

**COMMUNICATION FROM THE EUROPEAN COMMUNITIES
AND THEIR MEMBER STATES^{1/2}**

GATS 2000: Financial Services

The attached communication³ has been received from the delegation of the European Communities and their Member States with the request that it be circulated to Members of the Council for Trade in Services.

I. INTRODUCTION

1. Financial services is a key sector for a sound economic development. The importance of financial services in this respect lies in the infrastructural nature of this sector: financial services are needed to support the development and functioning of other sectors, and therefore to make the economy work properly. The presence of foreign operators can contribute to the creation of an efficient financial sector through financially sound institutions which provide much needed capital, new products, transfer of expertise, labour training, etc. Local savings can be channelled by competitive domestic capital markets, thus improving economy-wide resource allocation and reducing reliance on foreign borrowing. Insurance allows for the necessary spread of risks. Cheaper and better financial services help to improve the performance of domestic companies.

2. Liberalisation which promotes trade in a sufficient range of financial instruments and which allows the commercial presence of foreign financial institutions can help to promote institutional capacity building (transparency, regulation and supervision, etc.). Liberalisation can also promote less distorted and less volatile capital flows, both directly (through the types of financial flows it encourages) and indirectly (through its effect on institutional capacity). Stronger institutions, greater efficiency and more manageable capital flows are, in turn, likely to increase financial sector stability. This liberalisation notwithstanding, it must still be possible for Members to take the appropriate temporary measures, as required and in accordance with the relevant provisions of the GATS, to control capital movements.

3. Substantial progress has been achieved in the past. Following the WTO financial services negotiations concluded in December 1997, over 100 Members have undertaken commitments in financial services.

¹ Hereinafter "The EC".

² The EC reserve their right to modify this proposal at any time. This proposal does not prejudice EC's position on other services sectors, nor any possible future offer on this or other sectors. This proposal has to be read together with the general approach of the EC to the services negotiations.

³ This document should be read in conjunction with S/CSS/W/32.

4. The EC's financial services sector is very open to foreign competition. Establishment of banking, insurance and securities subsidiaries is subject to no restrictions other than the usual prudential measures. Foreign institutions can establish subsidiaries which benefit from a "single passport" under national treatment conditions. Direct branching is also possible under broadly national treatment conditions in each EC Member State. The Member States' regulatory frameworks and supervisory practices are among the most advanced in the world and are currently being further improved. The "Framework for Action" and its implementing Action Plan are a useful step in this direction.

II. SCOPE OF THIS PROPOSAL⁴

5. No definition of financial services is provided in the GATS other than "any service of a financial nature offered by a financial service supplier of a Member"⁵; an extensive but non-exhaustive list of financial services is provided in the GATS Annex on Financial Services (the "Annex"), according to which financial services include all insurance and insurance-related services, as well as all banking and other financial services.

6. A large majority of Members have based their Schedules on the classification in the Annex or on the W/120 classification, which are fairly similar. However, there are variations which reduce the clarity of the commitments and which make a cross-country comparison of Schedules difficult. The classification in the Annex provides a good way of overcoming with these problems. Therefore, we suggest that Members use the classification provided in the Annex on Financial Services wherever possible.

III. PROPOSAL

7. The Council for Trade in Services in Special Session should initiate a debate, either in the Council or in the Committee on Trade in Financial Services, on broad aims for negotiations in the financial services sector.

1. Current levels of commitments and restrictions

8. Most of the existing commitments cover the core services in insurance, banking and securities. Fewer Members have made commitments in areas such as insurance intermediation and the provision and transfer of financial information. Only about half of the Members which have commitments have made them in derivatives trading. The focus at present is on establishment (mode 3). Coverage of cross-border services (mode 1), more particularly of transport insurance (MAT), reinsurance and advisory and other auxiliary banking and insurance services, is generally limited. Fewer commitments are made on cross-border service provision (mode 1) than on consumption abroad (mode 2), the latter being generally limited to non-insurance financial services.

9. Many trade restrictions exist in both developed countries and developing countries: ceilings on foreign shareholding; economic needs tests to allow new market entry; limitations on the form of commercial presence (e.g. only through a subsidiary, or via a branch); restrictions on geographical expansion; discrimination as to the types of activities that can be carried out in different geographical areas; quota systems, or even a prohibition on new entries; restrictions on key personnel that can be transferred; etc.

⁴ The content of this proposal is without prejudice to the EC's final positions on classification issues and on classification of their existing commitments. CPCs mentioned refer to Provisional CPC classification.

⁵ GATS Annex on Financial Services, paragraph 5(a).

10. The EC reserve their right to present, in due time, a formal proposal concerning horizontal commitments listed by WTO Members. At this stage, some horizontal commitments can already be underlined as particularly affecting the financial services sector:

- Unspecified authorisation requirements;
- Economic needs tests;
- Certain limitations on the purchase or rental of real estate;
- Restrictions on equity holdings;
- Nationality requirements;
- Certain tax and subsidy measures;
- etc.

