

**INTERNATIONALIZATION OF FINANCIAL SERVICES IN ASIA-PACIFIC AND THE  
WESTERN HEMISPHERE**

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## **I. Introduction**

During the past decade countries in the Western Hemisphere, and more recently in Asia-Pacific, actively pursued the liberalization of international trade through the development of regional and bilateral arrangements. The aim of this study is to analyze the financial services component of these arrangements, in particular, the rules and disciplines that govern international transactions of financial services and the level of financial services market openness bound by signatory countries. The paper also examines whether these arrangements deepened financial services internationalization, particularly cross-border transactions, with respect to the limited internationalization achieved so far at the multilateral level. In fact, the majority of developing countries and countries in transition made more liberal commitments in banking and insurance under commercial presence or mode three than under cross-border trade or mode one in the extended WTO General Agreement on Trade in Services (GATS) negotiations concluded in 1997 (Kono and Schuknecht, 1998). Moreover, only a few countries in our sample – Australia, Canada, Japan, New Zealand and the USA - signed the GATS Understanding on Financial Services.

The task is challenging, not only because a large number of arrangements following different approaches have been developed in each region, but also because the very particular characteristics of financial services make their internationalization dependent on a number of different, yet complementary regulatory reforms. These comprise the liberalization of trade, reform of domestic financial regulations and the elimination of most restrictions to the cross-border flow of capital. A further complication stems from the fact that trade in services may take place through one or a combination of four different (usually substitute) modes of supply<sup>1</sup>, whose requirement for regulatory reform (trade, domestic regulations or capital flows) differ substantially.

This challenges policy-makers to find a mix and sequence of reforms that, while promoting the internationalization of financial services, it does not adversely affect the stability of the financial system. In fact, one of the most important reasons for the lack of opening of cross-border trade (but also of investment) in financial services at the multilateral level, particularly by developing countries, is that it has been associated with financial market instability and capital flow volatility.

Arrangements are classified between those that contain specialized text on financial services and those that cover these services through horizontal disciplines for all services sectors. This revives a long standing debate about whether it is essential that trade arrangements develop specialized text for certain services sectors or whether these are best treated through horizontal disciplines.

Within the arrangements that contain specialized text on financial services, the study analyzes the disciplines binding reforms related with trade liberalization, domestic regulation and capital account opening. A trade openness index is constructed to assess the level of financial services market opening bound by countries, which allows comparison across sectors, modes of supply, countries and regions. A capital flows openness index (borrowed from Dailami, 2000) complements the analysis by allowing a more comprehensive assessment of the level of financial services internationalization effectively achieved by countries. A complete picture of the level of financial services internationalization would also require an assessment of the quality of domestic regulations in each country. Such a complex exercise should be the subject of a separate study.

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<sup>1</sup> In the WTO GATS, trade in financial services is defined in terms of four modes of supply, namely: cross-border supply (mode 1), consumption abroad (mode 2), commercial presence (mode 3), and movement of natural persons (mode 4).

The study is organized as follows: section II presents the analytical framework and section III discusses the historical background and modalities for the treatment of financial services in trade arrangements in Asia-Pacific and the Western Hemisphere. Sections IV and V discuss sector-specific disciplines, as well as the level of commitments bound under each arrangement. Section VI concludes.

## II. Analytical Framework

The internationalization of financial services must be distinguished from what is commonly known as financial liberalization or reform. The latter refers to an internal phenomenon dealing with domestic deregulation, like allowing interest rates to be market-determined or permitting domestic providers to supply new or complementary financial services. Financial services internationalization, on the other hand, deals with the opening of financial services markets to foreign competition, but also with complementary domestic policies and regulations that have the potential to impede international transactions of financial services. For instance, a country might freely allow foreign financial firms to establish locally to compete with domestic providers within the system of regulation, and yet discourage foreign entry through *excessively* stringent non-discriminatory prudential regulations and/or by a prohibition to transfer capital necessary to establish the business. Alternatively, it is possible to deregulate a country's financial system completely but still keep its financial markets closed to foreign competition.

Formally, financial services internationalization requires three different, but complementary, regulatory reforms: (1) trade liberalization, (2) reform of domestic financial regulation and, (3) capital account opening.<sup>2</sup> Trade liberalization in (financial) services involves essentially the removal of discriminatory regulation – that is, quantitative or qualitative regulations that discriminate between foreign and domestic providers both before and after they enter the market. It comprises the liberalization of cross-border trade (modes one, two, and four) and commercial presence/investment (in the form of portfolio or foreign direct investment). Domestic financial regulatory reform deals with measures that affect foreign and domestic providers alike, i.e. they are non-discriminatory, including licensing requirements and prudential regulation and supervision. Although it is usually associated with the deregulation of financial markets, it also involves the adoption of pro-competitive regulations. Capital account opening, on the other hand, involves the removal of restrictions on capital transactions *essential* to the supply of the financial service and currency convertibility.

Financial services internationalization *does not*, however, require *full* capital account opening and *complete* deregulation of domestic financial markets. The requirement in the former case is that only transfers, payments and investments *essential* to the supply of the financial service are allowed to move freely between countries. In the later case, it requires that financial domestic regulation be non-discriminatory and not more burdensome than necessary to achieve its legitimate objective. Trade agreements covering financial services hence face the difficulty of finding the right balance between limiting the trade inhibiting effect of certain legitimate regulatory and policy measures, while recognizing the sovereign right of countries to regulate their financial services markets and maintaining the stability of their financial systems.

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<sup>2</sup> Monetary policy may also indirectly impede trade in financial services. For instance, in order to avoid a high reserve requirement foreign banks may decide to lend cross-border instead of establishing a commercial presence. In this case, the implicit tax not only prevents a certain type of trade (mode 3), but it also results in increased and probably more volatile capital flows.

### *Modal Nature of Trade in Financial Services*

The effective and efficient liberalization of trade in financial services is further complicated by its modal nature. As mentioned above, trade in services may take place via four different and usually substitute modes of supply. This requires that the right balance be found in the provisions that govern each mode of supply, so that substitutability between modes is not “artificially” reduced and the choice of liberalizing each of the four modes of supplying financial services responds only to efficiency considerations.

Modal unbiasedness (symmetric liberalization of modes of supply)<sup>3</sup> is particularly difficult to attain, since the need for complementary capital account opening and regulatory symmetry between trade partners differs across modes of supply. For instance, cross-border trade in financial services (particularly mode one of supply) usually requires a much higher degree of capital account opening and regulatory symmetry than commercial presence/investment. Kono and Schucknecht (1998) show that commitments to mode three liberalization only require the liberalization of capital inflows related to commercial presence whereas mode one requires liberalization of both inflows and outflows. Moreover, cross-border provision tends to be biased towards lending at the short end, with adverse effects on volatility.

In turn, established foreign financial institutions abide by domestic regulations, usually on a national treatment basis, whereas for cross-border transactions it is not always clear whether home or host country regulation and supervision apply. Since host and home country rarely share a common regulatory framework, the relative cost of complying with the different regulations put at a competitive disadvantage either the domestic or foreign cross-border provider of financial services. Asymmetries in regulations between countries may also affect –fairly or unfairly – the local provision of financial services by a foreign regulated branch of a foreign financial institution. In addition, regulatory jurisdictional uncertainty and the lack of supervision and monitoring of foreign providers of financial services may increase systemic risks.

The above discussion suggests that financial services internationalization, particularly through cross-border trade, requires high levels of regulatory transparency and cooperation. The international community has devised three approaches to deal with these issues, namely: harmonization of regulations, mutual recognition agreements and adoption of international standards (see White, 1996). The three approaches can be thought of as a continuum where harmonization of regulations constitutes the highest degree of regulatory integration and adoption of international standards the lowest.<sup>4</sup> However, harmonization and mutual recognition should be seen as complements to, rather than substitutes for, international standards (Mattoo and Sauvé, 2003). To a different extent all three reduce regulatory asymmetries between trade partners.

A high degree of regulatory harmonization is however not always feasible or desirable as regulatory asymmetries usually reflect legitimate differences between countries in taste, income distribution, market culture, geography, risk aversion and more generally, prevailing patterns of state-society relationships (Nicolaodis, 2002). For instance, regulatory harmonization would not be feasible between trade partners where the risk tolerance of consumers differs greatly. Those with high-risk intolerance will not accept a laxer regulatory framework. Even if countries agree on the regulatory framework, confidence in compliance verification methods may differ. Mutual recognition agreements (MRAs) are a viable alternative in these cases, since they take into account idiosyncratic factors, while allowing regulatory competition and encouraging cooperation

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<sup>3</sup> For evidence of modal bias in GATS commitments see Kono and Schucknecht (1998), Mattoo (1999) and Valckx (2001).

<sup>4</sup> Opponents to the idea of regulatory harmonization argue that the benefits of regulatory competition offset the costs of regulatory asymmetries such as regulatory capture and poor regulations (see Nicolaodis, 2002 for a review of this discussion).

in regulation and supervision. MRAs, however, constitute a de facto departure from the most-favored-nation principle.<sup>5</sup>

The adoption of international standards implies the acceptance of a minimum number of common rules embedded in codes of best practice, while further harmonization is left to market forces. Markets have the capacity not only of spreading existing standards across jurisdictions, but also, and more importantly, to develop contractual and regulatory standards through arbitrage and competition (Jordan and Majnoni, 2002). A problem with international standards is that their adoption is usually non-binding and hence subject to reversals.

To be operative, even the lowest level of regulatory harmonization requires the mutual recognition of foreign regulatory systems (*recognition of the validity of foreign regulation*) and the principle of home country control (i.e. *recognition of the validity of foreign supervisory authorities*).<sup>6</sup> In other words, international trade in financial services critically requires cooperation between regulators on the supervision of foreign financial services providers and sharing of information on their transactions. Clearly, the requirements are greater with cross-border trade and branching than with other forms of trade. This type of coordination in supervision is however extremely difficult to attain as market participants fear that the transfer of information between regulators will not adequately safeguard their confidentiality and most legal regimes do not allow on-site inspection by home country regulators.

### *Sequencing of Liberalization*

It is commonly argued that an inadequate mix and sequencing of reforms might render a financial system more vulnerable to capital flow volatility and financial market instability. Empirical evidence shows that financial services internationalization that promotes the use of a broad spectrum of financial instruments and allows the commercial presence of foreign financial institutions, while not unduly restricting their business practices; results in less distorted and less volatile capital flows and promotes financial sector stability (Kono and Schucknecht, 1998). Valckx (2001) also provides evidence that greater, more liberal commitments in financial services seem to reduce the risk of currency crises, but tend to raise the likelihood of banking problems.<sup>7</sup> Additional evidence shows that financial services internationalization promotes growth and welfare.<sup>8</sup>

It is now widely agreed that to the extent that financial services trade liberalization is associated with a high degree of short-term capital flows, fears about a trade-off between increased efficiency and loss of financial stability may be well founded. For instance, financial services internationalization that encourages short term lending, can trigger more volatile flows, as short-term loans can be called in easily, instead of being rolled over. In a context of poor macroeconomic management and a weak financial system that allows for an unbalanced financing structure, this can aggravate financial sector difficulties and lead to a financial crisis.

During the Asian crises, for example, most of the economies affected had previously removed controls on international capital movement, had bad corporate and bank financing structures (high

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<sup>5</sup> The most favored nation principle obliges members to an agreement to give the most favorable treatment accorded to any of their trading partners, to all the other members immediately and unconditionally.

<sup>6</sup> Jordan and Majnoni, 2002.

<sup>7</sup> One possible explanation for the positive correlation between more liberal commitments and banking problems is that Valckx does not control for the quality of financial sector regulation in his regressions. Kono et.al use the “Law and Order” index developed by the International Country Risk Guide to proxy for this variable, and find evidence that it negatively affects the incidence of financial crises and positively affects the volatility of “portfolio and other investment.”

<sup>8</sup> See, for instance, Levine (1997), Kono et.al (1998), Mattoo (2001) and Bekaert (2002).

short-term debt, high foreign currency debt, high level of non-performing assets in the banking system), the financial sector was relatively underdeveloped and governments protected domestic producers through directed policies. In this context, a strong extension of private credit coupled with weak prudential regulation and supervision undermined investors' confidence and led to a massive capital flight. Similarly, prior to 1994, a combination of strong monetary expansion, lax regulation and supervision of the financial system, fixed exchange rate and strong capital inflows conspired to facilitate a lending boom in Mexico. In 1994, the Government shortened and dollarized debt, which coupled with rising U.S. interest rates raised doubts about the ability to repay such debt and triggered huge capital outflows (see Fingerand and Schuknecht, 1999, IMF, 2000, World Bank, 2000).

The adjustment costs of an 'inadequate' liberalizing sequence may also be considerable, for instance, in cases where the financial system is currently undercapitalized or financial institutions currently operate at inefficient levels of production. In such cases, rapid entry could worsen financial distress among domestic suppliers as profits decline due to increased competition. The transition period may also involve some economic costs as output declines in the previously privileged sectors and resources are re-allocated. Furthermore, Kono et al. (1997) argue that policy errors are more likely, and more harmful, when financial markets are still underdeveloped, confidence in the new policy regime is still weak, and experience with the proper management of the macro economy and the financial sector is more limited.

