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TTIP Negotiations and Financial Services

Issues and Problems for Financial Services Regulation

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Introduction

In the EU's mandate for the negations for a Transatlantic Trade and Investment Partnership (TTIP), financial services are covered in different ways with diverse effects on the financial services market, on regulation and financial stability.

This document provides an overview of the issues at stake and a preliminary assessment of the potential impacts of the TTIP on financial sector regulation and financial stability / markets. As trade negotiations are often complex, this paper aims to increase the understanding of which TTIP issues that would need to be monitored during the negotiation process s in order that the European Parliament, and the EU in general, can preserve its regulatory power.

The EC has been insisting that financial services would be incorporated in the TTIP as described below. Mr Faul, Director General of DG Internal Market & services, has visited the main regulators in the US beginning October 2013 to argue for inclusion of the financial services, including regarding the regulatory framework.[1] Although he has argued that "regulation determines market access", he has claimed that "the risks of including financial services in TTIP are limited".[2] However, the Obama administration so far does not agree to all the regulatory aspects to be included in the TTIP. Also the Trans-Atlantic Consumer Dialogue and other civil society groups are concerned about safeguards for all future financial and prudential regulation.[3]

The EC has had many meetings with the US and EU industry, and has been carefully assessed how to incorporate their demands in the TTIP agreement, as discovered by accident.[4] It needs to be monitored how the EC balances corporate interests with the democratic process of regulation and the protection of public interests.

Note that the EU and the US are currently also negotiating financial services under the Trade in Services agreement (TISA) with 20 other WTO members and that negotiations on financial services regulation might go beyond of what is being discussed during the current TTIP negotiations (e.g. a standstill on regulations).

[1] http://www.europolitics.info/kiosque/in-washington-faull-urges-inclusion-of-financial-services-in-ttip-artr355722-42.html
Transatlantic Trade and Investment Partnership
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[3] TADC, Letter to Ambassodor R. Kirk and Commissioner K. De Gucht, 5 March 2013, http://tacd.org/index2.php?option=com_docman&task=doc_view&gid=353&Itemid=40

[4] See the EC's document : http://corporateeurope.org/sites/default/files/commission-assess-ment-bechamber-paper.pdf

1. Liberalization of trade and investment in financial services

The EU, and its member states, on the one hand, and the US on the other hand, will make a list that covers all those financial services (sub-)sectors they want to permanently open up ("**commitments**") for investments and cross-border trading by each other's financial services providers and financial products. This includes for instance, trade in OTC derivatives, investment banking, trust services, asset management services (e.g. hedge funds, ETFs), about some of which the EU is still deciding on new regulations (e.g. MIFID-II, bank structuring, UCITS, limits on leverage, money laundering).

Making commitments means not only market opening but also that these financial services need to be subject to the rules and disciplines on regulations embedded in the articles of the agreement (see below). Exceptions to commitments can be made for the market access rule and national treatment rules (see below).

It needs to be noted that according to GATS Art. V, services liberalisation needs to have substantial coverage, which the EC has been interpreting in past (EPA) negotiations as being 90% of the services sector. This means that not many services sectors can be excluded nor exceptions made. The EU and the US may want to go beyond what they have already opened up in the GATS negotiations.

Issues to monitor in order to assess the preservation of the EU's regulatory powers are:

- Which financial services will be more liberalised than in GATS?
- Which financial services that are in the list of commitments are subject to (future) regulations?
- The US might be in favour of liberalisation of financial services through a negative list approach, i.e. all financial services (also future ones) are liberalised unless exceptions have been made in the list of schedules. This might prevent restrictions on trade and investment of future so-far unknown new financial services.

2. A treaty rule on 'market access' that prohibits particular regulation

As in GATS (Art XVI), the TTIP will include a 'market access' article that 'disciplines', i.e. prohibits what governments can do in the financial sector. Some of the prohibitions can contradict current and future EU financial reforms. Regulations and measures that are contradictory to this market access rule, and that have not been exempted in the list of commitments or by the 'prudential carve-out' (see below), can be subject to the dispute settlement system and potentially be sanctioned or removed. The market access rule of TTIP, as in many FTAs, prohibits the following measures and regulations:

(a) Limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;

(b) Limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;

This could affect regulation on too big to fail by shrinking financial conglomerates or tackling the current level of concentration by a few financial services suppliers in certain sub-sectors (e.g. credit rating agencies).