2. Schedules of commitments

11. The Understanding on Commitments in Financial Services (the “Understanding”) offers an alternative way of undertaking commitments in this area. It consists of a predetermined set of commitments, from which exceptions remain possible, and has been used by around 30 Members, including the EC. It essentially covers the following:

- Scheduling of monopoly rights and a “best endeavours” commitment for their elimination;
- Most-favoured-nation and national treatment in public procurement of financial services;
- Cross-border provision of MAT insurance, reinsurance and retrocession as well as services auxiliary to insurance;
- Transfer of financial information and financial data processing, and other auxiliary financial services, excluding intermediation;
- The right to purchase abroad a wide range of financial services (basically excluding direct insurance);
- The right of establishment and expansion of a commercial presence;
- Permission for established suppliers to offer new financial services;
- Permission for the entry of certain personnel of established suppliers subject to certain conditions, including senior managers and certain specialists; and
- Standstill on certain non-discriminatory measures.

12. It is our view that the use of the Understanding should result in more coherent sets of commitments, although no presumption is created under the GATS as to the degree of liberalisation to which a Member is committing itself by scheduling in accordance with the Understanding. Thus, the EC propose that WTO Members schedule their commitments in accordance with the Understanding (alternatively, Members may want to consider and take account of the Understanding when undertaking commitments in accordance with the usual scheduling approach under Part III of the GATS).

(a) Modes 1 and 2:

13. Due to technological developments and the increasing sophistication of financial services, the difference between modes 1 and 2 is becoming increasingly blurred. In order to avoid divergences or doubts as to the mode of supply of the relevant transaction affecting legal certainty, care should be taken to ensure that where appropriate, commitments undertaken for mode 1 are consistent with those offered for mode 2. Given the generally limited commitments made in mode 1, Members should especially consider going further than they currently have. Any mode 2 restriction should be adequately justified.

14. Our proposal for commitments for modes 1 and 2 is based on articles B.3 and B.4 of the Understanding, according to which Members would:

- permit, either as principal, through an intermediary or as an intermediary, the cross-border provision of MAT insurance, reinsurance and retrocession, as well as auxiliary services;
- permit the transfer of financial information and financial data processing, and other auxiliary services, excluding intermediation; and
- permit their residents to purchase abroad a wide range of financial services (basically excluding direct insurance).

(b) Mode 3:

15. Improved commitments for commercial presence should remain a priority. In order to encourage the long-term commitment of financial companies to their respective host countries, it is essential for them to be able to establish, control and expand commercial operations in third countries. To this end, we would argue that ceilings on foreign ownership should disappear and full foreign ownership rights should be allowed, although this could be associated with transitional periods, depending of the situation of the Member concerned. Such transitional periods may prove useful if they are used by national authorities to introduce effectively the appropriate supervisory standards and practices.

16. Moreover, investors should be able to establish in the legal form of their choice (i.e. subsidiary, joint venture, branch, etc.). Financial institutions should also be able to adopt the legal form of their choice, subject to the prudential requirements of the host country; any such requirements should be non-discriminatory.

17. In addition, we believe that any existing investments should be safeguarded (grandfathered) under the WTO, and that restrictions as to geographical expansion or to the types of activities that can be carried out in a given geographical area should also be eliminated.

18. Finally, Members should have the right of non-discriminatory access to payment systems, funding and refinancing facilities, as well as the right of non-discriminatory membership in any self-regulatory body, stock/securities/futures exchange or market, clearing agency or other organisation or association.

(c) Mode 4:

19. The EC schedule includes, *inter alia*, temporary movement of intra-corporate transferees as well as contractual service suppliers (i.e. the service is supplied, on the basis of a contract, by an employee of a company not established in the Member's territory). The EC propose that, on this basis,

further discussions are held on how to improve and facilitate the temporary movement of natural persons for the provision of specific services.

3. Other

20. It is our view that one pre-requisite for a successful and orderly opening of financial markets is the existence of an appropriate regulatory structure, as well as the ability of local supervisory authorities to monitor a more complex market. The EC emphasise its support for regulation that is transparent, proportionate and necessary. WTO work on regulatory issues will be useful in supporting domestic regulatory reform efforts, and should reflect upon the consideration of international standards as developed by the competent international organisations (IOSCO, IAIS, the Basle Committee, IMF, World Bank, etc.). The WTO shall in no way seek to replace or take up the role of these competent international organisations; rather, the work of the WTO and of these other international organisations should be mutually supportive.

21. We should also tackle regulatory issues in this sector. The GATS Annex on Financial Services recognises the importance of prudential measures for ensuring the integrity and stability of the financial system and, accordingly, the right of Members to regulate in pursuance of this policy objective, provided that the measures taken in this respect are not used as a means of avoiding GATS market access and national treatment commitments.

22. In addition, it is our view that MFN exemptions taken for the purpose of reciprocity do not fit well into the GATS approach to liberalisation. Members that still maintain such exemptions should be able to explain whether the reasons that justified them still exist and, wherever possible, delete them from their MFN lists. In any case, exemptions should be precise, transparent, temporary and for specific purposes.
