Global Business & Development Law Journal

Volume 15
Issue 1 *Symposium: Transnational Business Law in the Twenty-First Century*

Article 8

1-1-2002

International Financial Services: An Agenda for the Twenty-First Century

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I. INTRODUCTION

I would like to take a few moments to identify certain issues that I believe will be significant items on the international financial services agenda for the twenty-first century—or at least for the foreseeable future. Certainly, any such exercise is inherently impressionistic and subjective; each of us could easily construct our own list. There might be some areas of overlap, but each list would reflect our own professional experience and intellectual interests. The following is a discussion of seven important items that may well shape the century.

II. AN AGENDA FOR FINANCIAL SERVICES

A. Trade in Services

First, you may expect that the regulation of trade in services under the General Agreement on Trade in Services (GATS)[1]—as well as Part Five of the North American Free Trade Agreement (NAFTA)[2] and the single market principle within the European Union (EU)—will become increasingly important as the century unfolds. Indeed, for mature western economies, where the service sector is already dominant, the regulatory contours of GATS will be for this century what the General Agreement on Tariffs and Trade (GATT) became for the second half of the twentieth century—the central focus of policy concern in international commerce.

 Portions of these remarks are drawn from the author's forthcoming book, BANKING IN THE TWENTY-FIRST CENTURY, to be published in 2002 by Carolina Academic Press.

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1. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, 33 I.L.M. 1125, 1167 (1994), *available at* http://www.wto.org/english/docs_e/legal_e/26-gats.pdf [hereinafter GATS] (last visited Dec. 15, 2001) (copy on file with *The Transnational Lawyer*). WTO members are not permitted to derogate from adherence to Annex 1B. *See* Marrakesh Agreement Establishing the World Trade Organization, art. XVI, ¶ 5, *available at* http://www.wto.org/english/docs_e/legal_e/04-wto.pdf (last visited Dec. 15, 2001) (copy on file with *The Transnational Lawyer*). For an excellent review of GATS and its implications for financial services, *see* Kristin Leigh Case, Note, *The Daiwa Wake-Up Call: The Need for International Standards for Banking Supervision*, 26 GA. J. INT'L & COMP. L. 215 (1996).

2. North American Free Trade Agreement, Dec. 8-17, 1992, U.S.-Can.-Mex., 32 I.L.M. 289, 296 (1993) (entered into force Jan. 1, 1994) [hereinafter NAFTA]. For a discussion of the implications of NAFTA for financial services, *see* Joel P. Trachtman, *Trade in Financial Services Under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis*, 34 COLUM. J. TRANSNAT'L L. 37, 58 (1995).

The GATS has only been with us for approximately five years, and so our experience with it so far is extremely limited.[3] For the future, we shall judge its success by a measure to be found in the Omnibus Trade and Competitiveness Act of 1988.[4] It mandated two policy objectives with respect to services, market access for services exports and establishment of an international system of services agreements.[5] Through the multilateral GATS, we now have that system of agreements, at least in principle, but much work remains for the new century.

Through the mechanism of the GATS or otherwise, we still need to achieve: (1) an agreement on structural issues, such as a still emerging services classification system, (2) financial services regulatory reform, implementing and expanding upon the GATS commitments of World Trade Organization (WTO) members, (3) generally acceptable rules regarding electronic commerce, and (4) rules regarding government procurement.

B. Financial Services Deregulation in the United States

One significant regulatory reform in the United States was the elimination of certain restrictive banking laws in the United States with the passage of the Gramm-Leach-Bliley Act of 1999 (GLBA).[6] Among other things, the GLBA repealed the 1933 limitations on affiliations between U.S. commercial banking enterprises and investment and merchant banking enterprises.[7] While this was certainly a dramatic change, it is probably one of the least interesting features of the GLBA. In terms of prospective impact, other provisions of the act dominate.

The GLBA generally endorses the principle of functional regulation, positing that similar activities should be regulated by the same regulator. Accordingly, banking activities are regulated by federal and state bank regulators, securities activities by federal and state securities regulators, and insurance activities by state insurance regulators.[8] This may have a significant impact on the efficiency and effectiveness of U.S. financial services regulation.

Issues remain, however. For example, functional regulation of securities disclosure by depository institutions and bank holding companies (BHCs) does not necessarily eclipse traditional bank regulatory policy concerning institutional safety and soundness, nor public confidence in the banking system. The GLBA requires the SEC to consult and coordinate with the appropriate federal banking regulators before taking any action or rendering any opinion with respect to

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3. For an interesting review of GATS experience so far, *see* Jeffrey M. Lang, *The First Five Years of the WTO: General Agreement on Trade in Services*, 31 LAW & POL'Y INT'L BUS. 801 (2000).

