The Australian APEC Study Centre

Facilitating best practice policies for trade and investment in financial services in the APEC Region

Good Practices Report

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RMIT UNIVERSITY

THE AUSTRALIAN APEC STUDY CENTRE
Asia-Pacific Economic Cooperation

APEC Symposium

Good policy and regulatory practices in facilitating trade and investment in financial services

Background

At the APEC symposium on "Facilitating best practice policies for trade and investment in financial services", held in Singapore on 27-28 November 2012, regulators, trade officials and private sector representatives from 13 APEC economies (Australia, China, Indonesia, Malaysia, Thailand, Vietnam, Japan, Chinese Taipei, Hong Kong China, Singapore, the Philippines, Mexico and Peru) discussed the regulation of trade and investment in financial services. This report summarises the key symposium outcomes, including common themes arising from the discussion of good practices to guide policy makers and regulators in adopting and maintaining open and transparent financial services sectors.

Outcomes of the Symposium

Discussions focused on the benefits of open and transparent financial services sectors, key impediments to trade and investment in financial services and reform priorities. There was a strong emphasis on information sharing among participants to identify "what works and what doesn't" in regulation of trade and investment in financial services among different APEC economies.

Participants highlighted the benefits of competition in financial services markets as a means to promote innovation, increase efficiency and lower costs. Free and open trade and investment in financial services helped to facilitate regional economic integration, enhancing the flow of capital across borders and enabling economic growth. Good regulation plays an important role in maintaining financial system stability, reducing the likelihood of market collapse and limiting the potential for financial crises to spread from one economy to another.

Participants discussed a number of good practices in the regulation of trade and investment in financial services. They agreed there was no single model for the effective regulation of this sector. Different approaches may be appropriate under different circumstances in different economies. The challenge for governments is to frame regulatory settings so they perform a legitimate policy function without unnecessarily hampering trade and investment and eroding the benefits of open and competitive financial markets.

The good practices and themes identified from the discussions are presented below. These are non-binding and voluntary in nature, presented as a basis for good policy, without prejudice to economies' positions in the WTO, free trade, and other regional and bilateral negotiations.

Key Themes of the Workshop Discussions on Good Practices

General Practices

- *Importance of competition* – Open, competitive financial services markets promote efficiencies, lower costs and enable economic growth. Foreign participation enhances competition and aids in financial market development through the transfer of new technologies, skills and experience to domestic services providers.
- *Trade facilitative policy and regulatory objectives* – The aim of economies should be to frame regulations so as to satisfy legitimate policy objectives (including, maintaining financial system stability) in the least trade- and investment-restrictive way. While regulatory practices should reflect international best practices, regulations should be sufficiently flexible to meet the economic and financial needs as deemed appropriate for financial stability for a particular

economy. They should not pose unnecessary impediments on businesses, domestic or foreign. Good policy and regulations are forward looking, reflecting and facilitating changes in financial market structure and products.

