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**Negotiating Group on the Multilateral Agreement on Investment (MAI)**

**Expert Group No.5 on “Financial Services Matters”**

**REPORT TO THE NEGOTIATING GROUP**

## **Report to the Negotiating Group**

1. I am pleased to present for the Negotiating Group's consideration the report by the Expert Group No. 5 on "Financial Services Matters" which met on 16-17 October and 5-6 December 1996.
2. In accordance with its mandate, the Group has examined the treatment of financial services matters in the MAI.
3. The Group has developed an agreed text on prudential measures and a definition of financial services based on the GATS annex on financial services.
4. In response to the request for advice from Drafting Group No. 3, the Expert Group considered questions relating to the definitions of investor and investment:
  - On the definition of "investor", the Group concluded after careful examination that "branches" should be excluded from the text.
  - On the definition of "investment", the Group was able to clarify the nature of delegations' concerns and to identify potential avenues for addressing them in the context of a broad asset-based definition of investment.
5. The Group has also identified a number of other issues that are important for, or specific to, financial services:
  - On six issues, the Group has prepared text or options which might be considered by the Negotiating Group after refinement of the drafting. The issues concerned are:
    - i) Recognition Arrangements
    - ii) Transparency
    - iii) New Financial Services
    - iv) Information Transfer and Data Processing
    - v) Self-Regulatory Organisations and Associations
    - vi) Payments and Clearing Systems/Lender of Last Resort.
  - In the case of other issues, the Group considers that further consideration is required before determining whether text is necessary and if so what that text should be.
6. The Group requests that its mandate be extended to enable it to complete the task of preparing text, where necessary, on financial services matters in the MAI. The Group also stands ready to give further advice, if requested, on the definition of investment and related questions.

Chair

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## **I. DEFINITION OF INVESTOR (“branches”)**

### *I. Text*

1. The Group recognised the importance of branches in the financial sector. It is therefore essential that a branch be included in the definition of “investment”.

2. However, after careful examination, it was found that, in most countries, the investment activities undertaken by branches are made on behalf of their parent or group, not in their own name. Accordingly, from the Group’s perspective, “branches” should be deleted from the definition of investor.

### *II. Commentary*

1. It was noted that branches in one country have the legal capacity to invest. However, this specific situation would be covered by the definition of investor even after deletion of the word “branch” since the list of “legal and other entities” covered by the definition of “investor” is not exclusive.

2. One delegation suggested that, in addition to deletion of the word “branches”, the word “provided it has the legal capacity to invest” be added at the end of the definition of “investor”.

## II. DEFINITION OF INVESTMENT

1. The Group held a thorough discussion of the definition of investment based on a Note by the Secretariat [DAFFE/MAI/EG5(96)3] and a contribution by one delegation [DAFFE/MAI/RD(96)51].
2. The Group noted that the main concerns raised with respect to a broad definition of investment are related to cross-border transactions which may have implications for monetary policy, exchange rate policy and the balance of payments. Monetary policy and exchange rate policy could be influenced by both inflows and outflows of capital. Balance-of-payments concerns relate primarily to capital outflows. However, it was unclear to some delegations what role discriminatory measures would have to play in addressing these concerns.
3. It was generally agreed that it would be very difficult in practice to make a distinction between different kinds of financial assets with respect to motivation, for example whether for purposes of hedging or speculation. It would also be difficult to make a judgement as to the intrinsic value of different investments. The question of fairness in the treatment of different investors was also raised.
4. The Group identified three main approaches to deal with the concerns identified while maintaining a broad asset-based definition of investment:
  - a short “negative” list of assets in the definition of investment related to transactions considered to be especially linked to the risk of disruptive cross-border flows of capital;
  - safeguard provisions, such as a balance-of-payments clause, a provision on monetary and exchange rate policies, or an exception to National Treatment for the acquisition or sale of certain assets;
  - country-specific reservations.
5. It was recognised that none of these approaches was perfect and trade-offs may need to be considered. For example, the broader the definition of investment the greater the need for safeguards clauses.
6. It may be useful, however, to consider these approaches in combination, provided that the result does not unnecessarily reduce the coverage of the MAI. With this in mind, some delegations suggested that any safeguard clause should be accompanied by anti-abuse provisions and be subject to dispute settlement and to limits in its application to the substantive obligations of the MAI. For example, a balance-of-payments clause might be subject to notification and review, while the exception to National Treatment might be confined to cross-border transactions in instruments of short maturity.
7. One delegation felt that it would be helpful to consider defining investment by a test of purpose related to establishing lasting economic relations in a Contracting Party.
8. The Group believes that further consideration is necessary before EG5 could make a firm statement on how best to proceed.

