Legal aspects of Financial Services Global Liberalisation

Dan Markus Kraft

Globalisation means more than freer movement of goods, services and capital across borders. It entails the faster movement of ideas.

Joseph Stiglitz

Introduction

The financial services industry has been profoundly reshaped in the past decades. This has not just been a result of huge information technology advancements, but also due to the de-localisation of economic agents in an increasingly borderless world, fomented by multilateral and regional understandings. Financial markets are today largely integrated and linked on a global basis.

Trade in goods, present in human existence from times immemorial, has been best multilaterally translated into more stable rules since Bretton Woods, under the GATT, and more recently, under WTO. Regulating and adjusting a global approach to financial services liberalisation, however, demands different tools from the ones known today for trade in goods, which did not yet reach an adequate formula.

As noted by Lovett, "international banking has a long history of involvement with foreign trade, shipping and investments. Italian merchant bankers were important in such finance during the Middle Ages and Renaissance and this banking activity gradually spread north to the Netherlands and German towns (...) London took the strong lead as an international banking centre during the 19th century, helping to enlarge British trade and industrial development. Britain placed a substantial volume of foreign investment in many countries, including the Americas".

The globalisation phenomenon has caused an immense development of the finance industry, this one mainly to serve the global economy. Financial services have also become an end in itself, as securities, banking and insurance products acquired independent spaces, sometimes lacking direct relation to commercial or industrial activities.

Hence, the international financial environment has become more integrated, complex and unstable. In this sense, national laws have proven to be insufficient to treat financial services, introducing an urgency sense towards adequate regulation and supervision. In addition, international finance networks helped build a very efficient crime highway, used for money laundering, easing the financing of drug and arms trafficking, as well as terrorism, demonstrating the need of a multi-nation approach and intense co-operation, on a fully integrated scale.

The community of global nations addresses regulation and supervision of the financial services industry in several fora, creating overlaps and legitimacy erosion problems, not to mention the competition of private unification initiatives. Understanding and regulating such industry clearly demands multidisciplinary information exchange and action.

Market players have almost endless means to create and implement products and strategies, easily overcoming less organised initiatives of nation states, multilateral agencies or international organisations. Understanding some of the positive meeting places between the finance industry, international fora and states, is the objective of this article.

In the nineties, the easily spelled motto was regulators no longer have sovereignty over the movement of capital across their national boundaries (...) Government policy is now largely influenced and dictated by the free and massive flow of capital

1 L'économie globale va être de plus en plus dominée par une logique financière de déréglementement qui déforme de son propre écho l'activité d'origine pour imprégner l'ensemble de l'activité économique. Minciaci, Charles-Albert. Les métamorphoses de la mondialisation, une approche économique, in Lequeux, Eric et al. La mondialisation du droit. Litt-Créalis, Dijon, 2000: p. 34.
3 Si le succès est international, ou plus encore, s'il peut s'envoler et s'envolner, tout se passe comme s'il s'applique – Marie-Anne Fitz-Entche. Le cadre juridique de la mondialisation des marchés financiers, in Lequeux et al., mai-juin 1995, p.46.
4 La naissance des sociétés de finance multinationales, qui ont évolué à partir de la mondialisation directe et indirecte. In Lequeux et al., mai-juin 1995, p.46.
7 Le cadre juridique de la mondialisation des marchés financiers, in Lequeux et al., mai-juin 1995, p.46.
8 The European Community and Monetary Union, has led to the development of a more integrated approach to financial services across the EU. In Lequeux et al., mai-juin 1995, p.46.
squeezed by market forces, and if no public participation exists in defining paths and rules, globalisation naturally becomes a synonym of old and well known dictatorships, which less developed countries frequently experienced in the past being much used to strong political regimes and ruthless statesmen.

The fact that the market squeeze may have been happening results on the widely accepted thesis on Seattle's battles, at the 1999 WTO summit. Those radical protests inspired different forms of clarification on the globalisation process piloted by industrialised countries, having, in a certain way, helped to re-orientate multilateral trade discussions and decisions.

Uncertainty about the scope of the discussions on trade liberalisation, as well as with regards to the actors involved, dimmed democratic control. As noted by Dillon, "it is the very open-endedness and unpredictability of the Services Agreement that has called forth such an extreme reaction from the WTO's critics, and such a spirited defence by the WTO itself."

As Auberge correctly put, there is no public democratic global space, as a shared political culture is purely absent. It may have been thought that some unification of services and their rules would perfect democracy, however this is not happening, mainly because democracies are founded in nation-state concepts. Without a global nation, nor a feeling of its existence or inclusiveness, global democracy is a chimera.

A valid initiative example in trying to introduce some public inclusiveness in globalisation is the not-so-successful United Nations Code of Conduct for Transnational Corporations. It laid down a set of guidelines defining the rights and responsibilities of transnational corporations in their international operations. The attempt aimed at introducing concepts of international public order within private cross-border activities. More than convincing nations and market participants on a certain conduct regarding opening national borders, the project searched for inducing a behaviour pattern through voluntary adhesion to a moral conduct in global businesses. The initiative has been applied in setting standards in the fields of human and consumer rights.

