualifications and authorisations. For this reason, it is potentially useful to deepen the scope for the temporary movement of staff by mutual recognition of relevant professional qualifications between the two jurisdictions.

4.7. Adapting to technological change

Banking and related financial services are increasingly powered by digital technology. Digital technology has changed the way financial markets operate and the way in which customers interact with their banks and financial services suppliers. Beneath this change is a huge volume of data powering operations, recording transactions and shaping financial analysis. It is important that trade policy reflects this technological evolution in financial services. It can do this in a range of ways, both in encouraging technology-friendly regulation and practice in key export markets through regulatory diplomacy and in securing a range of commitments to good practice in FTAs or WTO frameworks. Examples include:

- Ensuring that regulation in trading partners is technologically neutral and non-discriminatory in the way it assesses services that are being delivered both digitally and physically. States should not discriminate between services delivered digitally or physically within markets provided that suppliers can meet the same objective regulatory requirements. The fact that a service is being delivered digitally should not in itself be used as justification for restricting cross-border supply;
- Encouraging coordinated approaches and standardised formats for the electronic submission of regulatory data for supervision purposes to help support operation in multiple jurisdictions and coordinated activity between supervisors. Open government data should be made available to the general public in standardised, machine-readable formats;
- Ensuring that protections against requirements to transfer technology as a condition of local establishment or import rights are clearly extended to source code and related algorithms (See Box 1 above);
- Ensuring that regulation confirms that foreign providers can provide new services as they develop on exactly the same basis as local firms;
- Ensuring that financial data can be moved out of import jurisdictions freely and is not subject to data localisation requirements. Personal data should also be transferable between jurisdictions, subject to robust data protection rules (see Section 4.4 above);
- Supporting the WTO moratorium on tariffs on electronic transmissions and all UK FTA partners should be asked to agree to such a moratorium on a bilateral basis;
- Advocating regulatory frameworks that support the use of electronic signatures and the submission of documents and other information in paperless forms.

4.8. Importing financial services into the UK

Much of this section has been framed in terms of what the UK as an exporting market or jurisdiction should advocate for in its trading partners as they optimise their regimes for trade in financial services. However, by implication, these are also the benchmarks that the UK should set in defining its own regime for the importation of financial services. As with any other traded input, an open import regime allows the importing market's consumers to draw on a wide range of competitive services. The UK already has one of the more liberal regimes in the world in this respect. This regime should be protected and enhanced in the years ahead, irrespective of the choices made by others. In particular, the UK should:

- Ensure that the UK has a regime for commercial establishment that is fully open to foreign investment in financial services on a national treatment and MFN basis;
- Preserve in any circumstance the approach codified in its OPE regime, which enables UK-authorised firms and sophisticated UK customers to access international markets and cross-border services on the basis of their own judgement and allows UK firms to intermediate cross-border transaction services that are provided to other UK investors;
- Ensure that UK customers can be supplied from abroad on an unsolicited basis where this carries an appropriate level of risk;
- Ensure that UK retail customers are free to procure financial services freely while abroad, and continue to be served by those providers in the UK in appropriate cases – for example, UK residents with a second home in the Republic of Ireland for which they wish to maintain an Irish bank account, UK high net worth borrowers that may need to access cross-border lenders and individuals who relocate to the UK but wish to continue using their foreign financial services supplier;
- Continue to seek ways to use deference with sophisticated partner jurisdictions to allow for appropriate regulatory relief for foreign firms established in the UK and as the basis for cross border rights that build on and complement those available under frameworks such as the OPE;
- Continue to seek ways in its supervision of foreign firms established in the UK to remove duplicative requirements that they might meet adequately via their home state obligations;
- Maintain an open regime for the movement of financial and other data in and out of the UK and no obligations for data localisation, subject to robust data protection protocols and assurances that all necessary data is available for supervisory purposes;
- Support the import of financial services to the UK with an open general migration regime for individuals with professional skills related to financial services; an open and simple regime for the temporary relocation of financial services professionals to the UK and an open and accessible regime for short term business travel.