4. Pub. L. No. 100-418, 102 Stat. 1107 (1988) [hereinafter OTCA].

5. *Id.* § 1101(a)(9).

6. Pub. L. No. 106-102, 113 Stat. 1338 (1999) [hereinafter GLBA].

7. *Id.* § 101 (repealing 12 U.S.C. §§ 78, 377).

8. *See, e.g.*, GLBA §§ 111-112, 115, 301 (codified at 12 U.S.C. §§ 1820a, 1831v, 1844(c)(4)A)-(B), (g), 15 U.S.C. § 6711).

reporting of loan loss reserves by any insured depository institution or insured depository holding company.[9]

The new legislation permits BHCs that qualify as financial holding companies (FHCs) to engage in activities, and acquire companies engaged in activities, that are "financial in nature" or that are incidental to such activities.[10] FHCs are also permitted to engage in activities that are "complementary" to financial activities if the Fed determines that the activity does not pose a substantial risk to the safety or soundness of depository institutions or the financial system in general. Regulatory issuances are tumbling out of the Fed and the Treasury on what exactly constitutes an activity "financial in nature," or "incidental" or "complementary" to such an activity;[11] and we are unlikely to have any exhaustive understanding of these concepts for several years to come. What is expected, however, is that the FHC will be an instrument for U.S. financial services enterprises to respond effectively to international competitive conditions in the financial services sector.

The GLBA also permits national banks and insured state banks to engage through a financial subsidiary only in financial activities authorized by the Act, with certain exceptions,[12] although the FHC approach will likely be the dominant one in international markets. For one thing, at least until 2004, direct bank

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9. GLBA § 241 (codified at 15 U.S.C.A. § 78m note).

10. GLBA § 103(a) (codified at 12 U.S.C. § 1843(k)).

11. *See, e.g.*, Financial Subsidiaries and Operating Subsidiaries, 65 Fed. Reg. 12,905 (Mar. 10, 2000) (codified at 12 C.F.R. §§ 5.24(d)(2)(ii)(G), 5.33(e)(3)(i)-(ii), 5.34, 5.35(e), (f)(1)-(5), (g)(2), (h), (i)(2), 5.36(c)-(f), 5.39; removing § 5.35(f)(3); redesignating § 5.35(f)(4)-(6) as (f)(3)-(5); redesignating § 5.36(c)-(d) as (d), (f)) (amending rules applicable to national banks in light of GLBA); 65 Fed. Reg. 14,433 (Mar. 17, 2000) (codified at 12 C.F.R. pt. 225) (amending bank holding company rules to include list of financial activities permissible for FHCs under GLBA); 65 Fed. Reg. 14,810 (2000) (codified at 12 C.F.R. §§ 208.71-208.77) (authorizing activities "financial in nature" for state member banks); 65 Fed. Reg. 14,819 (Mar. 20, 2000) (codified at 12 C.F.R. pt. 1501) (establishing procedure for national banks and other interested parties to request that Treasury Secretary determine whether activity is "financial in nature" or incidental to financial activity, and therefore permissible for financial subsidiary of national bank); 65 Fed. Reg. 15,053 (Mar. 21, 2000) (codified at 12 C.F.R. pt. 225) (concerning FHC election by foreign banks); 65 Fed. Reg. 47,696 (Aug. 3, 2000) (to be codified at 12 C.F.R. pt. 225) (proposing activity of acting as "finder" as "financial in nature," permissible for FHCs); 65 Fed. Reg. 80,384 (Dec. 21, 2000) (to be codified at 12 C.F.R. pt. 225) (proposing certain financial and nonfinancial data processing activities as "complementary" to financial activities); 65 Fed. Reg. 80,735 (Dec. 22, 2000) (codified at 12 C.F.R. pt. 225) (adding acting as a "finder" to list of activities permissible for FHCs under streamlined, post-transaction notice procedure); 66 Fed. Reg. 400 (Jan. 2, 2001) (codified at 12 C.F.R. pt. 225) (replacing three prior Fed interim rules governing FHCs with final rules); 66 Fed. Reg. 8466 (Jan. 31, 2001) (codified at 12 C.F.R. pts. 225, 1500) (Fed and Treasury jointly adopted final rule governing merchant banking investments made by FHCs). *See also* 65 Fed. Reg. 15,526 (Mar. 23, 2000) (codified at 12 C.F.R. §§ 303.120-303.121, 303.122(a), 303.123(b), 362.16-362.18) (establishing the FDIC interim rule procedure for authorizing activities of insured state nonmember banks that are permissible for financial subsidiaries of national banks); 66 Fed. Reg. 1018 (Jan. 5, 2001) (codified at 12 C.F.R. pts. 303, 337, 362) (adopting FDIC final rules governing activities and investments of insured state banks). *See generally* 1 MICHAEL P. MALLOY, BANKING LAW AND REGULATION §§ 1.4.8.11-1.4.8.12.2 (1994 & Cum. Supp.) (discussing developments in financial services regulation).