### III. PRUDENTIAL MEASURES

#### I. Text

1. The Group considered that the MAI should include a provision relating to prudential measures very similar to that contained in the Annex on Financial Services of the GATS. The Group, therefore, adopted the following text:

“Article X. Prudential measures

1. Notwithstanding any other provisions of the Agreement, a Contracting Party shall not be prevented from taking prudential measures with respect to financial services, including measures for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by an enterprise providing financial services, or to ensure the integrity and stability of its financial system.
2. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Contracting Party's commitments or obligations under the Agreement.”

2. The Group also agreed that, for the purposes of the prudential provision and for any other provisions dealing with financial services, the MAI should contain a definition of financial services which is the same as that used in the GATS, as contained in the annex to this report.

#### II. Commentary

1. The proposed draft Article applies to measures taken with respect to financial services. Given the coverage of the MAI, the Article will apply to measures affecting investors and their investments in the financial services area and not all aspects of international trade in financial services. The Group considered that there was no need to make this point explicit in the proposed draft Article.

2. The proposed text recognises the right of a Party to take prudential measures which do not conform with National Treatment, MFN and the other provisions of the Agreement, provided that the measures are not used as a means of avoiding Party's commitments and obligations. One delegation suggested that a requirement that prudential measures be not more restrictive than necessary to meet the prudential objective might be included in the proposed draft Article.

3. One delegation asked whether restrictions on transfers taken in connection with orders or judgements related to civil, administrative and criminal proceedings, etc. would be covered by paragraph 1 of the proposed article, subject to the anti-abuse provision of paragraph 2. This question may be related to paragraph 4.6 in the “Transfers” Article of the Agreement [DAFFE/MAI(96)16/REV1].

4. In paragraph 1 of the proposed draft Article, the Group opted for the term “enterprise”. This term was understood to be broader than “institution” which is generally only an entity expressly authorised to do business and regulated or supervised under the law of the party in whose territory it is located.

5. Except for one delegation, the Group took the view that the exercise of a Party's right to take prudential measures which do not conform with the provisions of the Agreement should in principle be

subject to the dispute settlement mechanism of the MAI. Most delegations were of the view that financial services expertise should be required for any arbitration panel for disputes on issues relevant to financial services.

6. The Group felt it would be desirable that the Agreement define certain terms including the term “measure”.

## **IV. OTHER MATTERS**

### **1. *General considerations***

1. It was agreed that the financial services sector, which is highly regulated for prudential reasons, is unique in some respects and to some extent calls for specific treatment. However, a number of delegations considered that the general provisions of the MAI are sufficient to meet the needs of the financial services sector in a number of potential areas.

2. The Group agreed that it should contribute to the development of a high standard investment agreement that adequately addresses the financial services sector. Most delegations considered it would be highly desirable that the MAI establish standards for investment in financial services at least equal to those already agreed in the GATS. However, not all delegations felt it necessary to include explicitly all the GATS standards in the MAI.

3. In some cases, proposals for text on financial services were considered to have more general application in the MAI. It was suggested that such text could be useful in the development of general disciplines in the MAI.

4. It was agreed that certain terms used in the text on financial services will need to be defined and specific language might be needed to clarify how provisions for financial services apply in the context of the other provisions of the MAI. The placement of any financial services provisions in the MAI also needs to be considered.

5. The texts developed by the Group have been derived primarily from GATS and to a lesser extent from NAFTA.

6. Most delegations were of the view that financial services expertise should be required for any arbitration panel for dispute on issues relevant to financial services. The group considered that it would be important to review the work by EG1 to consider the implications for financial services.

7. Country-specific reservations may be necessary with respect to some of the provisions on financial services.

## 2. *Recognition arrangements*

### I. *Text*

1. The Group considered that the treatment of recognition arrangements is an important issue for financial services. While these arrangements facilitate the removal of barriers to investment in financial services, they could be viewed as denials of the MFN obligation of the MAI, unless an exception is specifically provided.

2. Accordingly, the Group agreed to recommend that the following text, based on paragraph 3 of the GATS Annex on Financial Services, be included in the MAI<sup>1</sup>:

“1. A Contracting Party may recognise prudential measures of any other Contracting Party or non-Contracting Party in determining how the Contracting Party's measures relating to financial services shall be applied. Such recognition, which may be achieved through harmonisation or otherwise, may be based on an agreement or arrangement with the other Contracting Party or non-Contracting Party concerned or may be accorded autonomously.