5. THE POLICY TOOLKIT FOR BANKING, PAYMENTS AND RELATED FINANCIAL SERVICES TRADE

As the previous sections have elaborated, the conditions for international trade in banking, payments and related financial services are set by a wide range of choices that states make as part of their regulatory regime. The most important choices relate to:

- How states regulate and supervise 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 for firms that are part of international groups;
- The conditions under which staff can enter their market on a temporary basis to provide services;
- 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.

The combination of these conditions creates the landscape for international trade in financial services. The combination of choices made by states in these areas makes up their **trade policy** for financial services. This section now reviews the toolkit to promote the forms of trade in financial services described in the previous section.

TOOL	KEY FEATURE
Regulatory diplomacy and unilateral reform	UK regulatory diplomacy targeting improved market access and operating conditions in markets abroad 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 in key trading partners. Examples 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 in trading partners. This creates certainty for exporters and can establish 'gold standards' in areas such as transparency and proportionality in regulation. FTA's can also be used to 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 for 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.

FIG 3: THE BASIC TOOLKIT FOR TRADE POLICY IN BANKING, PAYMENTS AND RELATED FINANCIAL SERVICES

5.1. Regulatory diplomacy and unilateral reform

The single most important driver of the liberation of international financial services trade over the last thirty years has been the willingness of market regulators to take unilateral steps to widen the scope for foreign participation in their jurisdictions. This is true of many services sectors, but is especially notable in financial services. States have liberalised both access to establishment in their domestic market for foreign providers and frameworks that allow their banks, institutional investors or corporates to contract cross-border with service providers in other markets. This is done through a combination of their inward investment frameworks for banking and capital markets services and their regulation of cross-border contracting.

Importantly, these arrangements have rarely been negotiated as concessions in trade agreements. Rather, they emerge as the outcome of an internal debate that balances the desire to deepen the choice and competition available to domestic customers with any perceived prudential – or protectionist - issues raised by foreign financial services firm ownership or cross-border contracting. Few of these regimes have been fully bound[24] in WTO GATS schedules or other trade agreements, but they nevertheless represent the practical operating landscape for financial services firms.

This poses a basic challenge for the UK: how can it help encourage this unilateral reform in key markets? Recognising that such liberalisation agendas must emerge from a domestic consensus in the market in question. The UK's most constructive role is to be a source of ideas and endorsement through practical, consistent regulatory diplomacy and cooperation. The UK should continue to use its wide range of economic and financial dialogues and international networks of regulatory and supervisory professionals to support and encourage valuable change.

It is important to emphasise that the UK's own unilateral regime is important in this respect. The terms on which it is possible to import financial services into the UK determine the depth and sophistication of its domestic financial services sector and the choice of services available to UK firms and individuals. They also provide a test case and example to others. The UK should maintain a healthy domestic debate on the appropriate frameworks for cross-border provision of financial services into the UK, but its current bias to openness is an important feature of the UK market and should be sustained.[25]

5.2. Multilateral cooperation and coordination on financial services standards

At the highest level international trade in banking, payments and related financial services is underpinned by multilateral approaches to financial services regulation. A world of converging approaches to financial services regulation and supervision will always be one in which it becomes easier in principle and practice to trade financial services across borders, build financial services businesses that serve multiple markets and create hubs for

24 For the meaning of "bound" in trade policy terminology, see box 9 below.

25 See Section 4.8 above for a more detailed elaboration of the important features of the UK import regime.

financial services sectors that allow the efficient and competitively priced provision of financial services across regions and the global economy. Such convergence should be encouraged wherever practical and possible. This can be done through supporting and engaging with such international organisations as the BCBS, the FSB, FATF and IOSCO. The more that global standards shape national regulation and supervision the easier it will be for firms to operate between national markets with less duplication and more common business and structural models.

5.3. Formal regulatory and supervisory cooperation frameworks

Most of the policy tools described in this report are ultimately dependent on a high level of regulatory and supervisory cooperation between jurisdictions that want to deepen trade in financial services between them. Alongside the supervisory college arrangements that go with the oversight of large financial services groups operating in multiple markets, this cooperation is best supported by structured forms of regulatory cooperation. These can range from formalised collaboration in defined areas (see Box 6: Fintech Bridges, below), to wider institutional dialogues and mechanisms for cooperation. They can be embedded in FTA governance structures or sit outside them on a stand-alone basis. The distinction that is important here in distinguishing these from general regulatory diplomacy is that they are formalised and structured, and may be codified in frameworks such as memoranda of understanding between regulators and supervisors (MOUs) or other instruments that provide the basis for cooperation, such as data-sharing.