An important lesson is drawn from these considerations. Treaties and conventions have been frequently torn apart, model laws have been adopted much less than desired, international public and private agreements have been insistently repudiated. All these incidents invariably have similar source: the absence of voluntary and positive will of the really affected parties, i.e. the populations involved. As in basic contract law theory, no agreement may be protected by law if it is not based in a free manifestation of will is given. Imposing formulas on populations has proven to be counterproductive, and as Rudolf von Ihering put it, laws should serve people, not people should serve laws.
At an industry roundtable hosted in Basel, in November 2003, participants discussed the subject of risk management and regulatory approaches in the banking, securities and insurance sectors. The discussions evidenced how much market practices are converging across the three sectors and whether differences in the regulatory approaches to risk across those sectors reflect actual differences in the underlying risk and management practices.

The prevailing view was that better information was needed, and so the need for international debate. A sense of public participation, more than just a place for market participants to discuss, creates hopes that the global society will create means to influence global decision at policy making fora.

**Globalisation**

Globalisation has several definitions, aspects and forms. Michalet suggests an interesting classification of the economic evolution phenomena in different phases: from international to global economy, going through a multinational economy. In what Michalet calls “International Economy”, strong reference to nation states prevails over international specialisation and economic liberalisation. At this stage, nation states are at the heart of the trading system. Theories laid during this period focused on explaining import and export movements of goods between national economies and, for rule making, in the advantages of international specialisation (still using D. Ricardo’s inspiration).

In a “Multinational Economy”, indicated by the author as dating from the 1960’s, a new dimension is given to direct investment and the mobility of productive activities, placing market players from one to another territory. This resulted in a radical change on how production is performed. This kind of economic organisation has been a recipe for companies’ strong growth, practising forums shopping to find best suited places where to establish activities, without much bothered about corruption, environmental, consumer and labour laws. Regarding financial services, at this same time, desert islands became more important with their tax benefits and some lawlessness, as well as countries attracting foreign industries with immediate benefits, despite long term adverse effects not accounted for.

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18 Housed by the Basel Committee, having senior representatives from 8 Committee member countries (France, Germany, Italy, Japan, the Netherlands, Spain, the United Kingdom, and the United States), the G10 supervisory group supervises the Japanese, Swiss, United States, and United Kingdom banking systems.

19 Rules are set not only by national governments but also by international bodies, such as the International Monetary Fund (IMF), the World Bank and the EU.


21 En effet, le forum des paradis fiscaux organisateurs des échanges d'argent, cit. 2.17


23 Dans l'économie mondiale, seules les marchés des biens et services débordent les limites posées par les frontières nationales, avec le développement de l'économie multinationale, les systèmes productifs deviennent multinationaux.

24 Loguin et al., La mondialisation du droit, Lavoisier, 2001, p. 22.

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The main characteristics of this stage, economic re-organisation, has been the penetration of national markets by other means than plain and simple exports. On the other hand, countries have also started organising themselves to create conditions which could draw investors’ attention. In this sense, studying economic sectors and their strategies has originated very specific nations’ policies, competition no longer lying only on production factors within a national territory.

The early 1980’s “Global Economy” is characterised by the predominance of a new financial dimension. The rationale behind the investment and production turned into seeking attractive rates of return, through alternative investments in the financial markets. Speculation soared and also liquidity, resulting in some well documented financial crisis that, due to urgency and carelessness in implementation, caused poverty increase and wealth inequalities, which generated a much more unsafe world.

In search of protection the regionalist trend increased, with the creation of free trade zones and other kind of associations for economic convergence, in competition of a GATT, and later WTO, multilateral economic relations of nations.

In today’s unified cyberspace market, competition among countries for investment and hosting financial services activities has soared. A balance between regulation and competitiveness is being constantly searched.

Cities and countries are in constant fight for hosting the fast-growing financial services industry and attracting investments. A physical allocation arbitrage is constantly made and nations are looking at ways to avoid destructive forum shopping. As noted by Fontaine, billions of dollars are daily re-allocated in search of almost insignificant different rates of return on investment, easiness in communication allowing that at a simple finger touch. Nations are constantly searching for a balance between attractiveness and internal security, thus the need for financial services global coordination.

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**Unification or harmonisation?**

Globalisation has become a test field for the theory of natural convergence. The idea that legal systems of societies will tend to become more alike, as the societies become more like each other, over simplifies the complexities of making different cultures converge.

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* The Asian Tigers being the best example.

* --- Entre les marchés financiers dans le monde entier évoluent des mouvements de capitaux importants. Ainsi, des milliards de dollars se déplacent pour profiter d'un arbitrage d'un taux d'intérêt pour cent sur l'arbitrage entre les marchés de capitaux sont isolés et se sont même d'arbitrage des États industriels, de la Thaïlande. Les marchés financiers internationaux évoluent A toute époque internationale, et pour que les marchés internationaux ne soient pas plus à des époques internationales, ce qui pourrait entrainer des incertitudes dûs à des taux d'intérêt et à des effets spécifiques les conditions économiques et d'incertitudes des séries économiques mondiales, PUF, Paris, 2005, P. 3.
Unification of laws has been part of the human civilisation, and the Middle Ages Glossators mastered very effective methods in this sense, creating conditions for the market economy to flourish.