2. A Contracting Party that is a party to such an agreement or arrangement referred to in paragraph 1, whether future or existing, shall afford adequate opportunity for other interested Contracting Parties to negotiate their accession to such agreements or arrangements, or to negotiate comparable ones with it, under circumstances in which there would be equivalent regulation, oversight, implementation of such regulation, and, if appropriate, procedures concerning the sharing of information between the parties to the agreement or arrangement. Where a Contracting Party accords recognition autonomously, it shall afford adequate opportunity for any other Contracting Party to demonstrate that such circumstances exist.”

### II. *Commentary*

1. One delegation suggested adding these provisions to the proposed article on prudential measures.

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<sup>1</sup> One delegation reserved its position on this provision.

### 3. *Transparency*

#### I. Text

The Group considered the following text as a basis for discussion:

“1. Each Contracting Party's regulatory authorities shall make available to interested persons their requirements for completing applications relating to the provision of financial services.

“2. On the request of an applicant, the regulatory authority shall inform the applicant of the status of its application. If such authority requires additional information from the applicant, it shall notify the applicant without undue delay.

3. A regulatory authority shall make an administrative decision on a completed application of an investor in a financial services enterprise or a financial services enterprise that is an investment of an investor of another Contracting Party relating to the provision of a financial service within [120][180] days, and shall promptly notify the applicant of the decision. An application shall not be considered complete until (all relevant hearings are held and) all necessary information is received. Where it is not practicable for a decision to be made within [120][180] days, the regulatory authority shall notify the applicant without undue delay and shall endeavour to make the decision within a reasonable time thereafter.

[4. Nothing in this Agreement requires a Contracting Party to furnish or allow access to:

- a) information related to the financial affairs and accounts of individual customers of financial services enterprises; or
- b) any confidential or proprietary information, the disclosure of which would impede law enforcement or otherwise be contrary to the public interest or prejudice legitimate commercial interests of particular enterprises.]”

#### II. Commentary

1. Some delegations felt that no transparency provisions specific to the financial services sector are necessary. They also suggested that any additional text on transparency should be considered at the general level.

2. Some delegations considered that the considerations dealt with in paragraph 4 in particular are already covered by the general MAI provision on transparency (in paragraph III.2.3 of the Consolidated Texts). However, at least one delegation did not consider that paragraph 2.3 of the general MAI article on transparency adequately addresses all concerns, such as coverage of other confidential information not directly concerning particular investors or investments. Accordingly, that delegation suggested amending this paragraph 2.3 by deleting the language “concerning particular investors or investments” and by deleting the brackets around “policies, or practices” in that paragraph.

3. The Group also considered a provision calling for advance notification, to the extent practicable, to all interested persons of any measure of general application that the Contracting Party proposes to adopt which may affect the operation of the agreement, in order to allow an opportunity for such persons to comment on the measure. The text reads as follows:

“Each Contracting Party shall, to the extent practicable, provide in advance to all interested persons any measure of general application that the Contracting Party proposes to adopt which may affect the operation of the Agreement, in order to allow an opportunity for such persons to comment on the measure. Such measure shall be provided:

- a) by means of official publication;
- b) in other written form; or
- c) in such other form as permits an interested person to make informed comments on the proposed measure.”

While delegations agree to the value of prior consultation, a majority of delegations expressed concerns that the above proposed provision may be unduly burdensome, and would not be practical.

#### 4. *New financial services*

##### I. Text

1. Two options for text were considered:

##### Option 1:

“A Contracting Party shall permit financial services enterprises of any other Contracting Party established in its territory to offer any new financial services.”

##### Option 2:

“A Contracting Party shall permit a financial services enterprise that is an investment of an investor of any other Contracting Party to offer in its territory any financial service that is not offered in the territory of the Contracting Party but which is offered in the territory of another Contracting Party, and which is of a type similar to those services that the Contracting Party permits, or would permit if requested, its own financial services enterprises, in like circumstances, to provide under its domestic law. A Contracting Party may determine the institutional and juridical form through which the service may be provided and may require authorisation for the provision of the service. Where such authorisation is required, a decision shall be made within a reasonable time and the authorisation may only be refused for prudential reasons.”