Specific Practices

- *Regulatory transparency* – Businesses are more likely to invest or trade in services if the technical and regulatory requirements to access new markets are readily identifiable and clear. Economies should make relevant regulations and policies freely available and frequently updated on well-publicised websites. Transparency provisions in free trade agreements can help in this regard. Third-party tools, such as the APEC Services Trade Access Requirements (STAR) Database can improve regulatory transparency.
- *Regulatory certainty* – Businesses are more likely to invest or trade in services if they can be sure that regulatory settings will not become more restrictive. Commitments on financial services under the WTO General Agreement on Trade in Services (GATS) can "lock in" certain existing regulatory settings and reassure investors. Financial services provisions in free trade agreements are another useful vehicle for promoting regulatory certainty. Consistency in the interpretation of regulations is also an important component of regulatory certainty.
- *Regulatory cooperation* – Unnecessary variations in regulations and standards across jurisdictions impose onerous costs on businesses with cross-border operations. Where possible, regulations should be aligned with global good practices and international standards to avoid "regulatory arbitrage". Communication and cooperation among regulators, relevant government ministries and agencies, both domestic and regional, can promote regulatory consistency. Cooperation among regulators can help build the necessary confidence to develop cross-border financial services capabilities. Regulatory cooperation also facilitates the management of cross-border securities or funds management activities, especially where regulators have a shared approach to prudential risk management and consumer protection.
- *Stakeholder consultation and regulatory impact analysis* – Widespread and effective consultation with all stakeholders in financial services markets is an essential first step in regulation and policy making. Regulatory impact analysis (RIA) is a useful tool to help ensure the costs of implementing new policies do not outweigh their benefits.
- *Regulatory enforcement* – Enforcement of regulations is essential in order to give effect to those rules necessary for maintaining confidence and integrity in the financial services sector. The benefits of good regulations can be eroded by poor enforcement.
- *Timeliness and transparency of regulatory approvals/decisions* – Unnecessary delays in regulatory decisions impose costs on business. Regulatory decisions relating to investment and the sale of new or reissued products and services should be completed within established and transparent time frames. Also, providing written reasons for unsuccessful decisions to all applicants for financial services licenses (domestic and foreign) significantly builds confidence in the financial system and acts as a strong incentive for financial investment.
- *Equality of commercial opportunity* – To promote competition, foreign market participants should have the opportunity to compete equally with domestic market participants and, as far as practicable, not be treated less favourably than like domestic counterparts.
- *Foreign equity limits* – Regulations that limit foreign equity can be a disincentive for foreign investment. Parent entities often provide a greater degree of corporate commitment in subsidiaries where they hold greater levels of foreign equity. Where adequate control is

permissible, the local institution can benefit from the transfer of capability and intellectual property, greater exposure to international markets and the training of local staff.

- *Joint ventures and local partners* – Joint venture (JV) investment or the involvement of a local partner can greatly facilitate market entry and boost the transfer of knowledge, skills and technologies, bringing long-term benefits for market development. However, mandatory requirements to operate as a JV, particularly when control is also affected, may discourage investment because the investor may not wish to assume the risk of operating in tandem with a partner that may not share the same vision or culture. Mandating a specific partner may furthermore stunt the development of healthy domestic competition and open avenues for corruption. Optional joint venture arrangements that allow commercially-negotiated choices of partner, corporate structure and equity stake are more attractive from the investor's perspective.
- *Non-discriminatory tax treatment* – Discriminatory taxation treatment can be a strong disincentive to investment. Excessive withholding tax laws impact on foreign entities' ability to run a business.
- *Excessive capital requirements* – Excessive capital requirements may stifle lending and discourage investment, particularly by smaller (but often well managed) financial services players. Capital charges should be applied at a level appropriate to financial and economic circumstances. Where possible, economies should align domestic capital requirements with international norms, such as Basel III. That said, variation in capital standards among jurisdictions may be necessary in certain situations.
- *Capital controls* – In specific instances, capital controls may be used to ameliorate the consequences of extreme volatility in cross-border capital flows. If applied, policies should avoid any discriminatory impact on foreign entities in a market. Capital controls can impede the ability of foreign entities to repatriate profits and reallocate capital among subsidiaries, reducing their ability to operate effectively.
- *Unimpeded cross-border data flows* – The efficient flow of data across borders is essential for business establishing operations in a new economy. Variation in standards and regulations for cross-border data flow can create inefficiencies when working with local partners. Reducing variation by developing common standards as far as practicable will be beneficial. Restrictions on the use of regional data hubs and geographic limitations on the location of servers lower efficiencies by depleting economies of scale. For prudential reasons, policies should also take into account the personal data protection of depositors and consumers and ensure safety of international data transmission. Regulators need to balance the efficient flow of data across borders with data security of financial consumers.
- *Promotion of financial inclusion and financial literacy* – Improving financial inclusion and financial literacy are critical elements in the development of financial markets in emerging economies. As the size of the middle class in the Asia-Pacific expands, empowering individuals to participate in financial markets will spread the benefits of increased efficiencies and lowered costs in open and competitive financial markets.
- *Capacity building for developing economy regulators* – Capacity building is essential to enhance the capability of policy makers and regulators from developing economies to implement good regulatory practices and policies. Lack of capacity and knowledge can impede the process of opening up financial services markets. APEC can play a strong role in regional capacity building.