### **III. Financial Services in Trade Arrangements in Asia-Pacific and the Western Hemisphere**

The remainder of the paper analyzes efforts to internationalize financial services in the Asia-Pacific region and the Western Hemisphere. A historical account and a description of the modalities for the treatment of financial services in each region are presented in this section.

#### *Historical Background*

The first attempt to internationalize financial services in the Western Hemisphere dates back to the free trade agreement signed between Canada and the United States in 1988. However, it was not until the entry into force of the North America Free Trade Agreement (NAFTA) in 1994, involving Canada, Mexico and the United States; that the internationalization of financial services gained momentum in the Western Hemisphere. Since then, 18 arrangements covering services trade have been developed in the region, out of which only one (the Mexico-Costa Rica agreement) explicitly excludes financial services. Ongoing negotiations, such as the Central American Common Market (CACM)-USA negotiations and the Free Trade Area of the Americas (FTAA) process are also contemplating the internationalization of financial services. In addition, eight trade agreements have been signed among a number of countries in the Western Hemisphere and countries in Europe and Asia. All of these agreements, except the one between Chile and Korea, foster the internationalization of financial services.

The first experience of financial services internationalization in the Asia-Pacific region is the 1989 Protocol on Trade in Services to the Australia New Zealand Closer Economic Relations – Trade Agreement (ANZCERTA). Contrary to the experience in the Western Hemisphere, financial services internationalization began extending across countries in Asia-Pacific only a decade after the implementation of the pioneering Australia-New Zealand trade initiative. To date, one regional agreement, the Association of Southeast Asian Nations (ASEAN), and four bilateral agreements contemplating the internationalization of services (and financial services) are

in place. Table 1 presents a full listing of economic arrangements – trade agreements and common market areas – in Asia-Pacific and the Western Hemisphere covering financial services.

The two regions have made important progress in establishing a transparent and a quite flexible legal framework for the internationalization of financial services. In a number of cases, however, actual liberalization has lagged behind the development of rules and disciplines, either because these have not been deep enough to address the special sensitivities of the financial sector or because member countries have agreed to defer the exchange of commitments to a future date. In some cases, the arrangements have not yet been ratified by the corresponding legislatures due to a lack of political will or simply because negotiations have been concluded recently. Table 1 shows that nine arrangements (or the financial services provisions included therein) involving Western Hemisphere countries (including the Singapore-USA FTA) have not yet entered into force.

#### *Modalities for the Treatment of Financial Services*

Four different modalities for the treatment of financial services have been followed by trade arrangements in Asia-Pacific and the Western Hemisphere. The first modality is to develop specialized text in a separate chapter or annex that elaborates upon, modifies, or supplements more general provisions in the arrangement. This modality is covered in full in the following sections for arrangements for which text is currently available. In addition, text on financial services is currently being developed in the Andean Community, Southern Cone Common Market (MERCOSUR) and Caribbean Common Market (CARICOM). In their FTA, Canada and Chile also indicated their intention to conduct future negotiations on financial services on the basis of Chapter 14 on Financial Services of the NAFTA.

A second modality is to develop very general sector-specific provisions within the services and/or investment chapters, in most cases supplemented by an obligation to develop more specialized text in the future. In some cases, the obligation applies only to investments related to financial services, while cross-border trade is excluded from any coverage. This is the case of all trade agreements signed by Chile with countries in the Western Hemisphere, excluding the recently concluded agreement with the United States. In other cases, the obligation to develop disciplines is stated more generally for services and investment (Canada-Costa Rica) or for labor and capital (common markets in the Western Hemisphere). A similar approach to the treatment of trade in financial services is found in the Services Chapter of the New Zealand-Singapore Agreement on a Closer Economic Partnership. Disciplines specific to financial services are, however, more detailed than in arrangements in the Western Hemisphere and there is no obligation to develop more specialized text in the future.

The third modality is silent about financial services other than in the context of provisions aimed at preventing the dissemination of confidential information and, in most cases, regulatory carve-outs for prudential, balance of payment or exchange rate control reasons. Under this modality, commitments to liberalize financial services trade are subject to the general provisions on services and/or investment contained in the arrangement and there is no obligation to further develop disciplines (specific or general). The Protocol on Trade in Services to ANZCERTA and the Dominican Republic- CARICOM and Central America-CARICOM agreements have followed this approach.

A fourth modality to the treatment of financial services is found in the Jordan-USA and Vietnam-USA free trade agreements (FTAs) and the ASEAN Framework Agreement on Services. All three agreements incorporate by reference the GATS Annex on Financial Services. In addition,

ASEAN, China, Japan, and Korea (ASEAN + 3) have put in place a cooperation agreement involving the liberalization of trade in financial services and the capital account. It also addresses issues such as the integration of the region's financial systems (through harmonization of regulations in the insurance sector, the development of an Asian bond market and cross-border issuance and investment), the implementation of regional early warning systems and a self-help and support mechanism.

**ECONOMIC ARRANGEMENTS WITH SERVICES PROVISIONS: COVERAGE OF FINANCIAL SERVICES**

	Entry into force	Financial services excluded from agreement (by mode of supply)	Obligation to develop provisions (by mode of supply)	Specific Chapter/Annex
<b>FREE TRADE AGREEMENTS</b>				
<b>WESTERN HEMISPHERE</b>				
Canada-Chile	July, 1997	Cross-Border Trade	Investment	No
Canada-Costa Rica	November, 2002	All Modes	Trade in services and investment	No
CARICOM-Dominican Republic <sup>&amp;</sup>	August, 1998*	No	No	No
Central America-Chile <sup>&amp;</sup>	Costa Rica-Chile: February, 2002 El Salvador-Chile: June, 2002	Cross-Border Trade	Investment	No
Central America-Dominican Republic	Costa Rica-Dominican Republic: March, 2002. El Salvador-Dominican Republic: October, 2001. Guatemala-Dominican Republic: October, 2001. Honduras-Dominican Republic: December, 2001.	No	No	No
Central America-Panama	February, 2002*	No	No	Chapter
Chile-United States	June, 2004*	No	No	Chapter
Mexico-Bolivia	January, 1995	No	No	Chapter
Mexico-Chile	August, 1999	Cross-Border Trade	Investment	No
Group of Three <sup>&amp;</sup>	January, 1995	No	No	Chapter
Mexico-Costa Rica	January, 1995	All Modes	No	No
Mexico-Nicaragua	July, 1998	No	No	Chapter
Mexico-Northern Triangle <sup>&amp;</sup>	El Salvador: March, 2001; Guatemala: March, 2001; Honduras: June, 2001; Mexico: March, 2001	No	No	Chapter
NAFTA <sup>&amp;</sup>	January, 1994	No	No	Chapter
<b>ASIA-PACIFIC REGION</b>				
Asean <sup>&amp;</sup>	December, 1998	No	No	No
Australia-New Zealand	January, 1989	No	No	No
Australia-Singapore	July, 2003	No	No	Chapter
Japan-Singapore	November, 2002	No	No	Annex
New Zealand-Singapore	January, 2001	No	No	No
<b>COMMON MARKETS</b>				
<b>WESTERN HEMISPHERE</b>				
Adean Community <sup>&amp;</sup>	June, 1998 (Decision 439)**	No	Sector specific Decision being drafted	No
CACM <sup>&amp;</sup>	August, 1995 (Protocol of Guatemala)** Treaty on Investment and Trade in Services*	No		Treaty contains a chapter on financial services
CARICOM	July, 1998 (protocol II)*	No	Sector specific disciplines not developed yet	No
MERCOSUR <sup>&amp;</sup>	December, 1997 (Protocol of Montevideo)*	No		Annex
<b>AGREEMENTS BETWEEN WESTERN HEMISPHERE COUNTRIES AND NON-WESTERN HEMISPHERE COUNTRIES/REGIONS</b>				
Chile-European Community	January, 2003	No	No	Chapter
Chile-Efta <sup>&amp;</sup>	June, 2003*	No	All Modes	No
Chile-Korea	October, 2002*	All Modes	No	No
Mexico-Efta	July, 2001 (Mexico, Norway, and Switzerland); October, 2001 (Iceland);	No	No	Chapter
Mexico-European Community	July, 2000	No	No	Chapter
Jordan-United States	December, 2001	No	No	Annex
Singapore-United States	January, 2004	No	No	Chapter
Vietnam-United States	December, 2001	No	No	Annex

\*: The agreement has not yet entered into force. The date of signature is provided.

\*\* : Decision 439, Protocol II, the Protocol of Guatemala and the Protocol of Montevideo cover trade in services and do not contain specialized disciplines on financial services. They all mandate, however, that these be developed in the future. Protocol II and the Protocol of Montevideo have not yet entered into force.

&: See Annex I for a list of member countries

Table 1

A special case is the Australia-New Zealand agreement. Trade in financial services between these two nations is almost completely liberalized, in spite of the fact that the Protocol on Trade in Services to this agreement is silent about financial services. In fact, in the most up-to-date annex to the Protocol (dated March 1999), Australia exempts only one sector from liberalization (third party motor vehicle insurance) and New Zealand exempts none. The apparent

contradiction between the development of trade rules and level of liberalization is explained by a high degree of symmetry in legal and commercial background between the two countries. Moreover, in a memorandum of understanding, the parties agree to continue the process of harmonization and co-operation, including the “removal of any impediments to trade that may arise out of differences between the business laws and regulatory practices of the two countries.” Regulatory cooperation in financial services focuses on issues such as disclosure of company operations, accounts and shareholding interests; securities industry regulation, including stock market rules, insider trading, transfer and settlement systems and licensing requirements; and futures industry regulation.

#### **IV. Specialized Text on Financial Services**

This section analyzes arrangements in the Asia-Pacific region and the Western Hemisphere that have developed specialized text on financial services in separate chapters or annexes. Table 2 shows the main provisions contained in the chapters or annexes, as well as provisions elsewhere in the arrangement that may affect the ability of providers and consumers to trade in financial services.

##### **1. Liberalization Approach**

Trade arrangements containing specialized text on financial services in both regions have followed two main approaches to liberalization: the GATS-type approach and the NAFTA-type approach. The GATS and GATS-type chapters/annexes on financial services cover the four modes of supply of financial services. The liberalizing approach follows a positive list, whereby countries undertake national treatment and market access commitments specifying the type of access or treatment offered to financial services or suppliers of financial services in scheduled sectors.

NAFTA and NAFTA-type chapters depart from the modal approach by developing provisions that cover cross-border trade (modes one, two and four) and investment in financial services (mode three). These agreements follow a negative list approach, whereby cross-border trade and investment in financial services are liberalized unless otherwise specified by reservations or non-conforming measures listed in an annex to the agreement. Under this approach, subsequent liberalization of non-conforming measures is bound at the new level of openness (a ratchet clause).<sup>9</sup>

Table 2 shows that the majority of arrangements containing specialized disciplines on financial services signed by Western Hemisphere countries have followed the NAFTA approach. The main advocate of this approach has been Mexico, who extended the NAFTA-type disciplines to all its agreements with Central and South American countries. Similarly, a NAFTA approach was adopted in the CACM-Costa Rica and CACM-Panama negotiations.

Very few arrangements have adopted the GATS approach in their chapters/annexes on financial services. These include the Chile-European Community (EC) chapter, MERCOSUR and the Japan-Singapore FTA.<sup>10</sup>

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<sup>9</sup> The Mexico-EC chapter includes a ratchet clause for subsequent liberalization, although it follows a hybrid approach (see below).

<sup>10</sup> The Japan-Singapore agreement adopted different liberalization approaches in its chapters on services and investment. The services chapter applies to the four modes of supply and commitments are scheduled on the basis of a positive list approach with respect to market access, national treatment and additional commitments. The investment chapter allows reservations (i.e. a negative list approach) with respect to national treatment and performance requirements.

A hybrid approach combining elements of the NAFTA and GATS approaches was adopted in the Australia-Singapore, Chile-USA, Mexico-EC and Singapore-USA chapters on financial services. The chapters included in the Australia-Singapore and Mexico-EC FTAs combine a modal definition of trade in financial services with a negative list approach to the undertaking of commitments. As with GATS commitments, reservations in the Australia-Singapore Chapter are listed with respect to market access and national treatment, but also with respect to domestic regulations. Additional commitments *a la* GATS are also permitted. Reservations in the Mexico-EC Chapter, on the other hand, are listed with respect to establishment, cross-border trade, national treatment and key personnel only. Both the Chile-USA and Singapore-USA FTAs adopt different modalities for investment and cross-border trade of financial services. For investments they follow the traditional negative list approach and for cross-border trade they follow the hybrid approach adopted in the GATS Understanding on Commitments in Financial Services – i.e. the listing of non-conforming measures for a specified (positive) list of sectors.

In terms of the architecture of the arrangements, there seem to be two approaches. The first one is followed by all but three arrangements - MERCOSUR, Australia-Singapore and Japan-Singapore – and consists of making the chapter/annex on financial services virtually self-contained - i.e. measures in the chapters on services and investment do not apply to financial services if they are covered in the financial services chapter. The Annex on Financial Services to the Protocol of Montevideo of MERCOSUR (from here on the MERCOSUR Annex), the Australia-Singapore chapter and the Japan-Singapore annex on financial services incorporate a very limited number of provisions aimed at supplementing more general provisions on services in the Protocol or the Services Chapter *a la* GATS.