##### II. Commentary

1. Option 1 is drawn from the WTO Understanding on Commitments in Financial Services (with minimum change necessary for the purpose of an investment agreement). Option 2 is based on NAFTA.
2. Several delegations noted that owing to the rapid pace of innovation in the financial services sector, it is important to ensure that an investor in the host country can introduce a new service to that market and that, as there are not adequate points of comparison relying on the National Treatment principle alone could effectively exclude new financial services. Therefore these delegations favoured the preparation of specific text.
3. Other delegations questioned the need for specific provision and preferred to rely on the National Treatment provision of the MAI, possibly accompanied by an interpretative note.
4. It was also noted that the issue relating to new financial services may be considered in the more general context of “market access”.
5. The Group agreed that further consideration on these matters is required.

## 5. *Information transfer and data processing*

### I. Text

1. Some delegations considered that limitations on the ability of investors to transfer and processing financial information can in certain circumstances act as a deterrent to foreign investors and favoured preparation of specific text.

2. The following text was proposed, based on language drawing on the GATS:

“1. No Contracting Party shall take measures that prevent transfers of information or the processing of financial information outside the territory of a Contracting Party, including transfers of data by electronic means, where such transfer of information or processing of financial information is:

- a) necessary for the conduct of the ordinary business of a financial services enterprise located in a Contracting Party that is the investment of an investor of another Contracting Party; or
  - b) in connection with the purchase or sale by a financial services enterprise located in a Contracting Party that is the investment of an investor of another Contracting Party of:
    - i) financial data processing services; or
    - ii) financial information, including information provided to or by third parties.
2. Nothing in paragraph 1:
- a) affects the financial service enterprise’s obligation to comply with any record keeping and reporting requirements; or
  - b) restricts the right of a Contracting Party to protect personal data, personal privacy, and the confidentiality of individual records and accounts so long as such right is not used to circumvent the provisions of the Agreement.”

### II. Commentary

1. It was understood that this provision would not in any way affect the ability of a Contracting Party to regulate activities within its jurisdiction.

2. A number of delegations questioned the need for such specific provisions in the MAI. The Group agreed that further consideration on this proposed provision was necessary before EG5 could make a firm determination on this matter.

## 6. *Membership of self-regulatory bodies and associations*

### I. *Text*

1. The Group considered that, where membership in stock exchanges, other markets, self-regulatory bodies or similar organisations is legally required in order for a financial services enterprise effectively to conduct a financial services business in a Contracting Party, it is important to ensure that such organisations that operate within the territory of a Contracting Party accord National Treatment to financial services enterprises which are investments of an investor of another Contracting Party.

2. Hence, the Group agreed to recommend that, in the absence of a broader provision in the MAI, the following text along the lines of the WTO Understanding on Commitments in Financial Services be adopted<sup>2</sup>:

“When membership or participation in, or access to, any self-regulatory body, securities or futures exchange or market, clearing agency, or any other organisation or association is required by a Contracting Party in order for financial services enterprises of any other Contracting Party to provide financial services on an equal basis with financial services enterprises of the Contracting Party, or when the Contracting Party provides directly or indirectly such entities, privileges or advantages in providing financial services, the Contracting Party shall ensure that such entities accord national treatment to investors of any other Contracting Party, or the investments of such investors, in a financial services enterprise resident in the territory of the Contracting Party.”

### II. *Commentary*

1. Several delegations considered that a provision along the above lines may be relevant to other sectors.

2. Some delegations noted that this issue is related to considerations relating to corporate practices and delegated authority which have been considered by EG3 [DAFFE/MAI/EG3(96)22].

3. It is generally understood that this provision does not to apply to enterprises of a Contracting Party which provide financial services on a cross-border basis and which are not established in the territory of the other Contracting Party. The Group agreed that further consideration should be given to refining the text.

4. It was agreed that an interpretative note should be added to provide: “Contracting Parties may meet their obligations on access to clearing systems for branches of financial services enterprises by providing indirect access, for example, through an enterprise incorporated in the territory of the Contracting Party concerned”. One delegation suggested adding: “provided that such access provides equal opportunities”. The Group agreed that further consideration on this matter is required.

5. The Group also considered an additional provision proposed by one delegation which provides for a “best endeavour” commitment to National Treatment in situations where membership in such organisations is not legally required in order to provide a financial service, but is "necessary" as a practical

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<sup>2</sup> One delegation reserved its position on this provision.

matter in order to engage in financial services on an equal basis with domestic enterprises. It was noted that a provision of this kind has been accepted in the OECD Code of Liberalisation of Current Invisible Operations. However, no agreement was reached on the necessity of such a text in the MAI. The text reads as follows:

“When membership or participation in, or access to, any self-regulatory body, securities or futures exchange or market, clearing agency, or any similar organization or association is necessary in order for financial services enterprises of any other Contracting Party to provide financial services on an equal basis with financial services enterprises of the Contracting Party, the Contracting Party shall endeavour to ensure that such entities accord national treatment to investors of any other Contracting Party, or the investments or such investors, in a financial services enterprise resident in the territory of the Contracting Party.”