12. *See, e.g.*, GLBA § 121(a)(2) (codified at 12 U.S.C. § 24a) (authorizing national bank financial subsidiaries).

subsidiaries are specifically excluded from four types of financial services activities: (1) insurance or annuity underwriting, (2) insurance company portfolio investments, (3) real estate investment and development, and (4) merchant banking. These types of financial activities may only be done in FHC affiliates.[13]

C. *Financial Dislocation and Realignment*

GATS, as well as other WTO agreements, contemplates progressive multilateral negotiation, towards relatively greater access and free movement of goods and services in international commerce. For developing countries, as well as transitional economies, this means regulatory reform to adjust for the norm of open competition, under principles of transparent,[14] generally applicable[15] law. In the financial services sector, the continuing process of adjustment has often created crisis conditions. "Of the last twenty-five banking crises in the world, eighteen were preceded by financial market liberalization."[16] While we may hope to get better at this process of market adjustment, there is every reason to believe that we shall continue to experience fiscal crises and financial dislocation and realignment as the GATS regime progresses.

D. *Adverse Reactions to Globalization*

In Seattle two years ago, we saw how dramatic the popular reaction against globalization could be.[17] We can expect that to continue, particularly in developing countries. However, these reactions are likely to moderate the pace of increasing globalization rather than reverse the direction. Hence, the level of access to host markets under WTO commitments may increase at a relatively slower rate than was the case with tariff bindings under GATT Article II. In part, this is probably also due to the difference in the character of multilateral negotiations in a service-oriented world economy.[18]

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13. GLBA § 122 (codified at 12 U.S.C. § 1843).

14. *See, e.g.*, GATS art. III (requiring publication or other public notice of measure affecting services regulation).

15. *See, e.g.*, GATS art. VI (requiring measures of general application affecting trade in services to be administered "in a reasonable, objective and impartial manner").

16. Lang, *supra* note 3, at 804.

17. *See* Helene Cooper, *Waves of Protests Disrupt WTO Meeting*, WALL ST. J., Dec. 1, 1999, at A2, *available at* 1999 WL-WSJ 24924047 (reporting on violent protests against WTO during its Ministerial Conference in Seattle); *see also* Helene Cooper, *Some Hazy, Some Erudite and All Angry: Diversity of WTO Protests Makes Them Hard to Dismiss*, WALL ST. J., Nov. 30, 1999, at A2, *available at* 1999 WL-WSJ 24923848 (noting extreme diversity of viewpoints among protesters and their organizations).

18. *See, e.g.*, Lang, *supra* note 3, at 803 (stating that:

> Services negotiations, particularly the difficult ones like telecommunications and financial services, do not mainly invoke the classic paradigm of trade negotiations, in which countries exchange concessions in order to get access to each other's markets for their most competitive exports. In services negotiations, especially those where neither

Ironically, the least developed countries, though resistant to increasing access, are the regions in which increased commitments would make a significant difference in terms of increasing levels of capital infusion.

E. PRC Entry into the WTO

While the details remain to be ironed out, the People's Republic of China's (PRC) entry into the WTO is virtually assured, particularly after the conclusion of PRC trade agreements with the United States and with the EU. The changes in the Chinese economy that should result from the obligations of WTO membership would be profound—assuming of course that the PRC complies with its WTO obligations in good faith.[19]

Under the U.S.-P.R.C. agreement, for example, agricultural tariffs on wheat, maize, and other bulk commodities must be reduced to 14.5 percent by 2004.[20] Tariffs on imported automobiles must fall from current levels of eighty to one hundred percent to twenty-five percent, allowing foreign car makers to offer direct financing for auto purchases.[21] After WTO accession, foreigners may hold up to forty-nine percent of telecom and Internet companies, with a fifty percent stake and management control in two years.[22] Foreign banks may engage in the local currency business with Chinese enterprises within two years of accession and with Chinese individuals within five years.[23] On accession, foreigners may own up to fifty percent of life insurance companies.[24] Fifty-one percent ownership on non-life and reinsurance companies is permitted on accession and wholly-owned after two years.[25]

> side makes concessions beyond current practice, developed and developing countries are seeking different but complementary objectives. The developed countries are, indeed, seeking market access. The developing countries, however, are seeking capital, service market development, and other inchoates that help build a competitive infrastructure).