## **2. Disciplines on Trade Liberalization**

Trade negotiations in the different fora have achieved considerable progress in the development of disciplines dealing with trade liberalization, as opposed to disciplines on domestic regulation or capital account opening. A comparative analysis of the provisions dealing with trade liberalization in chapters/annexes on financial services in trade arrangements in Asia-Pacific and the Western Hemisphere is presented below.

### *Scope*

Financial services are defined in most chapters/annexes following either GATS or NAFTA,<sup>11</sup> except the Mexico-Nicaragua chapter, which does not incorporate a definition of financial services. In addition, only one NAFTA-type FTA (Mexico-Bolivia) adopts the GATS definition instead of the NAFTA definition.

GATS-type chapters/annexes apply to measures relating to the supply of financial services via the four modes of supply, while NAFTA-type chapters, as well as the Chile-USA and Singapore-USA chapters, distinguish between investment and cross-border trade in financial services. Measures on investment seem to apply more broadly in these chapters than in their GATS-type counterparts, as they affect financial institutions (i.e. the service supplier), as well as investors and investments of such investors in financial institutions. The provisions in GATS-type chapters/annexes apply to the service and the service supplier only (see discussion under National Treatment below).

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<sup>11</sup> The GATS Annex on Financial Services provides a long indicative list of financial services under two broad categories: insurance and insurance-related services and banking and other financial services. In NAFTA, a financial service is defined as a service of a financial nature, including insurance, and a service incidental or auxiliary to a service of a financial nature.

MAIN PROVISIONS AFFECTING TRADE IN FINANCIAL SERVICES IN TRADE ARRANGEMENTS IN THE WESTERN HEMISPHERE AND ASIA-PACIFIC

Main Provisions/Agreement	NAFTA APPROACH							GATS APPROACH			HYBRID APPROACH				GATS
	NAFTA	Central America-Panama	CACM-CR	Mexico-Bolivia	G3	Mexico-Nicaragua	Mexico-Northern Triangle	Chile-EC	MERCOSUR	Japan-Singap.	Australia-Singap.	Chile-USA	Mex-EC	Singapore-USA	Annex and Understanding
<b>Trade liberalization</b>															
Scope	C	C	C	C	C	C	C	C	A	A	C	C		C	A
Commercial Presence/Establishment	C	C	C	C	C	C	C					A			U
Cross-Border Trade	C	C	C	C	C	C	C					C	C	C	U <sup>1</sup>
Most Favored Nation Treatment	C	C	C	C	C	C	C	O	O			C	C	C	O
Market Access								C	O	O	O	C	C <sup>7</sup>	C	U
National Treatment	C	C	C	C	C	C	C	C	O	O	O	C	C	C	U
Senior Management and Boards of Directors/Key Personnel	C	C	C	C	C	C	C					C	C	C	
Specific Commitments/Non-Conforming Measures	C	C	C	C	C	C	C	C	O	O	O	C	C	C	O
New Financial Services	C	C	C	C	C	C	C	C		A	C	C	C	C	U
Future liberalization	A	A	C	A	A	A	A	C	O			A	A	A	O
<b>Domestic regulatory reform</b>															
Transparency	C	C	C	C	C	C	C	C	O	O	O	C	C	C	U <sup>1</sup>
Domestic Regulation									O	O	O		C	C	O
Licensing and Certification	O	O	O	O	O	O	O	C <sup>2</sup>	O	O	O <sup>3</sup>	O	C	O	O
Recognition of Prudential Measures	C <sup>2</sup>	C	C	C	C	C	C	C	A	A		C <sup>2</sup>	C	C <sup>2</sup>	A
Harmonization									A						
Self-Regulatory Organizations	C	C	C	C	C	C	C					C		C	
Prudential Carve-Out	C	C	C	C	C	C	C	C	A	A <sup>3</sup>	C	C	C	C	A <sup>3</sup>
Exception relative to the Dissemination of Confidential Information	O	O	O	O	O	O	O	C	A	A <sup>3</sup>	C <sup>6</sup>	O	C <sup>4</sup>	O	A <sup>3</sup>
Payment and Clearing Systems												C		C	
Expedited Availability of Insurance Services								O	O			C	O	C	O
<b>Capital account opening</b>															
Payment and Transfers	O	O	O	O	O	O	O	O	O	O	O	O	O	O	O
Limitations on Capital Flows								O		O		O		O	
Exceptions for Monetary Policy and Exchange Rate Reasons	C	C	C	C	C	C	C	C	O			C	O	C	O
Exceptions relative to Balance of Payment difficulties	O	O	O	C	C	C	O	O	O	O	O	O	O		O
<b>Other</b>															
Financial Services Committee	C	C	C	C	C	C	C	C				C	C	C	
Dispute Settlement	C	C	C	C	C	C	C	C	O	A	C	C	C	C	A

C: provision in the chapter on financial services; O: provision in an other chapter of the agreement (Usually in the services chapter); A: provision in an annex  
 1: Under Market Access; 2: Under the MFN; 3: Under Domestic Regulation; 4: Under Prudential Carve-Out; 5: Under Scope; 6: Under Transfers of Information and Processing of Information  
 7: The provision is entitled "Establishment of Financial Service Suppliers", however it deals with market access issues.

Table 2

The more liberalizing nature of chapters following the NAFTA definition of scope is further enhanced by the separation between investments in regulated and non-regulated financial institutions. Investments in regulated institutions (including branches) are covered under the chapter on financial services, while investments in non-regulated institutions are subject to the more general disciplines in the investment chapter. The chapters in NAFTA and the Chile-USA and Singapore-USA FTAs also amend the definition of investment so that a loan or debt instrument issued by a financial institution constitutes an investment (i.e. is subject to the more stringent disciplines of the financial services chapter) only when the Party in whose territory the financial institution is located treats it as regulatory capital.<sup>12</sup> GATS-type chapters/annexes do not distinguish between regulated and non-regulated financial institutions, nor do they qualify investments in debt securities (i.e. these are always covered by the services chapter).

The Mexico-EC chapter does not specify the scope of its text on financial services, however it implicitly limits its coverage to regulated financial institutions through an authorization requirement for financial services suppliers. The chapter on financial services of the Australia-Singapore FTA, on the other hand, applies to the four modes of supply of financial services (as in the services chapter) and to regulated financial institutions - it also incorporates an authorization requirement for financial services providers. As regards investment in services, both the

<sup>12</sup> The Chile-USA and Singapore-USA chapters also modify the definition of "investor of another party", so that a *dual* national is considered an "investor of the other party" (i.e. subject to the disciplines in the chapter) only if his/her dominant nationality is that of the foreign country.

Australia-Singapore and Japan-Singapore agreements borrow the provisions from the investment chapter.<sup>13</sup>

### *National Treatment*

All of the chapters/annexes being analyzed, except those in MERCOSUR and the Singapore agreements with non-Western Hemisphere countries, re-state the national treatment obligation to address the special sensitivities of financial services. In all of these cases the national treatment principle is of general application (except in the Chile-EC FTA, where it applies to scheduled sectors) and extended to both cross-border suppliers (or modes one, two and four) and investment (or commercial presence) in financial services. However, the coverage of the obligation differs among agreements for two reasons: 1) the NAFTA-type definition of investment is broader than the modal definition and 2) there is no consensus about what the discerning criterion between domestic and foreign suppliers should be. Under the NAFTA model national treatment is extended to investors of the other Party, to financial institutions of the other Party and to investments of investors of the other Party in financial institutions. Meanwhile, the obligation would not seem to extend to investors and investments of such investors in financial institutions under the GATS model.

As regards the discerning criterion, agreements involving the EC grant financial services and financial service suppliers of the other Party treatment no less favorable than that accorded to the first party's own "like financial services and financial services suppliers" (i.e. GATS language).<sup>14</sup> The NAFTA-type language replaces the term "like financial services and services suppliers" for "in like circumstances" and applies to investment as defined above. Advocates of the latter argue that the NAFTA term is more precise than the GATS term since it shifts the focus of attention from the service or service supplier to the characteristics of the situation. The discerning criterion becomes the regulatory framework under which the service is provided, however the critical issue of whether the services are substitutes is still not resolved.

Another modification introduced by NAFTA-type chapters (and also the Chile-USA, Mexico-EC and Singapore-USA chapters) on financial services is that the national treatment obligation applies for the entire life cycle of the investment. NAFTA-type chapters also qualify the national treatment obligation by requiring that a party's treatment of foreign suppliers afford them "equal competitive opportunities". The term "equal competitive opportunities" requires that financial institutions and cross-border investors of the other party be not at a disadvantage, relative to domestic providers, in their ability to provide the service. By excluding this qualification the Chile-USA, Singapore-USA and GATS-type agreements allow more discretion in the interpretation of the national treatment obligation.

### *Most-Favored-Nation Treatment*

The Chile-USA, Singapore-USA and NAFTA-type chapters on financial services re-state the Most Favored Nation Treatment (MFN) provision in similar fashion to the NT obligation. The MFN principle is of general application and is extended to investors and financial institutions of the other Party, investments of investors in financial institutions and cross-border financial service providers of the other Party, in like circumstances. Mexico and the EC also specialize the

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<sup>13</sup> The Australia-Singapore and Japan-Singapore agreements cover commercial presence/investment under both the services and investment chapters. Their main objective is to subject commercial presence to the discipline on domestic regulation included in services chapter.

<sup>14</sup> This discussion is also relevant to the services chapters of the different arrangements.

MFN provision to financial services, although their provision adopts the GATS language. Agreements in the Asia-Pacific region do not incorporate an MFN clause.

### *Market Access*

The treatment of market access in financial services in trade arrangements in the Asia-Pacific region and the Western Hemisphere has followed five different approaches, which combine elements in GATS and NAFTA. The GATS approach consists of the inclusion of a separate market access provision, which applies to a country's specific commitments in each of the four modes of supply of (financial) services. For WTO member countries that have signed the Understanding on Commitments in Financial Services (from here on the GATS Understanding), this provision is supplemented by standstill, right of establishment and temporary entry of personnel<sup>15</sup> obligations, as well as specific conditions for cross-border trade in financial services opening (see below). NAFTA is silent about market access, but includes a separate article granting the right of establishment to investment in all financial services subsectors (i.e. not limited to scheduled commitments as in GATS) and another one on cross-border trade. The approaches followed by trade arrangements in Asia-Pacific and the Western Hemisphere are summarized below.

- The NAFTA approach (NAFTA-type agreements).
- The GATS approach specialized on financial services and excluding the provisions of the GATS Understanding (Chile-EC chapter).
- Inclusion of a separate article on cross-border trade in financial services and an article on market access, which applies generally to investments in all financial services subsectors (Singapore-USA and Mexico-EC chapters).
- Inclusion of a separate article on cross-border trade in financial services and an article (of general application) on market access for financial institutions, supplemented by an annex granting the right of establishment in non-insurance financial services (Chile-USA).
- Incorporation by reference of the market access article in the services chapter/protocol. MERCOSUR and the Australia-Singapore and Japan-Singapore agreements follow this approach. The first two apply the principle generally to all services sector and the Japan-Singapore agreement to scheduled sectors only.

Agreements that incorporate a market access article (or the Mexico-EC article on establishment) reproduce GATS Article XVI.2. Exceptions are the Mexico-EC article, which excludes the prohibition to restrict or require specific types of legal entity or joint venture and the Chile-USA and Singapore-USA articles, which cover the prohibition to limit the participation of foreign capital under the national treatment obligation.

The Singapore-USA, Chile-USA, Mexico-EC and Chile-EC agreements incorporate a number of additional provisions to further promote market access in financial services. The most relevant innovations are found in the recent Chile-USA and Singapore-USA FTAs. These include consultations to allow foreign control in the banking sector, elimination of numerical restrictions or limitations on the juridical form of establishment of banking and other financial institutions, establishment of additional financial institutions to supply the full range of financial services allowed under the domestic law, prohibition to limit all financial services or a complete financial services subsector, foreign participation in pension system and branching in insurance services. A detailed description of these provisions is presented in Annex II.a.

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<sup>15</sup> Senior management and specialists related to a commercial presence.

### *Cross-Border Trade*

A separate provision on cross-border trade in financial services was first included in NAFTA and later adopted by all NAFTA-type agreements and the Mexico-EC, Chile-USA and Singapore-USA FTAs. Through this provision countries commit to extend national treatment to cross-border financial services suppliers of the other Party and (except in the Chile-USA and Singapore-USA FTAs) to a standstill on cross-border trade in financial services. Parties are also allowed, if they deem necessary, to require cross-border suppliers of the other Party to register.<sup>16</sup> The Australia-Singapore and Japan-Singapore FTA incorporate a similar registration provision, but applies to all four modes of supply.

The NAFTA-type provision further requires countries to permit persons located in their territories, and their nationals wherever located, to purchase financial services from cross-border service providers of an other Party located in the territory of that other Party. The article in the Mexico-EC FTA does not extend the obligation to nationals wherever located and a similar provision incorporated in the GATS Understanding is limited to a Party's residents.