Once any UK relationship covers a sufficient range and depth of financial services trade, regulatory and supervisory cooperation then it should be supported by a standing financial services committee or institutional dialogue, comprised of officials nominated by both sides and including all necessary regulatory and supervisory bodies. Such a committee could have sub-committees as required, including in areas such as retail and wholesale banking, capital markets, payments and asset management. In some cases these committees can be stablished as part of FTA commitments, as with the EU-Japan Financial Services Regulatory Forum. Or they can be established in the absence of an FTA structure, as with the US-UK Financial Markets Dialogue and Financial Regulatory Working Group.[26]

Such institutional channels should oversee:

- The ongoing implementation of any FTA or other legal/formal commitments between the two sides;
- The regular review of reservations to commitments from each side, and of formal or performance requirements that caveat commitments (if these exist in an FTA);
- A regulatory dialogue that includes an early sight mechanism for both sides for all key pieces of financial services legislation or relevant supervisory guidance in which officials and industry representatives have an opportunity to comment;

26 See the September 2020 British American Finance Alliance (BAFA) paper for specific recommendations concerning the US-UK FRWG.

- Where recognition (such as deference) has been adopted as the basis for market access or other aspects of supervisory treatment, the ongoing oversight of these recognitions and the development of a set of protocols for prospectively reviewing material changes in regulatory frameworks themselves (see Section 5.7 below).

The committee proposed here should also develop the protocols for the withdrawal of recognitions, which should include clear consultation rights and adequate 'off-ramp protocols' to ensure that businesses and citizens have time to manage any disruption caused by a revision of rights.

Trading partners could also underpin their formal regulatory and supervisory cooperation through:

- A parliamentary dialogue where appropriate, in which legislators on both sides meet regularly to align their work, compare approaches and contribute constructively to the work of designing and adopting financial and banking markets standards on both sides;
- A stakeholder dialogue, in which industry input is sought regularly on aspects of the relationship that require the committee's attention.

The UK's proposed Global Financial Partnerships are an important development in this area, blending elements of regulatory cooperation and an explicit intention to explore opportunities for cross-border trade based on deference[27]. Similarly, the October 2020 MOU between the Bank of England and the US Commodities and Futures Trading Commission provides a firm basis for information sharing, cooperation and coordinated supervision that will support cross-border operations in this area[28]. These are both models that should continue to be fully explored.

27 See here for detail on the UK-Switzerland GFP.

28 The text of the MOU is available here: https://www.bankofengland.co.uk/news/2020/october/cftc-boe-sign-new-mou-for-supervision-of-cross-border-clearing-organizations

BOX 6: FINTECH BRIDGES – SINGAPORE, HONG KONG, UAE, UK, AUSTRALIA ET AL.

The Fintech bridge concept, as pioneered by Singapore, Hong Kong, the UK and others, is a good example of an approach to regulatory diplomacy that formalises regulatory cooperation and collaboration with the collateral benefit of facilitated market entry. It institutionalises cooperation between regulators, deepens the legal basis for information sharing and, as such, underpins the capacity of Fintech firms to scale from one market into the other.

The first Fintech bridge was established between Singapore and the UK in 2016 and has since expanded into similar mechanisms employed by Hong Kong, Australia, Canada, China, Japan and South Korea. These bridge arrangements are bilateral cooperation agreements that serve a range of purposes:

- They create the formal basis for regulators to share information efficiently about financial services innovation in their respective markets;
- They encourage authorities to collaborate in reviewing emerging trends and the regulatory issues they raise;
- They aim to foster innovation in the area of Fintech by sharing best practice on the regulation of new concepts and services;
- They provide a 'calling card' for firms authorised in one jurisdiction who seek authorisation in the other, with both supervisors encouraged to acknowledge that firms have been authorised by a trusted partner.

The Fintech bridge model has application in areas where two trading partners want to create a catalyst for institutionalising regulatory and supervisory cooperation – and exports - in financial (or other) services.

5.4. Recognition/deference frameworks

Recognition regimes can play an important part in the liberalisation process. Under such arrangements, host supervisors in one market defer to the regulatory regime applied by their peers in a third country as discussed in Section 3.2, page 9.