(c) Limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;

This could contradict EU financial reforms that de facto should result in reductions, or particular regulations such as position limits on food commodity derivatives.

d) Limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;

(e) Measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service;

This prohibition could affect EU reforms of a bank structure that require particular legal forms of separation of retail and investment banking, to prevent too-big-too-fail banks, and UK ‘ring-fencing’ of banks.

(f) Limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

This means that all financial services (sub-)sectors can to be taken over by 100% by US financial service suppliers !

3. A chapter on regulatory framework for trade in services and investment, with a special section on financial services

In a chapter that aims to discipline the domestic regulatory framework for services and investment provides amongst others:

□ Conditions for licencing and qualifications, e.g. that they need to be “objective” (without specifications) and “pre-established” (which challenges whether they can be changed);

□ Conditions for licencing and qualification procedures.

There will **be a separate section on financial services** that includes :

□ A prudential carve-out which:

  - allows countries and the EU to take measures for prudential reasons such as financial stability and the protections of investors or depositors, which could be contradictory to other treaty rules (e.g. market access rule)
  - BUT prudential measures should not be more burdensome than necessary;
- An article that obliges countries to permit any new financial service from the other side of the Atlantic. A juridical form may be required but refusing a new financial service can only be done for prudential reasons.
- Methods for mutual recognition or equivalence of domestic/EU regulations.

The problem is that these disciplines can seriously undermine how licensing and qualifications in the financial sector can be set by financial authorities and regulators.
Moreover, the prudential carve-out does not allow much preventive measures since the financial crisis has shown that it can never be heard beforehand what is ‘necessary’ to prevent a crisis.

4. A framework to have a dialogue on financial regulation

The EU wants to include a new framework for regulatory cooperation on financial services, **aiming first of all at tackling barriers to trade in financial services** (as the EC considers that after the crisis “new barriers” were created) and at preventing fragmentation in order to create a more “efficient market place for financial firms”. Therefore, the EU is aiming at harmonizing financial regulation (or striving towards equivalence), a common framework for prudential cooperation and discuss regulation before making legal proposals domestically. One objective is to avoid extra-territorial regulation. Another objective is to have more organised dialogues in case of conflicts about regulations and to embed the conclusion of such dialogues of disputes under the TTIP treaty. There has been quite some discussion about this among the member states given that this could affect the right to regulate but also promote the interests of the financial sector that does not want double regulations, ignoring that

The EC clearly has the offensive objectives of the financial industry in mind, which does not want double regulation but as little regulation as possible. There is very little emphasis by the EU about improving cooperation on supervision that would be essential to guarantee financial stability. There is actually no objective being included at providing better services to citizens, at ensuring that the financial needs of the economy (and SMEs) are being served, or that financing of the transition to climate friendly societies is being promoted.

The US is opposed to including such a regulatory cooperation framework on financial services in a trade agreement and wants it to be done in a separate forum. Major concerns are that this framework will result behind closed doors decision-making, undermining democratic decision-making, or even weakening of financial regulation (which is a reason for the US to oppose it).

5. Financial investors to sue the EU under an investor to state dispute settlement mechanism?

The EU has proposed to include an investor-to-state dispute settlement system in TTIP after an assessment is made of the achievements in the later stages of the negotiations. How this assessment will be made and on the basis of what the EU may decide to include such a dispute settlement system, is unclear.

The Obama administration is opposed that the financial sector can use the investor-to-state dispute settlement system (as is the Canadian government in the current CETA negotiations).

Indeed, such a system would allow financial players to sue the EU and its member states for direct and indirect expropriation, including for regulations that undermine (future) profits of investors. Under other treaties that include investor-to-state dispute settlement systems, regulations have been attacked and needed to be withdrawn. Sometimes, just the threat of a dispute can stop regulators to go ahead with proposals ("regulatory chill"). As the financial industry has shown to easily use the courts to remove regulations it does not want, the EC totally ignores the threat to the EU's regulatory powers and freedom. This dispute settlement system is being advocated by the financial industry while civil society is warning for the dangers based on such disputes in the past.

6. Freedom of current and capital account transactions related to commitments

Only for balance of payment problems and only after complying with many restrictive conditions, can money transactions be restricted of forbidden. By including freedom of current and capital account transactions related to activities by the financial sector, which can be huge, the EU is restricting its policy options and preventive measures against destabilizing financial flows.

However, even the IMF has now admitted that if Spain and Greece would have been able to impose capital controls, the financial crisis would be been less harsh. The effects of quantitative easing by the US outside its borders, are another problem that might make the EU revise how to deal with freedom of capital flows in the future.