The Chile-USA and Singapore-USA FTAs show a renewed compromise to liberalize cross-border trade in financial services. The most significant innovations of the cross-border provision incorporated in these agreements are *binding*<sup>17</sup> commitments on mode four of supply of insurance services (except Chile)<sup>18</sup> and mode one of supply of a number of financial services excluded from the GATS Understanding. Chile also eliminates its GATS requirement for an economic needs test for the sectors included in an annex to the cross-border provision (this applies to both cross-border supply and investment). The newly incorporated sectors include, within insurance services, reinsurance brokerage and consultancy and actuarial and risk assessment. Within banking-related services, the list includes corporate finance advisory, financial leasing, trading in money market instruments, foreign exchange and interest rate instruments; investment advice and portfolio management services and credit reference and analysis. A detailed description of provisions in both the Chile-USA and Singapore-USA chapters is presented in Annex II.b.

In addition, signatories to these FTAs bind commitments on mode one of supply of insurance services (excluding life insurance) and non-core banking services included in the GATS Understanding. They also exempt from liberalization all cross-border modes of supply of core banking (deposits and lending) and securities services, as well as mode two of supply of insurance services.<sup>19</sup> Chile and Singapore further pledge their commitment to liberalize cross-border trade in financial services by binding high levels of capital flows liberalization (see Disciplines on Capital Account Opening below).

### *New Financial Services*

The GATS Understanding on Commitments in Financial Services requires that a Member permit financial services suppliers of any other Member established in its territory to offer in its territory any new financial service. A similar provision in the Mexico-EC and NAFTA-type FTAs applies to cross-border providers also and is limited to any new financial services of a type similar to those services a Party permits its own financial institutions, in like circumstances, to provide

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<sup>16</sup> In a side letter to the Singapore-USA FTA, the USA clarifies that a Party may require registration or authorization of cross-border providers of insurance services and cross-border providers of non-insurance financial services, including cross-border portfolio management.

<sup>17</sup> Note that Chile and Singapore have not yet signed the GATS Understanding on Commitments in Financial Services.

<sup>18</sup> Although mode four is contemplated in the cross-border provision of the GATS Understanding, countries that have signed the Understanding either explicitly exclude mode four from the coverage of cross-border trade or inscribe unbound in mode four entries.

<sup>19</sup> Singapore commits to consult on further liberalization of cross-border trade (see Annex II.b).

under its domestic law. Australia and Singapore combine the provisions in GATS and NAFTA, so that established suppliers are allowed to supply the type of new financial services allowed in NAFTA. In all cases, a Party may determine the juridical form through which the service may be provided and may require authorization for the provision of the service. When it does, authorization may only be refused for prudential reasons.

The NAFTA-type provision has raised concern when combined with a negative list approach. As opposed to the GATS positive list, any new financial service that complies with the conditions in the provision is automatically liberalized under a negative list. In response to this concern the Chile-EC, Singapore-USA and Chile-USA agreements have limited the coverage of “new financial services” to those that do not require legislative action and those a Party actually permits (as opposed to those of a type similar to) its own financial institutions, in like circumstances, to provide under its domestic law. For financial services not supplied within the territory of neither Party, the Chile-USA and Singapore-USA chapters stipulate (in a footnote) that the foreign provider must seek formal authorization.

A provision dealing with new financial services is also contained in the Japan-Singapore chapter, however it is not stated as an obligation and applies to regulated financial services only. The provision is silent about the reasons for refusing authorization.

#### *Other Sector-Specific Provisions*

The Chile-USA and Singapore-USA FTAs incorporate two additional provisions excluded from other regional agreements. The first provision is drawn from the GATS Understanding on Financial Services. It requires that parties facilitate the participation of established financial institutions of the other Party by granting them, on a national treatment basis, access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business. The provision does not however confer access to the lender of last resort facilities in the host country. The second provision, acknowledges the importance of maintaining and developing regulatory procedures to expedite the offering of insurance services by licensed suppliers.

### **3. Disciplines on Domestic Financial Regulation**

Compared to disciplines on trade liberalization, agreements in the Asia-Pacific region and the Western Hemisphere have developed few and limited disciplines on financial domestic regulation. Although in some cases these disciplines have improved over those developed at the multilateral level, the evidence presented in a later section shows that they are still not deep enough to promote a more profound internationalization of cross-border trade in financial services, particularly of *core banking*, *core insurance* and *securities services*. The main provisions on domestic regulation incorporated in these arrangements are discussed below.

#### *Right to Regulate*

All arrangements, except the Japan-Singapore FTA, including a chapter/annex on financial services recognize in separate articles a Party’s right to regulate its financial market, so long as these regulations are not discriminatory and not more burdensome than necessary to achieve their aim. They all incorporate the GATS prudential carve-out to ensure the integrity and stability of the financial system, however in a number of cases (NAFTA-type, Chile-EC, Chile-USA, Mexico-EC and Singapore-USA chapters) the objective of the prudential carve-out is expanded to

safeguard the maintenance or the safety, soundness, integrity or financial responsibility of financial service suppliers.

In reserving the right to adopt prudential regulations, arrangements follow either the GATS language (e.g. Australia-Singapore, Japan-Singapore, MERCOSUR) or the NAFTA language (e.g. NAFTA-type chapters and the Chile-EC, Chile-USA, Mexico-EC and Singapore-USA chapters). The NAFTA language applies more generally as it allows measures for prudential reasons to protect not only investors, depositors, policyholders or persons to whom a fiduciary duty is owed by a financial services supplier, but also financial market participants and policy claimants (Mexico-EC). The responsibility for adopting prudential measures falls on regulators of financial institutions, except in the Chile-USA and Singapore-USA chapters, where it is also the responsibility of regulatory or administrative authorities more generally.

Regulatory autonomy is further enhanced in the Chile-USA and Singapore-USA agreements through a provision allowing parties to adopt or enforce measures such as those relating to the prevention of deceptive and fraudulent practices or to deal with the effects of a default on financial services contracts. These measures need be non-discriminatory or shall not constitute a disguised restriction on investment in financial institutions or cross-border trade in financial services.

In a separate article on domestic regulation in financial services, the Singapore-USA FTA requires that all measure of general application to which the chapter applies be administered in a reasonable, objective and impartial manner. The Chile-USA chapter also incorporates this type of provision in its transparency article. These are the only two agreements that make this provision (included in most services chapters) specific to financial services.

An exclusion clause in all arrangements recognizes the right of countries to conduct activities in pursuit of monetary (and related credit policies in the Chile-USA and Singapore-USA chapters) or exchange rate policies and to limit foreign participation in services supplied in the exercise of governmental authority. These include activities forming part of a statutory system of social security or public retirement plans and other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government. The Singapore-USA, Chile-USA and EC-Chile FTAs incorporate the GATS language permitting foreign participation in services supplied in the exercise of governmental authority if these are provided in competition with a public entity or a financial service supplier.

Regulatory exceptions under the Chile-USA and Singapore-USA FTAs apply notwithstanding provisions in chapters such as on investment, cross-border trade in services, telecommunications, competition and electronic commerce.

### *Transparency*

Specialized text on transparency is developed in a separate article in all financial services chapters involving Western Hemisphere countries, except MERCOSUR.<sup>20</sup> Countries member to NAFTA-type and hybrid-type FTAs involving Western Hemisphere countries commit to make the application process to obtain authorization to provide financial services transparent and not excessively burdensome. Parties to these FTAs also commit to make *best endeavors* to allow interested persons to comment on measures of general application that a Party proposes to adopt. Chile, Singapore and the USA agree that, to the extent practicable, substantive comments

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<sup>20</sup> The transparency provision in the MERCOSUR Annex deals with the dissemination of confidential information.

received from interested persons with respect to the proposed regulations will be address in writing and to establish appropriate mechanism to respond to inquiries from interested persons regarding measures of general application covered by the chapter. NAFTA-type chapters incorporate a weaker provision requiring parties to merely notify other parties about such measures.

Agreements in the Asia-Pacific region and MERCOSUR incorporate the transparency article form the services chapter and/or the chapter on general provisions, by which member countries are only required to promptly publish and notify laws and regulations of general application, make the application process to obtain authorization to provide services transparent and not excessively burdensome and promptly respond to questions from the other Party. The article on domestic regulation of the services chapter of the Australia-Singapore agreement encourages the parties (or their competent authorities) to “endeavor to provide opportunity for comment, and give consideration to such comments, before their adoption, when introducing measures that significantly affect trade in services.”

The Chile-USA and Singapore-USA agreements acknowledge for the first time the importance of transparency in the rules of general application adopted by self-regulatory institutions. They also explicitly recognize the potential trade-inhibiting impact of non-transparent regulations governing the activities of financial institutions and cross-border financial service suppliers. Moreover, the USA and Singapore commit to consult with the goal of promoting objective and transparent regulatory processes in each Party.

#### *Disclosure of Information*

All trade agreements in our sample limit the disclosure of information relating to the financial affairs and accounts of individual customers of financial service suppliers. In GATS-type chapters, as well as in the Australia-Singapore chapter, this exception also applies to confidential or proprietary information in the possession of public entities. Under NAFTA-type and the Chile-EC, Chile-USA and Singapore-USA chapters a party is not required to provide “confidential information, the disclosure of which would impede law enforcement, or otherwise be contrary to the public interest, or which would prejudice legitimate commercial interests of particular enterprises, public or private.”

A rule is established in all chapters/annexes, except in the MERCOSUR and Japan-Singapore annexes, that a party shall permit the transfer of information in electronic or other form of data processing and, in the Australia-Singapore chapter, also equipment where such equipment and processing is required in the ordinary course of business. The Chile-EC chapters and all hybrid-type chapters also permit a Party to adopt appropriate safeguards where the information being transferred consists of personal data.

#### *Regulatory Harmonization/Cooperation*

Most trade agreements in the Asia-Pacific region and the Western Hemisphere contemplate some degree of regulatory harmonization. The highest degree of binding regulatory harmonization is found in the MERCOSUR annex. In a separate article entitled “Harmonization Commitment” the Parties to MERCOSUR commit to “continue progress in their process of harmonization...of prudential regulations and consolidated supervision, as well as in the exchange of information in the area of financial services.” This provision supplements a separate article dealing with recognition of prudential regulations. The text is similar to that in the GATS Annex provision, as it permits a Member State to recognize prudential measures of another Member State and allow

that recognition be accorded unilaterally, through harmonization or via a mutual arrangement. A Member State that is member to a mutual agreement or has afforded recognition unilaterally to a second Member State shall afford adequate opportunity for other Member States to prove that there is case for recognition.

Japan and Singapore have also acknowledged the importance of cooperation for further integration of their financial markets. Their agreement contains a separate chapter on financial services cooperation, however, as opposed to the MERCOSUR commitment, the modification to laws and regulations arising from such cooperation is not binding. The aim of the Chapter is to promote regulatory cooperation in the field of financial services, facilitate the development of financial markets, including capital markets, in the Parties and in Asia; improve financial infrastructure and maintain financial stability. Regulatory cooperation focuses on issues such as implementing sound prudential policies, enhancing effective supervision of financial institutions, responding to issues related to globalized financial markets (e.g. e-finance), maintaining an environment that does not “stifle” financial market innovations and conducting oversight of global financial institutions to minimize systemic risks and to limit contagion effects in the event of crises. The Parties also agree to cooperate in sharing information on securities markets and securities derivatives markets for the purpose of contributing to the effective enforcement of the securities laws of each Party.

With two exceptions, the remaining arrangements merely contemplate the *promotion* of mutual recognition of prudential regulations. The provision is, however, broader than that in GATS as it permits the recognition of prudential measures of both another Party and a non-Party. In spite of this provision, no mutual recognition agreements dealing with financial services have been reported so far in Asia-Pacific or the Western Hemisphere.

The EC, in its agreements with Chile and Mexico, followed the least harmonizing approach, which is the adoption of international standards. In both cases the parties commit to make *best endeavors* to implement *non-binding* internationally agreed standards for regulation and supervision in the financial services sector and for the fight against money laundering. Mexico and the EC specify the type of international standards the parties should aim to implement and apply in their territories, namely: the Basle Committee’s “Core Principles for Effective Banking Supervision”, the International Association of Insurance Supervisors’ “Key Standards for Insurance Supervision” and the International Organization of Securities Commissions’ “Objectives and Principles of Securities Regulation”. They also agree to consider the extent to which the “Ten Key Principles of Information Exchange” promulgated by the Finance Ministers of the G7 Nations may be applied in bilateral contracts.<sup>21</sup>

In the Asia-Pacific region, the Japan-Singapore agreement promotes the adoption of international standards by allowing parties to “recognize the prudential measures of any international regulatory body.” It also requires, and so does the services chapter of the Australia-Singapore agreement, that parties resort to international standards of relevant international organizations when determining whether licensing and qualification requirements and technical standards comply with the obligations. Only one agreement, the Australia-Singapore FTA, is completely silent about the recognition of prudential regulations both in its services and financial services chapters.