WTO members are free unilaterally to recognise the standards of other WTO members and condition operational rights for foreign firms in this way. However, unless such arrangements are embedded in WTO-compatible bilateral trade agreements, they must do so in a way that does not discriminate unreasonably between WTO members. Where a member unilaterally recognises another country's regulatory regime it must give other WTO members the opportunity to demonstrate their own qualification for the same recognition.[29]

Once granted, these recognitions can be used in a range of ways, including:

- recognition or reliance on the actions or other functions of a home supervisor to reduce duplicative requirements;
- the waiving or relaxing of local authorisation requirements for the provision of cross-border services;
- relaxed operational requirements for cross-border firms, or for the branches or subsidiaries of foreign firms;
- mitigating treatment for cross-border exposures to institutions in the recognised/equivalent jurisdiction, or other accounting treatment.

29 Paragraph 3 of the Annex on Financial Services I of the General Agreement on Trade in Services (GATS). Article VII of the GATS also permits WTO members to develop systems of recognition to underpin trading or operational rights, but requires that such recognition should be available on the same terms to all WTO members.

BOX 7: RECOGNITION IN THE WTO RULEBOOK

It has long been recognised that formal differences in standards can act as a source of duplication and frictional cost in trade in both goods and services. A company that meets the formal standards for supplying a service in Country A and is licensed or accredited to do so may nevertheless have to meet completely separate licensing processes in Country B if they wish to provide the same service there. In the same way, goods that meets the product standards requirements of Country A will nevertheless need to formally be recognised as meeting the same product standards in Country B, even if the product standards are themselves similar or identical.

WTO members can unilaterally recognise the standards of other members, exempting companies that meet the requirements in their home state from parallel requirements in the host state in which they wish to conduct business. WTO rules allow such recognition provided it is open, in principle, to all other members of the WTO[30] and is not used as a "means of discrimination between countries in the application of its standards or criteria for the authorization, licensing or certification of services suppliers, or a disguised restriction on trade in services."[31]

In the area of financial services, the GATS acknowledges that members may – through an agreement or arrangement or unilaterally – recognise the prudential measures of any other country in determining how their own measures should be applied. For example, some "third country regimes" under EU financial services legislation can unilaterally give firms from third countries similar treatment to EU firms without compliance with all the requirements of EU legislation, if the European Commission determines that the relevant third country has an "equivalent" regulatory regime, appropriate regulatory and supervisory cooperation arrangements exist and, in many cases, there is an effective reciprocal regime for equivalent treatment of EU firms.

Under the GATS Annex on financial services, a member that is a party to such an agreement or arrangement or grants that recognition unilaterally must afford adequate opportunities for other interested members to negotiate their accession to the agreement or arrangement or to negotiate or request comparable agreements or arrangements, where there would be equivalent regulation, supervision and enforcement and, if appropriate, information sharing procedures.

In financial services, such recognition, and its corollary effects, can take a range of forms. It is generally extended by regulators and supervisors on the basis of their assessment of the regulatory regime applied by their peers in a third country. Recognition can be accorded unilaterally, achieved through agreed harmonisation of the rules between two countries, or based upon an agreement or arrangement between two countries to align their regulation and supervision (but not necessarily the detail of their rules), or treat their current practice as already having this effect. The effects of such recognition can include:

- the waiving or relaxing of local authorisation requirements for the provision of cross-border services;
- relaxed operational requirements for cross-border firms, or for the branches or subsidiaries of foreign firms;
- recognition or reliance on the actions or other functions of a home supervisor to reduce duplicative requirements;
- mitigating treatment for cross-border exposures to institutions in the equivalent jurisdiction, or other accounting treatment.

Treatment granted and applied on the basis of recognition is inevitably contingent on the underlying assessment of adequacy, comparability or equivalence by the authorities that extend it. Unlike an eliminated tariff in a trade agreement, which can only be reinstated subject to compensatory concessions to a trading partner, treatment based on recognition can be removed unilaterally if either party changes their regulatory approach in such a way as to remove the basis for equivalence.

For practical reasons, such recognition frameworks should ideally be subjected to protocols that give firms foresight of any withdrawal of recognition and time to adapt to the market changes they can bring.