## **7. *Payments and clearing systems/Lender of last resort***

### ***I. Text***

The following text was proposed :

“Under terms and conditions that accord national treatment, each Contracting Party shall grant to financial services enterprises that are investments of investors of any other Contracting Party established in its territory 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. This paragraph is not intended to confer access to the Contracting Party's lender of last resort facilities.”

### ***II. Commentary***

1. Some delegations suggested that a provision related to payments and clearing systems as outlined above should be accompanied by a carve-out for the activities of central banks and other monetary authorities along the lines of paragraph 1.b) of the GATS Annex on the Financial Services. Otherwise, aspects of the above provision could be considered redundant.
2. This subject needs further consideration.
3. It was agreed that an interpretative note should be added to provide: “Contracting Parties may meet their obligations on access to clearing systems for branches of financial services enterprises by providing indirect access, for example, through an enterprise incorporated in the territory of the Contracting Party concerned”. One delegation suggested adding: “provided that such access provides equal opportunities”. The Group agreed that further consideration on this matter is required.

## 8. *Other issues*

1. The Group held a preliminary exchange of views on a number of other issues that are important for financial services. Text was put forward on some of these issues and may be suggested for other items.
2. It remains to be determined whether these issues need to be covered in the MAI, either specifically for financial services or more generally.

### Right of Establishment

3. When the right of establishment is subject to a national treatment text without further elaboration, foreign investors may be disadvantaged compared to domestic investors in certain situations. For example, a moratorium on banking licences may meet the de jure national treatment test but deny market access to foreign entrants. Such situations could be addressed by provisions modelled on the GATS (Article XVI(2)) or NAFTA (Article 1403.4).

### Equality of Competitive Opportunity

4. To avoid the possibility of an overly narrow interpretation of the national treatment standard in the MAI, it was suggested that an additional text on “equal competitive opportunities” be adopted, based on NAFTA (Articles 1405.5 and 1405.6). The text would make clear that national treatment requires that the investor of another Contracting Party and its investment in a financial services enterprise should not be “disadvantaged” in competitive opportunities compared to domestic investors.

### Sub-national Units of Government

5. A proposal was made to specify how the national treatment standard should apply to matters within the jurisdiction of sub-national units of government.

### Other issues

6. The following additional issues were suggested by some delegations as being possible candidates for inclusion in the MAI:
  - a. Restrictions based on dotation capital of branches of financial services enterprises.
  - b. Restriction on transfers for enforcement purposes by financial regulatory agencies.
  - c. The need for a balance of payments safeguards clause and the role of the IMF [DAFFE/MAI/EG5/M(96)1].
  - d. The need for a carve-out for the activities of central banks and other monetary authorities.
  - e. Standstill (“Acquired Rights”) and the lodging of country specific reservations in the financial services sector.

- f. Before taking a definitive position on text which draws on GATS provisions, two delegations wished to examine further the question of how the proposed MAI and the GATS obligations on financial services operate together.

## Annex

### DEFINITION OF FINANCIAL SERVICES

#### *I. Text*

“Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance). Financial services include the following activities:

##### *Insurance and insurance-related services*

- (i) Direct insurance (including co-insurance):
  - (A) life
  - (B) non-life
- (ii) Reinsurance and retrocession;
- (iii) Insurance intermediation, such as brokerage and agency;
- (iv) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

##### *Banking and other financial services (excluding insurance)*

- (v) Acceptance of deposits and other repayable funds from the public;
- (vi) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction;
- (vii) Financial leasing;
- (viii) All payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts;
- (ix) Guarantees and commitments;
- (x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:
  - (A) money market instruments (including cheques, bills, certificates of deposits);
  - (B) foreign exchange;
  - (C) derivative products including, but not limited to, futures and options;
  - (D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;
  - (E) transferable securities;

- (F) other negotiable instruments and financial assets, including bullion.
- (xi) 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;
- (xii) Money broking;
- (xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;
- (xiv) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;
- (xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services;
- (xvi) Advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (v) through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.”

## *II. Commentary*

1. This definition is the same as that used in the GATS.
2. One delegation asked whether transfer of credit risks (for instance, credit swaps) and the provision of stored value cards were considered as financial services. The Group understood the proposed list of financial services as an open-ended one. Therefore, it was considered that, unless otherwise specified, the services in question should be regarded as financial services.