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<sup>21</sup> The Mexico-EC chapter on financial services also incorporates a more general provision excluding from the MFN obligation treatment granted under other agreements concluded by one of the parties with non-parties, which have been notified under GATS Article V. It also requires that parties afford adequate opportunity to the other Party to negotiate the benefits granted under such agreements.

### *Self-Regulatory Organizations*

Another common provision to all NAFTA-type chapters, as well as the Chile-USA and Singapore-USA chapters, deals with self-regulatory organizations. The relevance of this provision is that the obligations in the article apply regardless of whether the organization has been delegated regulatory powers by relevant authorities. The provision draws from the GATS Understanding on Financial Services and recognizes the important role played by self-regulatory organizations in financial markets and that membership to these organizations often constitutes a requirement for the provision of the financial service. The provision also stipulates that these organizations must comply with the national treatment and most favored nation treatment obligations as regards investment in financial institutions or cross-border trade in financial services. In GATS, the requirement is limited to national treatment to resident financial services suppliers.

### *Dispute Settlement*

Although not directly related to trade liberalization or domestic regulation, transparent and clear dispute settlement procedures are key in establishing an enabling framework for international business. NAFTA-type chapters and the Chile-USA and Singapore-USA chapters take the lead in this regard. Their chapters on financial services re-state the usual dispute settlement provision found in most agreements, so that investor-state disputes and state-state disputes are treated separately. The former are dealt with under the provisions in the investment chapter, unless the disputing party invokes the article on exceptions of the financial services chapter.<sup>22</sup> In such cases the matter is referred for a decision to a Committee on Financial Services composed of representatives from the parties' authorities in financial services.

State-state disputes are dealt with in the financial services chapter. The dispute settlement procedures are drawn from the investment chapter and are modified to reflect the specificities of the financial sector. Modifications include the conditions under which the complaining party may suspend benefits to financial services providers and the requirement that a panel with participation of financial experts addresses disputes dealing with the financial sector.

The dispute settlement article in the Australia-Singapore, Chile-EC, Japan-Singapore and Mexico-EC chapters/annexes on financial services is more limited than those following the NAFTA language, since its only requirement is that financial experts resolve financial sector disputes involving the parties. The article in the Chile-EC chapter also reformulates the text dealing with procedures for initiation of consultations. In all cases, the procedures on dispute settlement are drawn from the dispute settlement article in the investment chapter or in a separate chapter. The MERCOSUR annex does not include a specialized dispute settlement provision.

## **4. Disciplines on Capital Account Opening**

A common principle contained in most trade arrangements is to secure rights with regard to expropriation and the transfer, in and out of each country, of capital and funds related to an investment, as well as the right to resolve disputes with a host government through binding international arbitration for these obligations (see *Dispute Settlement* above). These provisions are commonly found in the investment chapter (NAFTA and NAFTA-type arrangements) or in

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<sup>22</sup> The article usually allows exceptions for prudential reasons, measures taken in pursuit of monetary and related credit policies or exchange rate policies or safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers.

the services chapter (GATS and GATS-type arrangements). NAFTA-type arrangements specify the types of flows that a Party to the arrangement must allow to be made freely and without delay. These include foreign direct investment, profits, dividends, the proceeds from the sale of an investment, and payments for loans or bond issues in a foreign market. Exceptions permit governments to prevent transfers, through the equitable, non-discriminatory and good faith application of certain laws of general application, such as bankruptcy laws and other law enforcement purposes. NAFTA and NAFTA-type arrangements also allow exceptions specific to financial services (i.e. in the financial services chapter), which permit a Party to prevent transfers by a financial institution or cross-border financial services provider to safeguard the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers. GATS and GATS-type arrangements, on the other hand, require that restrictions on any capital transactions be not inconsistent with a country's specific commitments regarding such transactions, except in the event of balance of payment difficulties or at the request of the International Monetary Fund. Other measures that may potentially prevent transfers are those taken for prudential reasons (other than the above safeguard) or in pursuit of monetary and related credit policies or exchange rate policies (see *Right to Regulate* above).

The most innovative provision of recent years is the one incorporated in the Chile-USA and Singapore-USA FTAs limiting the ability of the Chilean and Singaporean governments to restrict the flow of capital. Chile did not grant this concession to the European Community. In fact in a separate annex to the Chile-EC FTA, Chile explicitly "reserves the right" of the Central Bank to limit on an MFN basis, capital transfers through, for instance, reserve requirements ("encaje").

Under the Chile-USA and Singapore-USA FTAs, Chile and Singapore are allowed to impose capital transfer restrictions for 12 months, as long as those restrictions do not "substantially impede transfers." If Chile or Singapore's capital transfer restrictions were found to substantially impede transfers, then damages would accrue from the date of the initiation of the measure. If Chile or Singapore imposes any restrictions on any transfers for longer than 12 months, they may be required to compensate the investors for the extent and loss of asset value beginning in the second year (United States Trade Representative). For Chile, the provision applies to both inward and outward payments and transfers and for Singapore it is limited to outward payments and transfers. In addition, loss or damages arising from Chile's restrictive measures on capital inflows are limited to the reduction in value of the transfers and exclude loss of profits or business and any similar consequential or incidental damages.

## **V. Analysis of Commitments**

This section presents a quantitative analysis of the level of liberalization of trade in financial services and the capital account in selected countries of Asia-Pacific and the Western Hemisphere. Countries are selected on the basis of whether they have bound commitments under a particular trade arrangement and data availability.

To assess the level of trade liberalization, the paper constructs an index that measures the degree of market entry allowed by each country. The index assigns scores –zero to five– to the market access limitations inscribed in the country's list of commitments to each FTA as of July 2003<sup>23</sup>. Reservations inscribed in agreements following a negative list approach are transformed into market access limitations under a positive list. This allows comparability across countries,

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<sup>23</sup> In positive list schedules, a limitation on market access is assessed regardless of whether it was listed under the national treatment or the market access column. In addition, a country's commitments on future liberalization are not incorporated into its index.

sectors and subsectors and modes of supply.<sup>24</sup> The methodology used to construct the trade openness index is described in detail in Annex III.

To measure the degree of openness of the capital account we borrow the Financial Openness Index in Dailami (2000). The index provides a comprehensive assessment of the degree of openness of a country to international capital flows, since it measures both the severity of controls and the different types of transactions contributing to capital flows. The higher the value of the indices, the more open a country is to international competition in financial services and capital flows, respectively.

Tables 3 and 4 present the trade openness index for each country under each trade agreement it adheres. The indices are classified in four different categories that range from virtually no market entry allowed (i.e. largely closed) to highly liberalized (open). Figures in Table 3 denote the level of openness of each mode of supply in each of five composite sectors. The composite sectors are weighted averages of deposit and lending (*core banking*), auxiliary financial services and financial data processing (*other banking*), life and non-life insurance (*core insurance*), reinsurance and retrocession services and services auxiliary to insurance (*other insurance*) and trading and issuing (*securities*). Figures in Table 4 are weighted averages of modes one, two and three for each of the subsectors in banking, insurance and securities services. The weighting methodology is described in Annex III.

A number of stylized facts are evident from Tables 3 and 4:

#### *Regional Facts*

##### *Mode one:*

- *Core banking, core insurance and securities services:* are closed or partially closed in both Asia-Pacific and the Western Hemisphere, except between Australia and New Zealand, in Australia for Singaporean providers and in Canada and the USA for NAFTA members.
- Auxiliary financial services and financial data processing: are completely closed to foreign competition only in Brazil and Mexico.
- *Other insurance services:* are open or largely open in most Asia-Pacific and Western Hemisphere countries, except in Brazil, Canada and Japan.

##### *Mode two:*

- All financial services subsectors in Asia-Pacific: are virtually fully open. A notable exception is Singapore, where *core banking, core and other insurance and securities services* are fully closed for USA providers.
- *Core banking and securities services* in the Western Hemisphere: are open only among NAFTA member countries and in Argentina.
- *Other banking services in the Western Hemisphere:* are open among NAFTA member countries, Argentina and Chile (to USA providers).
- Life and non-life insurance in the Western Hemisphere: are substantially open only among NAFTA member countries. Mexico has also opened these services partially to Colombian providers<sup>25</sup> and substantially to EC providers.

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<sup>24</sup> It is important to note that the reservations or non-conforming measures listed under a negative list de facto reflect the level of application of laws and regulations, whereas commitments bound under a positive list may be more restrictive than the status quo (e.g. some developing countries in GATS that have not signed the GATS Understanding on Financial Services) unless they make specific reference to laws and regulations. Commitments bound under all of the agreements following a positive list mentioned in this study reflect the level of regulatory application, except those bound by Singapore in its FTA with Japan.

<sup>25</sup> Venezuela has not yet inscribed its commitments under the G-3 agreement. Hence, commitments regarding the G-3 in the tables should be interpreted as involving Colombia and Mexico only.

- Other insurance services in the Western Hemisphere: are substantially open in Argentina and among NAFTA member countries, except Canada.<sup>26</sup>

#### *Mode three*

- *Core and other banking, core and other insurance and securities services:* are mostly open or largely open in both Asia-Pacific and Western Hemisphere countries. The main exceptions are *core banking* and *securities services* in Brazil (GATS and MERCOSUR), *core and other banking services* in the USA (GATS and NAFTA), reinsurance and retrocession services in Chile (GATS and Chile-USA FTA) and *core banking services* (all agreements) and *securities services* (GATS and Japan-Singapore FTA) in Singapore.

#### *Country-Specific Facts*

- Australia and New Zealand grant virtually full market opening to each other in all financial services sectors and all modes of supply, except Australia to New Zealand in modes one and two of supply of non-life insurance services (largely open).
- Japan replicated its GATS commitments in its agreement with Singapore for all sectors and modes of supply. It is always open or largely open, except in mode one of supply of *core banking, core and other insurance and securities services*, as well as mode two of supply of *core insurance services*.
- Singapore is the only Asia-Pacific country where *core banking, financial data processing and securities services* are mostly closed. Singapore's commitments with the USA improve over previous agreements only in non-life insurance (modes one) and financial data processing services (modes one and two). Singapore also seems to have made more restrictive commitments in reinsurance and retrocession services (modes one and two), services auxiliary to insurance (modes one, two and three) and *securities services* (modes one and two) in its agreement with the USA than in GATS. This responds to a number of exclusions from the cross-border trade annex to the bilateral agreement,<sup>27</sup> but more importantly, to exchange rate regulations that are listed by Singapore in its bilateral agreement with the USA, but not in GATS.<sup>28</sup> Since these regulations apply to all foreign competitors alike, Singapore's GATS commitments in the above subsectors do not reflect the level of regulatory application. This line of reasoning also applies to Singapore's commitments with the USA on a number of sectors that were not included in the calculation of the trade openness index, namely financial leasing, trading in money market instruments, foreign exchange, exchange rate and interest rates instruments (see Annex III).
- The ASEAN incorporates Member's GATS commitments.
- Argentina is open or largely open to foreign providers in all financial services subsectors (Table 3) and modes of supply (Table 4), except in services auxiliary to insurance and mode one in *core banking and core insurance services*. It is the only country in the sample that maintains services auxiliary to insurance fully closed. Argentina offers its MERCOSUR partners more liberal market entry than to GATS members only in mode three of supply of *core insurance services* and reinsurance and retrocession services.<sup>29</sup>

<sup>26</sup> Mode two of supply of services auxiliary to insurance are highly open in Canada for NAFTA members. The low score for *other insurance services* hence responds to a combination of a high weight and very limited market entry allowed in reinsurance and retrocession services for NAFTA members (and also WTO members).

<sup>27</sup> Recall that modes one, two and four of supply of banking deposits and lending, life insurance and securities services, as well as mode two of supply of non-life insurance services are excluded from the annexes on cross-border trade to the Chile-USA and Singapore-USA FTAs.

<sup>28</sup> Singapore also inscribed in its ASEAN schedule of commitments a national treatment restriction dealing with offshore bank lending that is more restrictive than that in GATS.

<sup>29</sup> For MERCOSUR members, Argentina lifted its GATS restriction on establishment of new insurance (excluding life) services providers.