30 GATS Article VII:2 https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm#articleVII and GATS Annex on financial services, paragraph 3 https://www.wto.org/english/tratop_e/serv_e/10-anfin_e.htm

31 GATS Article VII:3 https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm#articleVII

Ideally, such regimes for recognition should be based not on exact approximation of rules or protocols but on the close alignment of intentions and outcomes. They can and should be based on wider assessments of a common culture of regulation and supervision and a joint commitment to multilateral standards and common intent and outcome in regulatory frameworks. Thus, the criteria for recognition should be much wider than simple comparisons of regulatory frameworks, and might include:

- The integration in a trading partner's law and practice of multilateral standards agreed at the level of the FSB, IOSCO or similar bodies;
- Whether the trading partner's regulation and supervision is directed to achieving similar public policy outcomes, most notably the preservation of financial stability but in areas such as data transfer this would be robust personal data protection;
- The adequacy of regulatory enforcement in a trading partner;
- The level of resources devoted to supervision and ancillary functions, as a measure of a trading partner's commitment to enforcing its rules;
- The perceived quality and institutionalisation of regulatory and supervisory cooperation between the trading partners, manifested in regulatory cooperation agreements and other arrangements.

As noted above, the global standard setters (the FSB, BCBS and IOSCO) and the IMF and World Bank verify in different ways the compliance of jurisdictions with global standards on financial services regulation and supervision. This independent verification of the adequacy of a home or exporting jurisdiction's financial services regime should offer a material measure of reassurances to states of the adequacy, equivalence or comparability of that partner regimes.

Treatment granted on the basis of recognition is inevitably linked to the underlying assessment of adequacy or comparability by the authorities that extend it. For this reason, such recognition frameworks should be subject to protocols that give firms foresight of such withdrawals of recognition and time to adapt to the market changes they can bring.

Ideally, unilateral recognition regimes should contain 'off-ramp ' protocols (i.e. provisions regarding the termination of the recognition, including appropriate time periods, rights of appeal and adjudication and the other typical features of due process). These should allow for consultation with a trading partner before they are withdrawn and reasonable timeframes for withdrawal that allow the necessary time for firms to adapt to changes, especially if these relate to customer service arrangements based on cross-border market access rights or important operational protocols like the risk weighting of exposures, which could have material implications for capital or liquidity.

Unilateral recognition can of course also be extended 'mutually' by means of a reciprocal agreement in a bilateral context. The reciprocity in these contexts serves a valuable political and signalling function, but is not intrinsic to the value of deference frameworks/recognition regimes.

BOX 8: RECOGNITION REGIMES

Unilateral - Australia, Germany and the EU

There are a wide range of unilateral recognition regimes for financial services in the global economy. They address different activities and classes of customer. They also take a range of approaches to the process of recognition itself, some requiring detailed side-by-side analysis of regulatory frameworks, while others are based on more holistic assessments of the comparability of regulatory philosophies, rulemaking and supervisory approaches.

- The Australian Securities & Investments Commission is introducing a new licensing regime for foreign financial services providers. Under this regime, providers that are licensed or authorised by an overseas regulatory authority under a regime determined by ASIC to be sufficiently equivalent to the Australian regime (which includes the UK regime) may apply for a foreign financial services licence to provide financial services to wholesale clients in Australia. Holders of these licences are exempt from a number of the obligations that would apply to firms that hold a standard financial services licence, on the basis that they are subject to sufficiently equivalent overseas regulatory requirements. This regime is replacing the previous regime which conditionally exempted overseas firms providing services to wholesale clients in Australia from the licensing requirement where the firm was regulated by an overseas regulatory authority under a regime determined by ASIC to be sufficiently equivalent to the Australian regime.[32]

- The German third country licensing regime allows certain German corporate banking customers to contract with 70-80 third country banks, including from Australia, Singapore, Switzerland and the US. This **unilateral and non-reciprocal deference** to the home regulator of these firms is based on an assessment of their regulatory regimes and a determination that the firms are effectively supervised by the home regulator according to internationally recognised standards and that the home regulator cooperates satisfactorily with the German prudential regulator the BaFin.