Id.

19. *See* Ian Johnson, *China Nears WTO Entry in EU Deal*, WALL ST. J., May 22, 2000, at A29, *available at* 2000 WL-WSJ 3030142 (reporting on implications of PRC-EU trade agreement). Congressional approval of a U.S.-P.R.C. trade agreement according permanent most-favored nation (MFN) treatment occurred shortly after the EU action. *See* Helene Cooper & Ian Johnson, *Opening Doors: Congress's Vote Primes U.S. Firms to Boost Investments in China*, WALL ST. J., May 25, 2000, at A1, *available at* 2000 WL-WSJ 3030780 (assessing likely effects of congressional approval).

20. Raj Bhala, *Enter the Dragon: An Essay on China's WTO Accession Saga*, 15 AM. U. INT'L L. REV. 1469, 1499 (2000).

21. *Id.* at 1498.

22. *Id.* at 1499.

23. *Id.* at 1516.

24. *Id.* at 1517.

25. *Id.*

F. Privatization Continues

China—along with much of the developing world—is moving aggressively toward "privatization" (or "corporatization"). The theory is that privatization is a powerful strategy for development, bringing free market and free trade efficiencies to developing economies. One might question this expectation, in light of the experience of the Russian economy, among others. In this century, we shall have occasion to see whether theory is ultimately vindicated by practice.

G. International Debt Forgiveness

Resolving the looming crisis of the crushing debt burden of the world's poorest countries is another significant issue that will probably occupy at least the first half of this century. It is not only an economic and fiscal problem, but also one of social welfare and responsibility.[26] As a practical matter, the international debt burden is an absolute impediment to development that needs to be resolved before market access can progress or effective development can occur.[27]

Some steps have already been taken to reduce official (government-to-government) debt burdens, through a joint IMF-World Bank initiative,[28] through coordinated action by the Western industrialized economies,[29] and through unilateral action, such as recent U.S. legislation to reduce official debt.[30] These measures typically require corresponding undertakings by the debtor states to implement monetary and fiscal policy reforms and to commit recaptured resources to social development. This would seem consistent with the drive toward international market liberalization that underlies the GATS itself. Indeed, as one commentator has argued, developed countries should resist making uncompensated trade concessions to countries that refuse to establish the rule of law.[31] Instead, they need to make a major, unilateral effort to establish the domestic rule of law in developing countries as part of their development goals for 2015.[32]

Whether or not official debt can be significantly reduced in a trade-off for greater fiscal and economic reform within developing countries—a question with no clear answer at this stage—there remains a considerable amount of

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26. For a thoughtful examination of the problem, *see* Chantal Thomas, *International Debt Forgiveness and Global Poverty Reduction*, 27 FORDHAM URB. L.J. 1711 (2000).

27. *See* Report of the United Nations Secretary-General on the Work of the Organization, 37 I.L.M. 913 (Apr. 13, 1998) (setting forth U.N. Secretary-General's arguments for debt reduction linked to development).

28. *See* Axel Van Trotsenburg & Alan MacArthur, *The HIPC Initiative* (Feb. 1999) (joint IMF/World Bank paper) (copy on file with *The Transnational Lawyer*).

29. *See* Roger Cohen, *An Agreement On Debt Relief For Poor Lands*, N.Y. TIMES, June 19, 1999, at A1 (discussing proposals).

30. *See, e.g.*, Consolidated Appropriations Act 2000, Pub. L. No. 106-113, 113 Stat. 1501, 1501A-311 - 1501A-318 (codified at 22 U.S.C. §§ 262, 286 (2001)).

31. Lang, *supra* note 3, at 804-805.

32. *Id.*

international debt extended by private lenders that will not be resolved by this process. International debt resolution will not be achieved in the near future.

III. CONCLUSION

The key development appears to be the emergence of multilateral and regional regimes for the free movement of services in international commerce. This development, which implicitly supports a relatively more competitive "free trade" model for the international market, has created not only a legal obligation, but also a practical need for structural reform, for national financial services regulatory reform, and for generally acceptable rules regarding new forms of commerce and new services. It also makes the resolution of the social welfare effects of free trade in services more urgent. Satisfying these concerns will be the measure of success in international financial services in this century.