- Brazil bound its GATS commitments in MERCOSUR. Only mode three is partially open, which results in all subsectors being closed or partially closed, except securities issuing and auxiliary financial services.
- Canada is virtually fully open in all sectors and modes to its NAFTA partners, except in modes one and two of supply of reinsurance and retrocession services.
- Chile's commitments in its agreements with the EC and the USA improved substantially over its GATS commitments for all *banking, insurance* and *securities* subsectors, except in *reinsurance and retrocession services* (for USA providers). Chile opened its markets more to the EC than to the USA in all services subsectors, except in *securities* services and *services auxiliary to insurance*, where it allows equal market opening to both EC and USA providers (Table 3). Chile also partially opened, for the first time, modes one and two of supply of auxiliary financial services and financial data processing and mode one of supply of services auxiliary to insurance and non-life insurance services to USA providers (Table 4).<sup>30</sup>
- Mexico increased its NAFTA level of market opening to Colombian and EC providers in all subsectors, except banking deposits and lending. The ratchet clause included in NAFTA obliges Mexico to extend to its NAFTA partners this new level of liberalization to the extent that it reflects the level of regulatory application.
- The indices show that the USA made more liberal commitments in its bilateral agreements with Chile and Singapore than in NAFTA only in mode three of supply of *core* and *other banking services* and modes one and two of supply of financial data processing services. As before, the ratchet clause in NAFTA obliges the USA to extend the new level of liberalization to its NAFTA partners. In addition, the USA made more liberal commitments in NAFTA than in its bilateral FTAs with Chile and Singapore in mode one of supply of non-life insurance services and auxiliary financial services and mode three of supply of insurance services (all subsectors). This is the result of the more extensive coverage of subsectors of NAFTA's negative list approach with respect to the hybrid approach followed by the Chile-USA and Singapore-USA FTAs.<sup>31</sup> There are also a number of cases where the USA allows a more restricted market entry bilaterally to Chilean and Singaporean providers than through GATS; these are explained by the exclusions to the annex on cross-border trade (see footnote 27).<sup>32</sup> It must also be noted that the USA listed state-by-state limitations in GATS, whereas it listed reservations at the federal level in NAFTA and in its FTAs with Chile and Singapore. The latter were interpreted to be less restrictive (though less transparent) than the USA's GATS limitations, possibly overvaluing the degree of openness the USA effectively affords its regional and bilateral partners. A more accurate assessment requires a state-by-state analysis of regulations affecting financial services in the USA.

Table 5 presents Dailami's index of capital account opening. The following stylized facts are evident from the Table:

- Most Asia-Pacific and Western Hemisphere countries are open to international capital flows.
- Chile's (and also Singapore's) capital account is more liberal than what the index shows due to its commitment to limit restrictions to one year in its agreement with the USA. This implies that no country in Asia-Pacific or the Western Hemisphere may substantially limit its cross-border opening through restrictions on capital flows.
- Canada and the USA (for NAFTA members) and Australia and New Zealand (to each other) are the most liberalizing countries in cross-border trade (modes one and two) in *core banking*

<sup>30</sup> Note that Chile's commitments on future liberalization (see section IV and Annex II) were not considered in the calculation of Chile's indices.

<sup>31</sup> Members to NAFTA and most NAFTA-type agreements reserve the right to adopt in the future any measure relating to cross-border trade. This implicit restriction to trade was not included in the calculation of the trade openness index.

<sup>32</sup> The only difference between the USA commitments in its agreements with Chile and Singapore, regarding the financial services included in the tables, is a registration requirement for Chilean cross-border providers only. This requirement is deemed a minimal restriction and assigned a five score (see Annex III).

and *securities services*. All of these countries combine modes one and two opening with very liberal capital flows.

## VI. Conclusion

The study shows that during the past decade countries in the Western Hemisphere, and more recently in Asia-Pacific, were very active in developing plurilateral or bilateral trade arrangements within their respective regions. Western Hemisphere countries also intensified their efforts to increase extra-regional trade relations, a trend that also seems to be extending to the Asia-Pacific region. For instance, Australia has begun negotiations of a bilateral FTA with the United States and is contemplating the development of another one with China; Japan has engaged in trade talks with Chile and Mexico; and New Zealand, Singapore and Chile are discussing the possibility of negotiating a trilateral FTA.

With few exceptions in the Western Hemisphere, the trade arrangements developed so far in Asia-Pacific and the Western Hemisphere foster the internationalization of financial services. The arrangements differ in terms of the depth of the disciplines that govern each of the three components of financial services internationalization (trade liberalization, domestic regulatory reform and cross-border flow of capital), the approaches followed to bind financial services opening (negative list, positive list or a combination thereof) and, most importantly, the level of financial services openness effectively granted between members.

The analysis of market opening bound under each FTA shows that, in most cases, countries broadened the levels of liberalization bound in GATS, the most notable exception being mode one of supply of *core-banking*, *core-insurance* and *securities services*. Countries in Asia-Pacific (except Singapore) seem to have more liberal financial services markets than countries in the Western Hemisphere, particularly in *non-core financial services* through modes one and two. In addition, Singapore, in spite of having signed more agreements than any other Asia-Pacific country, has so far achieved the lowest levels of financial services liberalization in the region. In the Western Hemisphere, NAFTA member countries in very few occasions made more liberal commitments in bilateral or regional agreements than in NAFTA, while Chile made important liberalization efforts in its agreements with the EC and the USA. Argentina has achieved the highest level of overall financial services liberalization in the Western Hemisphere.

The evidence presented also suggests that countries tend to see the development of specialized text as a precondition for financial services internationalization. This has been the case in GATS (as evidenced by the extended negotiations that culminated in 1997) and also in most regional and bilateral trade arrangements in Asia-Pacific and the Western Hemisphere. This discussion revives a long-standing debate about whether rules and disciplines should be developed horizontally for all services sectors or whether certain services sectors should be treated separately. Since the economic case for regulation stems from the existence of market failures<sup>33</sup>, one might claim that specific disciplines could be developed for sectors subject to this problem and, moreover, that such disciplines should target the individual market failure rather than the specific sector. However, financial services differ from other sectors subject to market failures, because not one but three different types of market failures affect them: *asymmetries of information*, *externalities* and *network effects*. Moreover, internationalization is likely to amplify market failures<sup>34</sup> (probably more so in financial services than in other sectors) and hence, increase

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<sup>33</sup> There is also a social case for regulation, which deals with equity considerations.

<sup>34</sup> For instance, the following problems tend to amplify with foreign competition: a customer entrusting money or assets to a financial service provider is likely to have less information about the ability of the provider to securely manage the money; failure of one financial service provider may undermine confidence in the financial system and cause other providers to fail; and markets with

the implicit discrimination arising between domestic and foreign providers and, in some cases, systemic instability. Therefore, specialized rules and disciplines on financial services are necessary to bridge the asymmetric treatment of market failures across countries and to address the need for enhanced coordination in supervision that should accompany financial services internationalization. Australia and New Zealand show that, if, on the contrary, countries have proximity in regulatory frameworks (and business practices), it is possible to treat financial services horizontally with all other services sectors.

How effectively then may specialized disciplines on financial services help promote further internationalization of this sector? It would seem that the answer to this question depends on the degree of the regulatory asymmetries and the type of financial services and modes of supply being liberalized. The evidence presented in the previous sections shows that it is possible to achieve relatively high levels of internationalization of cross-border trade and investment (mode three) in *non-core financial services* and investment in *securities services* through the development of a few specific disciplines. These comprise trade disciplines specialized on financial services (e.g. national treatment), supplemented by provisions expanding governments' autonomy to adopt and implement domestic regulations for the financial sector and deepening transparency in the rules and procedures set forth by domestic regulators and self-regulatory institutions. Some agreements have also acknowledged the need for cooperation in supervision through a very limited binding provision promoting the exchange of information between regulators (Chile-USA and Singapore-USA FTAs) and non-binding initiatives promoting dialogue between supervisors (mainly in Asia-Pacific).

In addition to the above provisions and to the limiting of restrictions on capital flows, the Chile-USA and Singapore-USA FTAs developed a formula approach (similar, for cross-border trade, to that adopted in the GATS Understanding on Commitments in Financial Services), which distinguishes between cross-border trade and mode three of supply opening. The formula enabled countries whose domestic regulations differ greatly to deepen the internationalization of financial services subsectors and modes of supply requiring limited regulatory harmonization and capital account opening (i.e. *non-core services* and mode three of supply) and to hold back opening in subsectors and modes of supply where these reforms are more critical (i.e. *core services* and cross-border trade). Moreover, the formula approach facilitated inter-sectoral trade-offs in *non-core financial services* (e.g. mode four of supply in the USA for mode one in Chile and Singapore), a negotiating modality that has had very limited applicability at the multilateral level.

The evidence also shows that in very few cases plurilateral or bilateral FTAs in Asia-Pacific and the Western Hemisphere promoted any opening of mode one of supply of *core-banking*, *core-insurance* and *securities services*. It seems unlikely that the development of disciplines dealing with trade issues, trade-related aspects of domestic regulations and capital account opening alone might substantially reduce the implicit discrimination arising when regulations dealing with these subsectors and modes of supply differ substantially and, more importantly, address concerns about systemic instability. These types of disciplines cannot and should not substitute for regulatory harmonization and coordinated international supervision. Where regulations do not differ greatly, mutual recognition agreements (MRAs) might constitute a viable mechanism to further promote this type of cross-border opening. However, if host country regulators remain unwilling to concede control (i.e. recognize the validity of foreign supervisory authorities), MRAs are bound to remain ineffective.

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network externalities may develop new incompatible technologies when technology development costs are declining over time (Katz and Shappiro, 1992).

Possibly the most viable alternative to promote further, though still limited, opening of cross-border trade in *core financial services* remains the binding of international standards (which so far promote very limited regulatory similarity), however complemented with the binding of deeper disciplines encouraging cooperation in supervision.<sup>35</sup> Japan and Singapore seem to have acknowledged the importance of this issue. Their FTA not only incorporates a separate chapter on cooperation (although the modification of laws and regulation emanating from this chapter are not binding), but also signatory countries agree to make *best endeavors* to follow the guidelines on financial cooperation of the ASEAN + 3. Other voluntary cooperation initiatives in Asia-Pacific include: the Asia Pacific Economic Cooperation Forum, Executives' Meeting of East Asia and the Pacific, Four Markets Group (Australia, Hong-Kong, Japan and Singapore), and Manila Framework Group. Voluntary cooperation initiatives in the Western Hemisphere seem to have a more limited objective and less formal support than those in the Asia-Pacific region. The most relevant initiatives are the Western Hemisphere Committee on Financial Affairs, Central-American Monetary Council and Andean Development Corporation's Kemmerer Program for Inter-Institutional Technical Cooperation.

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<sup>35</sup> It must be noted that regulatory harmonization need be accompanied by cooperation in supervision to be effective. In fact, even if regulatory harmonization has taken place, a lack of cooperation in supervision might still impede trade.



	BANKING				INSURANCE					
	Open	Largely Open	Partially Closed	Largely Closed	Open	Largely Open	Partially Closed	Largely Closed		
<b>Financial Data Processing</b>										
Argentina	GATS 5.0								GATS 0.0	Western Hemisphere
	MS 5.0								MS 0.0	
Brazil									GATS 0.0	
									MS 0.0	
Canada	GATS 4.4									
	NAFTA 4.5									
Chile		Ch-USA 3.1							GATS 0.0	
		Ch-EC 3.3								
Mexico		Mx-EC 3.1	NAFTA 2.5	GATS 0.0						
		G-3 3.1								
USA	Ch-USA 3.5	GATS 2.6								
	Sg-USA 3.5	NAFTA 2.6								
Australia	Au-NZ 5.0	GATS 3.1								
	Au-Sg 3.8									
Japan	GATS 4.7									
	Jp-Sg 4.7									
New Zealand	GATS 4.7									
	Au-NZ 5.0									
	NZ-Sg 4.7									
Singapore		Sg-USA 3.3	GATS 2.5							
			Au-Sg 2.5							
			Jp-Sg 2.5							
			NZ-Sg 2.5							
<b>Services Auxiliary to Insurance</b>										
									GATS 0.0	
									MS 0.0	
									GATS 3.0	
									MS 3.0	
NAFTA	4.5	GATS 3.3								
		Ch-USA 3.0	GATS 1.4							
		Ch-EC 3.0								
		Mx-EC 2.7	GATS 2.4							
		G-3 2.7	NAFTA 2.5							
NAFTA	4.3	GATS 2.8								
		Ch-USA 3.5								
		Sg-USA 3.5								
Au-NZ	5.0	GATS 3.5								
Au-Sg	4.7									
GATS	4.7									
Jp-Sg	4.7									
GATS	5.0									
Au-NZ	5.0									
NZ-Sg	4.7									
GATS	4.9									
Au-Sg	4.7									
Jp-Sg	4.9									
NZ-Sg	4.9									
Sg-USA*	3.9									