  Under the EU Markets in Financial Instruments Regulation, firms authorised and regulated in a non-EU state can register with the European Securities and Markets Authority (ESMA) to provide cross-border services to eligible counterparties and certain professional clients in the EU if the European Commission has determined that the legal and supervisory regime in the non-EU state is equivalent to the EU regime for investment firms. Non-EU firms registered with ESMA do not have to comply with all the rules applicable to EU firms providing those services, on the basis that they are subject to equivalent home state rules. However, they will have to comply with limited conduct of business obligations, information and record keeping requirements and (in some cases) additional reporting, transparency and trading obligations. The European Commission has not yet made any equivalence determinations under these provisions.

Standalone mutual recognition agreements – US, EU, and Australia

Several WTO members have taken the initiative of negotiating and agreeing standalone mutual recognition frameworks that go beyond any core arrangements for prudential recognition in their domestic regulatory frameworks. These stand-alone agreements are reciprocal and targeted at specific activities of mutual interest to both sides. Some examples include:

- The **US Covered Agreement on Prudential Measures regarding insurance and reinsurance with the UK (2019)**[33] this provides for exemptive relief for US insurers in the UK from the application of US solvency requirements on the basis of the worldwide operations. In both cases, deference to home supervision for the purposes of solvency requirements was agreed. The agreement also eliminates collateral and local presence requirements for reinsurers from each market in the market of the other.

  Underpinning the agreement is the mutual recognition that the standards of the other party are sufficient to assure adequate prudential

32 See City of London Corporation: UK cross-border trade in services with Australia, July 2020

33 See Text

outcomes with respect to certain cross-border or group activities, not least because both implement multilateral standards for insurance supervision.

- The **2008 mutual recognition arrangement**[34] on cross-border trade in securities services between the US Securities and Exchange Commission ("SEC") and its Australian counterparts provided that the SEC will provide exemptive relief to Australian broker-dealers seeking to do business with defined US qualified investors in certain Australian equity and debt securities, with the Australian authorities providing corresponding relief to US broker-dealers seeking to do business with defined Australian wholesale clients in certain US equity and debt securities.

34 See SEC announcement

5.5. Bilateral Free Trade Agreements

As the momentum behind multilateral frameworks has slowed in the last decade, attention has increasingly turned to bilateral trade agreements. Such agreements are the basic tools of commercial diplomacy. They are used to establish and bind preferential or general terms of market access and non-discrimination between two or more states. They can also act as a useful basis for confirming high standards of regulatory practice in both parties, and in doing so help establish global benchmarks in these areas. Although they are negotiated and signed outside of the WTO framework, they are compatible with it, provided they comply with the WTO agreements, chiefly by covering a sufficient level of trade between the parties[35].

From the perspective of financial services businesses, the use of FTAs for making commitments with respect to trade in financial services has a number of potential benefits:

- Such commitments can help to lock in the existing access provided by one FTA party to the firms of another by bringing their guaranteed access closer to what they actually provide in practice (see Box 9 on page 44). This provides greater certainty for investing and trading firms;
- Such commitments in an FTA are binding on a trading partner and can only be amended if new concessions are provided in other areas to balance the market access rights being withdrawn – or by withdrawing from the free trade agreement. This helps make them relatively robust and reliable;
- Such commitments in an FTA can provide preferential treatment for the two parties not extended, in principle or practice, to any other WTO member, provided they meet the terms set out in GATS Article V. For example, an FTA can in principle allow two parties to apply recognition regimes to each other that are not made available to other parties[36], or extend majority or wholly foreign ownership rights for banks to firms of the two parties where they may not be available to all other trading partners on an MFN basis;
- Such commitments in an FTA can in principle be made subject to the dispute resolution arrangements embedded in an FTA. This provides a formal mechanism to resolve disputes about them in an open and transparent way.
- Such commitments can help 'lock in' forms of best practice in regulation and regulatory, supervisory and legislative transparency and responsiveness, putting a floor under good practice and signalling it to others.

35 Article V of the General Agreement on Trade in Services (GATS) permits WTO members to sign preferential trading agreements between themselves covering services, provided such agreements include "substantial sectoral coverage", with "substantially all discrimination" removed in the sectors covered. The precise meaning of this definition is subject to debate, but it is generally taken to mean that the agreement should cover a large majority of the GATS' categories of service and should not exclude any mode of service trade on principle.