Table 3 continued

OPENNESS INDEX BY MODE OF SUPPLY														
	Mode 1				Mode 2				Mode 3					
	Open	Largely Open	Partially Closed	Largely Closed	Open	Largely Open	Partially Closed	Largely Closed	Open	Largely Open	Partially Closed	Largely Closed		
Core Banking	Argentina				GATS 0.0	GATS 5.0			GATS 5.0				Western Hemisphere	
					MS 0.0	MS 5.0			MS 5.0					
	Brazil				GATS 0.0				GATS 0.0		GATS 2.8			
					MS 0.0				MS 0.0		MS 2.8			
	Canada	NAFTA 4.0				GATS 0.0	GATS 4.0			GATS 3.8				
						NAFTA 4.0			NAFTA 4.9					
	Chile					GATS 0.0			GATS 0.0	Ch-USA 3.6	GATS 2.8			
						Ch-USA 0.0			Ch-USA 0.0	Ch-EC 4.0				
						Ch-EC 0.0			Ch-EC 0.0					
	Mexico					GATS 0.0		NAFTA 3.0	GATS 0.0	NAFTA 3.8	GATS 3.2			
					NAFTA 0.0		Mx-EC 3.0		Mx-EC 3.8					
					Mx-EC 0.0		G-3 3.0		G-3 3.8					
USA	NAFTA 4.0				GATS 0.0	NAFTA 4.0	GATS 3.0		Ch-USA 0.0		Ch-USA 3.4	GATS 2.3		
					Ch-USA 0.0				Sg-USA 0.0		Sg-USA 3.4	NAFTA 2.4		
Australia	Au-NZ 5.0		Au-Sg 2.5	GATS 0.0	GATS 5.0				Au-NZ 5.0	GATS 3.4				
					Au-NZ 5.0				Au-Sg 4.5					
Japan					GATS 0.0	GATS 4.0			GATS 4.3					
					Jp-Sg 0.0	Jp-Sg 4.0			Jp-Sg 4.3					
New Zealand	Au-NZ 5.0				GATS 0.0	GATS 5.0			GATS 4.7					
					NZ-Sg 0.0	NZ-Sg 5.0			Au-NZ 5.0					
					NZ-Sg 5.0				NZ-Sg 4.7					
Singapore					GATS 0.0	GATS 5.0						GATS 2.0		
					Au-Sg 0.0	Au-Sg 5.0						Au-Sg 2.0		
					Jp-Sg 0.0	Jp-Sg 5.0						Jp-Sg 2.0		
					NZ-Sg 0.0	NZ-Sg 5.0						NZ-Sg 2.0		
					Sg-USA 0.0	Sg-USA 5.0						Sg-USA 2.3		
Other Banking	Argentina	GATS 5.0			GATS 5.0				GATS 5.0				Western Hemisphere	
		MS 5.0			MS 5.0				MS 5.0					
	Brazil				GATS 0.0				GATS 0.0		GATS 2.2			
					MS 0.0				MS 0.0		MS 2.2			
	Canada	NAFTA 4.0		GATS 2.5		GATS 4.0	NAFTA 4.0			GATS 4.2				
						NAFTA 4.0			NAFTA 4.8					
	Chile		Ch-USA 3.0			GATS 0.0		Ch-USA 3.0		GATS 0.0	Ch-EC 5.0	Ch-Sg 3.2		GATS 1.1
						Ch-EC 0.0			Ch-EC 0.0					
	Mexico					GATS 0.0		NAFTA 3.0	GATS 0.0	Mx-EC 4.3	NAFTA 3.6	GATS 1.7		
						NAFTA 0.0		Mx-EC 3.0		G-3 4.3				
					Mx-EC 0.0		G-3 3.0							
USA		GATS 3.5			GATS 3.5				Ch-USA 3.2	GATS 2.4				
		NAFTA 3.5			NAFTA 3.5				Sg-USA 3.2	NAFTA 2.4				
		Ch-USA 3.5			Ch-USA 3.5									
		Sg-USA 3.5			Sg-USA 3.5									
Australia	Au-NZ 5.0			GATS 2.0	GATS 5.0				Au-NZ 5.0	GATS 3.4				
				Au-Sg 2.0	Au-NZ 5.0				Au-Sg 4.5					
Japan	GATS 5.0				GATS 4.0				GATS 4.6					
					Jp-Sg 4.0				Jp-Sg 4.6					
New Zealand	GATS 5.0				GATS 5.0				GATS 4.6					
					Au-NZ 5.0				Au-NZ 5.0					
					NZ-Sg 5.0				NZ-Sg 4.6					
Singapore					GATS 3.0							GATS 3.3		
					Au-Sg 3.0							Au-Sg 3.3		
					Jp-Sg 3.0							Jp-Sg 3.3		
					NZ-Sg 3.0							NZ-Sg 3.3		
					Sg-US 3.0							Sg-USA 3.4		

Table 4

		Mode 1				Mode 2				Mode 3					
		Open	Largely Open	Partially Closed	Largely Closed	Open	Largely Open	Partially Closed	Largely Closed	Open	Largely Open	Partially Closed	Largely Closed		
Core Insurance	Argentina				GATS 0.0 MS 0.0				GATS 0.0 MS 0.0	MS 5.0	GATS 3.4			Western Hemisphere	
	Brazil				GATS 0.0 MS 0.0				GATS 0.0 MS 0.0		GATS 1.4				
	Canada	NAFTA 4.0		GATS 1.5		NAFTA 4.0		GATS 1.5		NAFTA 4.8	GATS 3.6				
	Chile			Ch-USA 1.5	GATS 0.0 Ch-EC 0.0				GATS 0.0 Ch-USA 0.0 Ch-EC 0.0	Ch-EC 4.6	Ch-USA 3.3	GATS 2.2			
	Mexico				GATS 0.0 NAFTA 0.0 Mx-EC 0.0 G-3 0.0	NAFTA 3.0	G-3 3.0		2.0	GATS 0.0	Mx-EC 3.9	GATS 3.7	G-3 3.9		NAFTA 3.6
	USA	NAFTA 4.0		GATS 1.5 Ch-USA 1.5 Sg-USA 1.5		NAFTA 4.0		GATS 1.5	Ch-USA 0.0 Sg-USA 0.0	NAFTA 4.5	GATS 2.9		Ch-USA 2.9 Sg-USA 2.9		
	Australia	Au-NZ 4.0	Au-Sg 3.0	GATS 1.5		Au-NZ 4.0	Au-Sg 3.0	GATS 1.5		Au-NZ 4.4	GATS 3.2				
	Japan			GATS 1.5 Jp-Sg 1.5				GATS 1.5 Jp-Sg 1.5			GATS 4.1 Jp-Sg 4.1				
	New Zealand	Au-NZ 5.0		NZ-Sg 2.5	GATS 0.5	Au-NZ 5.0 NZ-Sg 4.0				GATS 0.5	Au-NZ 5.0 NZ-Sg 3.9	GATS 3.5			
	Singapore			Sg-USA 1.5	GATS 0.0 Au-Sg 0.0 Jp-Sg 0.0 NZ-Sg 0.0	GATS 4.0 Au-Sg 4.0 Jp-Sg 4.0 NZ-Sg 4.0				Sg-USA 0.0	Au-Sg 4.6 Jp-Sg 4.9 NZ-Sg 4.9 Sg-USA 4.6	GATS 2.8			
Other Insurance	Argentina				GATS 4.4 MS 4.4				GATS 4.4 MS 4.4	MS 4.4	GATS 3.0			Western Hemisphere	
	Brazil				GATS 0.0 MS 0.0				GATS 0.0 MS 0.0		GATS 1.8 MS 1.8				
	Canada				NAFTA 2.2	GATS 0.4			GATS 2.2	NAFTA 4.8	GATS 2.8				
	Chile	Ch-EC 4.4	Ch-USA 3.0	GATS 2.6					GATS 0.0 Ch-USA 0.0 Ch-EC 0.0	Ch-EC 4.6		GATS 2.2	Ch-USA 2.4		
	Mexico			GATS 2.6 NAFTA 2.6 Mx-EC 2.6 G-3 2.6		NAFTA 3.0 Mx-EC 3.0 G-3 3.0			GATS 0.0	Mx-EC 3.9	GATS 3.7	G-3 3.9	NAFTA 3.6		
	USA	NAFTA 4.0	GATS 3.6			NAFTA 4.0		GATS 2.2	Ch-USA 0.0 Sg-USA 0.0	GATS 3.8		NAFTA 4.5	Ch-USA 3.8 Sg-USA 3.8		
	Australia	Au-NZ 5.0	GATS 3.0			Au-NZ 5.0	GATS 3.0			Au-NZ 5.0	GATS 3.7				
	Japan			GATS 2.4 Jp-Sg 2.4			GATS 3.1 Jp-Sg 3.1				GATS 4.2 Jp-Sg 4.2				
	New Zealand	GATS 5.0 Au-NZ 5.0 NZ-Sg 5.0				GATS 5.0 Au-NZ 5.0 NZ-Sg 5.0				GATS 5.0 Au-NZ 5.0 NZ-Sg 4.6					
	Singapore	GATS 5.0	Sg-USA 3.0			GATS 5.0 Au-Sg 5.0 Jp-Sg 5.0 NZ-Sg 5.0				Sg-USA 0.0	GATS 4.1 Au-Sg 4.6 Jp-Sg 4.9 NZ-Sg 4.9 Sg-USA 4.6				
Securities	Argentina				GATS 0.0 MS 0.0	GATS 5.0 MS 5.0				GATS 5.0 MS 5.0				Western Hemisphere	
	Brazil				GATS 0.0 MS 0.0				GATS 0.0 MS 0.0	GATS 4.3 MS 4.3					
	Canada	NAFTA 4.0			GATS 0.0	GATS 4.0 NAFTA 4.0				NAFTA 4.8	GATS 2.7				
	Chile				GATS 0.0 Ch-USA 0.0 Ch-EC 0.0				GATS 0.0 Ch-USA 0.0 Ch-EC 0.0		Ch-USA 3.2 Ch-EC 3.1		GATS 1.1		
	Mexico				GATS 0.0 NAFTA 0.0 Mx-EC 0.0 G-3 0.0	NAFTA 3.0 Mx-EC 3.0 G-3 3.0			GATS 0.0	Mx-EC 4.1 G-3 4.1	GATS 3.2	NAFTA 3.6			
	USA		NAFTA 3.0		GATS 0.0 Ch-USA 0.0 Sg-USA 0.0	GATS 3.0 NAFTA 3.0			Ch-USA 0.0 Sg-USA 0.0		GATS 3.6 NAFTA 3.6 Ch-USA 3.6 Sg-USA 3.6				
	Australia	Au-NZ 5.0	Au-Sg 3.0			GATS 0.0 Au-NZ 5.0 Au-Sg 5.0				Au-NZ 5.0 Au-Sg 4.5	GATS 3.7				
	Japan				GATS 0.0 Jp-Sg 0.0	GATS 4.0 Jp-Sg 4.0					GATS 4.6 Jp-Sg 4.6				
	New Zealand	Au-NZ 5.0			GATS 0.0 NZ-Sg 0.0	GATS 5.0 Au-NZ 5.0 Au-Sg 5.0					GATS 4.6 Au-NZ 5.0 Au-Sg 4.6				
	Singapore				GATS 1.0 Au-Sg 1.0 Jp-Sg 1.0 NZ-Sg 1.0 Sg-USA 0.0	GATS 5.0 Au-Sg 5.0 Jp-Sg 5.0 NZ-Sg 5.0				Sg-USA 0.0	Au-Sg 2.8 NZ-Sg 2.8 Sg-USA 2.8	GATS 1.8 Jp-Sg 1.8			

Table 4 continued

CAPITAL FLOWS OPENNESS INDEX

	Open	Largely Open	Partially Closed	Largely Closed		
Argentina	1.78					
Bahamas, The			1.36			
Barbados				1.28		
Belize			1.44			
Bolivia	1.79					
Brazil				1.19		
Canada	1.92					
Chile			1.43			
Colombia			1.38			
Costa Rica			1.48			
Dominican Republic			1.49		Western Hemisphere	
Ecuador		1.54				
El Salvador	1.91					
Guatemala	1.73					
Honduras		1.56				
Jamaica	1.76					
Mexico	1.69					
Nicaragua	1.82					
Panama	1.9					
Paraguay	1.81					
Peru	1.9					
Australia	1.77					Asia-Pacific
Indonesia			1.46			
Korea			1.42			
Japan	1.73					
Malaysia				1.34		
New Zealand	1.9					
Philippines	1.59					
Singapore	1.78					
Thailand			1.46			

Source: Dailami (2000)

Table 5

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## **Annex I: Member Countries of Regional Blocks and Common Markets**

### *Andean Community*

Bolivia, Colombia, Ecuador and Peru

### *Association of Southeast Asian Nations (Asean)*

Brunei Darussalam, Indonesia, Malaysia, The Philippines, Singapore, Thailand and Vietnam

### *Central American Common Market (CACM)*

El Salvador, Guatemala, Honduras and Nicaragua. The Treaty on services was also signed by Costa Rica

### *Caribbean Common Market (CARICOM)*

Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, St. Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago

### *Central America*

El Salvador, Guatemala, Honduras and Nicaragua

### *Efta*

Iceland, Liechtenstein, Norway and Switzerland

### *European Community*

Austria, Belgium, Denmark, Finland, France, Germany, Great Britain, Hellenic Republic, Ireland, Luxembourg, Portugal, Spain, Sweden and The Netherlands

### *Group of Three*

Mexico, Colombia and Venezuela

### *Southern Cone Common Market (MERCOSUR)*

Argentina, Brazil, Paraguay and Uruguay

### *North America Free Trade Agreement (NAFTA)*

Canada, Mexico and the United States

### *Northern Triangle*

El Salvador, Guatemala and Honduras

## **Annex II: Further Market Access Provisions**

### **a. Market Access**

Both the Singapore-USA and Chile-USA chapters on financial services add a number of provisions to further promote market opening in specific areas. In an annex to the Singapore-USA agreement the parties agree to consult, no later than January 2007 and every three years thereafter, concerning any existing limitation on acquisition of control by United States financial institutions of Singapore-incorporated banks that persons in this country control. Singapore also commits to considering applications for access to automated teller machines networks operated by local banks in the country for credit cards of non-bank issuers that are controlled by persons in the United States and allows USA firms to supply debit services through an Electronic Funds Transfer at Point of Sale network. It also lifts quantitative limits on the number of customer service locations permanently, and of full bank licenses, for 18 months. For Australian providers, Singapore commits to eliminate a quantitative restriction on the number of wholesale banks allowed to operate in its market within four years after the entry into force of the agreement.