36 In principle, parties can embed 'most favoured nation' clauses in bilateral agreements that require that they benefit from, or have fair access to, forms of preferential access agreed by the other party to an FTA with a third country in the future. Such clauses have been used narrowly in the EU-Canada and EU-Korea FTAs, applied to the investment and cross-border trade in services chapters.

However, as noted above, while states have been willing to bind commercial establishment rights in many cases, they have often been reluctant to bind market access conditions for cross-border trade in financial services, except where they have already made narrow commitments of this kind at the WTO level. A number of recent FTAs, including those negotiated by the UK with Japan (like the Japan-EU FTA from which it is derived) have covered financial services in some form.[37] This coverage has generally focused on:

- Binding the conditions of commercial establishment at least to its current level, ideally removing any limitations on majority or wholly foreign ownership and establishing a level playing field for established foreign banks with their domestic competitors;
- Binding to some extent cross-border access where it is provided by the parties. In this area FTAs have been especially limited, generally creating or binding little access and often leaving cross-border traders subject to authorisation requirements in the host market, which can sharply devalue commitments made;
- Binding as much as possible the terms for the temporary posting of staff to the other market for the provision of services;
- Establishing a shared level of transparency on protocols for regulation and authorisation processes, often with rights of consultation for the other party and general requirements that regulation impose only necessary burdens;
- Creating an institutional structure such as a Joint Committee for cooperation on the implementation of the agreement and other issues related to financial services markets.

In addition, a number of FTAs contain most-favoured nation commitments which make it more difficult for one of the parties to agree more favourable arrangements on services in other FTAs with third countries, because it may have to extend the benefit of those arrangements to the original FTA partner (without securing any reciprocal concessions negotiated with the third country in exchange for those benefits).

37 See Ortino and Lydgate (2019) "Addressing Domestic Regulation Affecting Trade in Services in CETA, CPTPP, and USMCA: Revolution or Timid Steps?" for a detailed discussion of how recent FTAs (e.g. USMCA, CPTPP) have covered financial services

BOX 9: APPLIED AND BOUND ACCESS

In trade policy terms there is an important distinction between the conditions that a state 'applies' in its market through its domestic regulatory framework and the conditions that it 'binds' in its WTO General Agreement on Trade in Services (GATS) schedule or in bilateral agreements with other WTO members. These 'bindings' make it materially harder for states to remove or revise these conditions in future. Applied measures can be changed at any time, provided that in doing so a state does not breach bound commitments.

This distinction between bound and applied conditions matters chiefly in terms of certainty for financial services businesses. While 'applied' access is obviously valuable, without 'binding' it is always potentially subject to removal or revision. For this reason, and as noted below, one of the aims of bilateral trade agreements in services is often to 'bind' a partner's applied regulatory regime for trade in services so that it cannot be reduced in scope in future. The extent to which a condition for trade is bound is an important test for any measure, and the extent to which a bilateral and multilateral trade agreement can bind applied conditions is an important test of its practical efficacy.

This is true for market access conditions and regulatory protocols around authorisation or rulemaking.

Nevertheless, it has to be recognised that the sensitivity of questions of regulatory prerogatives inevitably shapes the way that states consider binding their market frameworks both at the level of WTO commitments and in preferential trade agreements. This simple calculus generally explains why the global market in financial services trade is much more open in practice – at the applied level - than the binding commitments of WTO states would suggest. It is also why even sophisticated modern bilateral free trade agreements have generally made limited progress in creating and binding new market access or non-discrimination, even if they have successfully bound current access and treatment. In practice, it suggests that trade policy should aim to deepen "applied" access and conditions wherever possible, and to bind these conditions wherever feasible. The tools set out in this report focus chiefly on new applied access, while noting and welcoming the role of the WTO and FTAs in binding that access once it has been established.

5.6. Multilateral commitments

All WTO members maintain a schedule of commitments under the terms of the 1994 General Agreement on Trade in Services (GATS). This schedule sets out the extent to which the state has 'bound' its current level of market access in a range of defined services sectors, including financial services. A GATS schedule is set out as a 'positive list', meaning that only the access and treatment that it explicitly provides for is treated as bound and cannot be changed without compensating other WTO members. Any restrictions to these positive list commitments are also set out in their schedule. In any other respect the WTO member is free to change its policy as it sees fit.

As a way of deepening the GATS' treatment of financial services, some WTO members have adopted the Understanding on Commitments in Financial Services[38]. This is not an integral part of the GATS but an adjunct instrument that allows WTO Members to take on specific commitments to liberalise financial services as an alternative approach to the individual national schedules of commitments under the GATS. The Understanding aims to widen the scope for trade in financial services and contains some additional commitments on cross-border supply of a small number of services, including some insurance-related services, some financial information services and other auxiliary services, but not any mainstream banking or capital market services. The Understanding, along with the Financial Services Annex of the GATS, also includes some basic regulatory disciplines in areas such as new services and financial data transfer (which have been elaborated in subsequent FTAs) and the original formulation of the so-called 'prudential carve-out'.

However, even WTO members following the GATS Understanding have in many cases only made limited commitments through their GATS schedules in financial services, especially for cross-border supply which is often not bound at all. This does not mean that their markets are not open at the applied level (see Box 9), but it makes any applied access terms potentially vulnerable to revision. Attempts to increase the scope of these commitments through the multilateral Doha Development Agenda negotiations have stalled. As a matter of principle it would be valuable to see another round of multilateral binding via a WTO-level agreement, even if this is unlikely in the foreseeable future.

As an alternative to the multilateral track, a number of WTO members have pursued the Trade in Service Agreement (TiSA) negotiations outside the WTO framework, but aligned with it. TiSA is intended to raise the level of binding in market access and national treatment commitments[39] among a small group of WTO states. However, the TiSA negotiations have effectively been in abeyance since late 2016, when the last negotiating round took place. It should be recognised that progress in TiSA could be very slow, as even for a small group the scope of sectoral negotiations has raised many political sensitivities.

38 The text of the Understanding can be consulted here

39 For more on national treatment see Section 4.2 above.

Nevertheless, such formats are one potential way of bringing together the small group of states that may have an interest in pursuing collective liberalisation or greater binding in areas such as wholesale banking or investment services. One area where a small group of states may have an interest in mutually reinforcing commitments to greater openness to cross-border provision may be in the provision of broker dealer services to qualified investors seeking access to securities and derivatives markets outside of their home market. This is an area where a number of states including the US, Australia and the EU, have established both unilateral and bilateral frameworks and where authorities may be interested in expanding such commitments into plurilateral agreements.

SEVEN KEY RECOMMENDATIONS TO THE UK AUTHORITIES

1. Develop a comprehensive regulatory diplomacy strategy for financial services. The UK has some of the most effective and experienced financial regulators and supervisors in the world. Their relationships with their international peers are a key channel for sharing best practice and shaping the way they develop and implement financial regulation and the way it treats UK firms that invest and trade.
2. Continue to play a leading role in setting international financial services standards. The single most effective way of driving convergence in financial services regulation internationally is by shaping the standards that shapes the rules. As a global financial centre, the UK has championed and led the work of the FSB, Basel Committee and IOSCO over the last decade and should continue to do so.
3. Build a network of formal platforms for regulatory and supervisory cooperation. These should be underpinned by formal agreements, protocols for data sharing and permanent structured dialogues. These can have a particular value in areas of rapid technological change such as cybersecurity, AI and digital financial services. Strategic collaboration with the US and EU are key here.
4. Pioneer the innovation and expansion of cross-border trading models based on recognition. With a small number of jurisdictions that match the UK's high standards, the UK should explore ways of opening new cross-border choice and competition based on cross-border supply. The new partnership with Switzerland is a perfect test case.
5. Use a new set of free trade agreements (FTAs) to lock in UK market access for financial services in key markets, codify world-class standards for financial services regulation and reinforce regulatory cooperation and collaboration. The UK-Japan FTA demonstrates the potential here.
6. Champion a range of WTO-level initiatives that will support trade in financial services. While the WTO framework in this area is unlikely to evolve materially in the years ahead the UK should remain an advocate of a revived Trade in services Agreement (TISA) and current work on digital trade and e-commerce.
7. Sustain the UK's openness to imported financial services. The UK's import regime for financial services both through inward investment and cross-border supply is very open. This is the right choice for the UK domestic economy and for the UK as a global financial centre. Whatever others do in the years ahead, the UK should sustain its open approach.