The Mexico-EC chapter also incorporates an obligation to review market access issues in the future. The obligation states that a decision on the elimination of “substantially all remaining discrimination” shall be adopted no later than three years following the entry into force of the Agreement. A decision on this regard had not been made at the time this study was concluded.

For banking and other financial services (excluding insurance), Annex 12.9 of the Chile-USA agreement permits the establishing financial institution to supply financial services allowed by the domestic law and eliminates numerical restrictions or limitations on the juridical form of establishment. Operating institutions may establish additional financial institutions as may be necessary to supply the full range of financial services allowed under the domestic law. The host country is however permitted to impose the juridical form of establishment for the supply of particular financial services or activities.

The Annex also stipulates that the right of establishment includes the acquisition of existing entities and that a Party may prohibit a particular financial service or activity, but it cannot prohibit all financial services or a complete financial services subsector such as banking. Subject to the inclusion of non-conforming measures, Chile allows investors from the United States to participate in its pension system by establishing an *Administradora de Fondos de Pensiones*, without application of an economic needs test.

In the area of insurance, Chile commits to allow *limited* branching of U.S. insurance suppliers. This must take place no later than four years after the date of entry into force of the agreement. However, Chile reserves the right to choose the type of regulation that will apply to branches of U.S. insurance institutions. Moreover, Chile is allowed to impose restrictions that may limit branching considerably, such as: i) the capital and reserves that foreign insurance companies assign to their branches must be effectively transferred and converted into domestic currency, ii) the increases of capital and reserves that do not come from capitalization of other reserves will have the same treatment as initial capital and reserves, iii) in the transactions between a branch and its parent or other related companies each shall be considered as independent entities, iv) the branch owners or shareholders meet the solvency and integrity requirements established in Chile’s insurance legislation and v) branches of foreign insurance companies that operate in Chile may transfer liquid profits only if they do not have an investment deficit in their technical reserves and risk patrimony, nor a deficit or risk patrimony. The United States, in turn, commits

to review regulations that do not allow entry of non-USA insurance companies as a branch in a number of States.

Further market access issues are specified in a separate article on key personnel - in the Mexico-EC agreement- and senior management and board of directors - in NAFTA-type agreements. The Chile-EC agreement does not incorporate this type of provision. The article in the Mexico-EC chapter establishes that a Party may not “require a financial service supplier of the other Party to engage individuals of any particular nationality as senior managerial or key personnel.” NAFTA-type agreements substitute the term “key personnel” for “essential personnel,” however in neither case are these terms defined. A more relevant divergence in the drafting of this provision may be found in the Chile-USA agreement. The provision in NAFTA-type agreements, as well as the Mexico-EC agreement, stipulates that a Party may not require that more than a simple majority of the board of directors of a financial institution (financial service supplier in the Mexico-EC article) of the other Party be composed of nationals of the Party, persons residing in the territory, or a combination thereof. The Chile-USA chapter softens the obligation by applying the requirement to not more than a *minority* of the board of directors.

## **b. Cross-Border Trade**

The Chile-USA and Singapore-USA chapters extend national treatment to the cross-border trade of a list of financial services included in a separate annex. In insurance, national treatment is accorded to mode one and mode four (except Chile) of supply and in banking to all three modes composing cross-border trade. In insurance the obligation applies with respect to:

Mode one of supply:

- Chile: international MAT insurance (excluding space launching and freight), reinsurance and retrocession, reinsurance and international MAT insurance brokerage, consultancy, actuarial, and risk assessment services.
- Singapore: MAT insurance, reinsurance and retrocession, reinsurance and MAT insurance brokerage, services auxiliary to insurance comprising actuarial, loss adjustors, average adjustors and consultancy services.
- United States: MAT insurance, reinsurance and retrocession, services auxiliary to insurance and insurance brokerage and agency services.

Mode four of supply:

- Singapore: services auxiliary to insurance comprising actuarial, loss adjustors, average adjustors and consultancy services.
- USA: all insurance services (as defined in the Chapter)

In banking, the obligation applies with respect to:

- Chile: provision and transfer of financial information, financial data processing and advisory and other auxiliary financial services, excluding intermediation and credit reference and analysis, relating to banking and other financial services.
- Singapore: financial leasing, provision and transfer of information, provision of financial data processing and related software; trading in money market instruments, foreign exchange, exchange rate and interest rate instruments with financial institutions in Singapore, corporate advisory services and advisory and other auxiliary services.
- USA: transfer of financial information, financial data processing and related software, and advisory services and other auxiliary services, excluding intermediation, relating to banking and other financial services

In a side letter, Singapore clarifies that for prudential reasons, its commitments regarding the cross-border supply of MAT insurance intermediation by brokerage in Singapore are subject to the requirement that the USA brokerage can only place MAT insurance with USA financial institutions. In annex 10C it also commits to consult on further liberalization of cross-border trade in financial services no later than January 2006.

Chile's commitments regarding sale and brokerage of international MAT insurance apply one year after the entry into force of the Agreement or when Chile has made and implemented the necessary amendments to its pertinent legislation, whichever occurs first. In banking services and other financial services (excluding insurance), Chile requires prior authorization for the cross-border supply of financial data processing services and reserves the right to allow credit reference and analysis to be supplied by cross-border financial service suppliers of the United States. Curiously, should Chile decide to allow the provision of such services, it is entitled to reverse this measure in the future.

Chile, Singapore and the United States allow a financial institution (other than a trust company or insurance company), organized outside their territories, to provide investment advice and portfolio management services (Annexes 12.9 and 10C of the Chile-USA and Singapore-USA agreements, respectively). Both agreements establish registration requirements for these providers (Annex 12.9 of the Chile-USA agreement and side letter to the Singapore-USA agreement). The USA and Chile further agree that a commitment on cross-border investment advisory services does not require a Party to permit the public offering of securities (as defined under their relevant laws) in its territory by the cross-border supplier of investment advisory services. Singapore also commits to afford MFN treatment to U.S. financial institutions in the award of asset management mandates by the Government of Singapore Investment Corporation.

## **Annex III: Methodology for Calculating the Trade Openness Index**

### ***Criteria***

The trade openness index builds upon the work of Claessens and Glaessner (1998). A country's commitments are rated on the basis of one or a combination of the following criteria:

#### **A. Establishment and ownership**

- 5 No limits on establishment or equity acquisition/participation in domestic banks/companies; current practice of granting new licenses.
- 4 Foreign branch establishment permitted within specific limits; limitation on the type of establishment; foreign equity participation in domestic banks/companies between 51% and 100%. Minor limitations: legal form, number of operation (branches), types of operations (branches v/s subsidiaries), value of transactions/assets, reciprocity, and registration (compliance with laws, acts, etc.).
- 3 No new licenses granted in practice; entry limited to joint ventures only; foreign equity participation in domestic banks/companies between 41 and 50%.
- 2.5 Foreign equity participation in domestic banks/companies between 31 and 40%; no quota limitation during a transitional period.
- 2 Foreign equity participation in domestic banks/ companies between 15 and 30%; no new licenses allowed unless licenses already acquired in other states within a country; economic needs test.
- 1 No new entry allowed – unbound for new entry; non-prudential government approval required for establishment (minimum limits on amount of FDI, “certain criteria for eligibility”); foreign equity participation in domestic banks/companies 14% and below.

#### **B. Offices/ATMs**

- 5 No restrictions on branch offices or ATMs.
- 4 Restrictions on branches of foreign companies, but none on joint ventures; partial removal of restrictions on additional branches; no limitation on ATM network.
- 3 Restrictions on branches of foreign companies; more than 5 ATMs allowed.
- 2 Extremely tight restrictions on sub-branching; up to 5 offices/ATMs permitted subject to Branches Act; ban on foreign branches from establishing own ATM network; permission from national ATM pool prior to setting-up ATM operations.
- 1 Non-prudential government approval required for all offices; unbound for ATM.

#### **C. Lending/activity**

- 5 No limits on lending/business activity.
- 4 Foreign banks/companies not subjected to directed lending or mandated principal business activity as domestic firms; in insurance, branches are not allowed to provide surety bonds for government contracts.
- 3 Restrictions on computation of capital/lending limits or on issuance of securities; specific limits on offshore banking; deposits and lending activities are limited to a specific type of banks; requirements on paid-up capital (e.g., higher for financial service providers); issuing/trading of selected securities only; transactions of securities only through established dealers; restriction on remittances; limits on specific operations; membership requirement to the stock exchange.
- 2 Specified limits on offshore lending or lending of foreign branches; strict (non-capital) limits on foreign companies vis-à-vis domestic firms; limits on membership to the stock exchange; minimum retention requirement for domestic reinsurers.

- 1 Restrictions on management and operations such as mandatory lending, transactions in local currency only; restrictions on broking; securities trading limited to selected firms; limits on investment trust services to selected establishments; tight regulatory control.

#### D. Universal banking

- 5 No limits on financial services.
- 4 Some limits on financial activities or approval required.
- 3 Limits on activities of offices of foreign branches to deposit-taking; approval required for new products.
- 2 Limits on foreign branch activities in foreign exchange, credit unions, credit cards, and trust services.
- 1 Restrictions on all activities normally undertaken by international banks with universal banking rights.

#### E. Residency requirement

- 5 No restrictions on composition of board membership; no residency requirement for membership to stock exchange.
- 4 Restrictions on composition of board membership to at least one national.
- 3 Restrictions on board membership by foreigners according to proportion of ownership; residency requirement for membership in the stock exchange; residency requirement for establishment; residency requirement for license; locally based CEO.
- 2 Restrictions on board membership by foreigners to less than one half; effective control of firms by nationals; permanent resident requirement for all senior managers.
- 1 Restrictions on board membership by foreigners to one half or more.

#### F. Cross-border trade

- 5 Free access to offshore financial instruments; free access allowed but solicitation or advertising by foreign institutions not permitted; free access allowed but registration required.<sup>36</sup>
- 4 Enrolment requirement in order to engage activities of cross-border financial services; free access during a specific time-frame.
- 3 Access to instruments subject to annual limits or access only to certain specified products in financial services; permission required for participation in issues; authorization required; cross-border transaction subject to exchange rate regulations.
- 2 Limits on deposit acceptance, offshore borrowing/convertibility; minimum retention requirement for domestic insurers; dealing/trading limited to certain foreign stock exchanges or IPOs limited to residents; overseas investment for institutional investors allowed but subject to restrictions.
- 1 Controls on cross border supply of all financial services; limits on insurance against risks and liability.

#### ***Subsectors Included***

##### *Insurance:*

- Life insurance
- Non-life insurance
- Reinsurance and retrocession
- Services auxiliary to insurance – such as consultancy, actuarial, risk assessment and claim settlement services, including insurance intermediation, such as brokerage and agency.

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<sup>36</sup> Solicitation restrictions and registration requirements are deemed the minimal requirements necessary for cross-border trade.

### *Banking*

- Deposit: acceptance of deposits and other repayable funds from the public
- Lending: Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transactions
- Financial data processing: Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services
- Auxiliary financial services: advisory, intermediation and other auxiliary financial services on all activities of banking and other financial services (excluding insurance), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

### *Securities*

- Trading: Transferable securities trading for own account or for account of customers.
- Issuance: participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues.

### *Sectors Excluded from the Index*

The financial services listed below were excluded from the index due to their small incidence in financial services trade and to the fact that their inclusion does significantly affect the results:

- Financial leasing
- All payment and money transmission services, including credit, charge and debit cards, travellers checks and bankers drafts
- Guarantees and commitments
- Money broking
- Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services
- Settlement and clearing services for financial asset, including securities, derivative products, and other negotiable instruments
- Trading for own account or for account of customers
  - Money market instruments (including checks, bills, certificates of deposits)
  - Foreign exchange
  - Derivative products including, future and options
  - Exchange rate and interest rate instruments, including products such as swaps, forward rate agreements
  - Other negotiable instruments and financial assets, including bullion

### *Weights*

Modal Weights

	Insurance					Banking				Securities	
	Life*	Non-life*	R&R	AIS		Deposits*	Lending*	AFS	FDP	Trading*	Issuing*
Mode 1	0.12	0.2	0.3	0.3		0.12	0.2	0.3	0.3	0.4	0.2
Mode 2	0.03	0.05	0.05	0.05		0.03	0.05	0.05	0.05	0.1	0.05
Mode 3	0.85	0.75	0.65	0.65		0.85	0.75	0.65	0.65	0.5	0.75

\*: Source: Hamins et.al. (2003) and Mattoo (1999).

R&R: reinsurance and retrocession services; AIS: services auxiliary to insurance; AFS: auxiliary financial services; FDP: financial data processing.

The trade openness index for each mode of supply equally weights the subsectors in each composite sector, except for other insurance services, where the weights are: 0.88 for reinsurance and retrocession and 0.12 for services auxiliary to insurance. These weights were calculated to reflect the USA's trade ratios with the rest of the World.