They introduced secular, not ecclesiastical, education, influencing legal practice and ways of administration. As noted by Robinson29, such researchers were not poets or alienated philosophers. As he mentions, "it is false to suggest that the glossators had no interest in law in practice;Innerius himself acted as judicial assessor, and also as an envoy to the Emperor Henry V on the death of Countess Matilda, while in 1118 he was in Rome taking a prominent part in the election of an anti-pope in the imperial interest".

Noting the importance of the Glossator’s inspiration on today’s unification and harmonisation practice, it is recognised that they “founded a science of law, in the sense of a framework of judicial concepts which made it possible to provide rational legal solutions to conflicts of interests in society in place of solutions based on custom or mere force. The offered law as a self-conscious structure, an ordering instrument for society, and this on a European scale”30.

As reminded by Arnoud31, in times of deep changes and economic reorganisation, the importance of the legal masters was extreme. They were assimilating the power of keeping knowledge and tradition. Based in ancient texts, written in much different times, these scholars commented and adapted documented laws, word by word, to a new era. This has been notably done in relation to property holding and trade, originating fundamental concepts of the law merchant and simplifying formulas, providing certainty and uniformity of interpretation for the movement of goods, until they reach their final destination.

Today we face a quite similar process, performed by unexpected hands. The process of contractualisation of international trade law is a fact experienced by the worldwide adoption of standardised contracts, imposed for entering certain types of transactions. Codes of conduct and market practices are well accepted sources of international trade law, and they have been the basis of the new financial services liberalisation architecture.

Contracts have become law within the global arena32. Legal unification under

30 Robinson, OF. OOp. Cit. p. 44
32 Cite extraction of the normalization contractualnelle ou even dans le phenomène de la déréglementation des marchés et donc l'insistance des Etats à réglementer des marchés immatériels. Courtesse écrire Pierre Delmas-Marty, « loin de réduire le poids du droit, la déréglementation marqua au contraire l'apparition d'un nouveau processus d'engagement du commerce écrit sur l'élaboration du principe huitachique. C'est cet afflanchage qui aboutit le respect de l'État au prix d'un marché sans frontières, dont il semble que le véritable pilier soit la mondialisation. Il a été ainsi possible de renouveler à l'Empire, se produisant une émergence de société permettant de l'autre, et privatrice d'activité économique, de la mondialisation. La valeur des opérations y associer un droit mondialisé. In Logion, Eric et al, La mondialisation du droit. Lévy-Creuton, Diizon, 2000. p 93.

this scheme avoids conflicts of laws, praising the freedom of contract in search of absence of public intervention within private conventions.

The financial markets are already unified, by means of contractual instruments and products. As noted by Lalay33, scientific and technical development, easy communication, demand for quick decisions, all this generates a demand for new formulas. These are transformed in professional usage at specific activities, in type- or model-agreements, before being codified by some trade association or public bodies.

The lex mercatoria phenomenon has been exacerbated by the deregulation wave of the 1990’s, with profound effects within the financial services industry. During such time, liquidity has sharply risen due to the creation of modern financial schemes like swaps and derivatives, which increased the distance between the real economy and the imaginative artificial – or synthetic - economy, composed of indexes and futures.

The International Swaps and Derivatives Association (ISDA) is a good example of a lex mercatoria originator, with regards to the financial services industry. ISDA represents participants in the privately negotiated derivatives industry, being the largest global financial trade association, by number of member firms34. Having introduced new methods of trading the derivatives came to light for over the counter transactions, an imaginative way to escape, at its creation time, some regulatory constraints for banks, primarily in OECD countries. Such creativity demanded public oversight and, although privately traded, derivatives soon came to supervisors’ attention, causing extensive regulation35 to be introduced, with full cooperation with ISDA and financial markets players.

Bond issues (international debt instruments) and global bank facilities (loans), including those generated in multilateral institutions, such as the World Bank, follow the same contractualist rationale, not giving much room of manoeuvre to borrowers. Despite national regulation, freedom of contract and mandatory waiver of immunity clauses in contract terms, by repetition, are turned into effective law, shaping the financial services sector.

When re-regulation of the markets turned to be urgent and necessary, due to

34 http://www.isda.org/
35 After Baring’s failure, regulatory agencies from 16 countries responsible for supervising future markets draw on the consequences for regulations regarding to hedge trades especially derivatives, micro and more inter-dependents, having decided to: (i) establish cooperation between market authorities for information exchange on most important players, their risk exposure and market presence; (ii) position protection (margin) and client overbalances more coherent between different markets and countries limiting losses of order givers if an intermediation failure; (iii) assume intermediary failure, especially sexual conduct for handling positions, rapid information exchange between regulators in case of failure and limitation of problem within failed member country, (iv) practical cooperation methods in case of urgencies (contingency plans).
the late perception of high exposures to risks demonstrated in bank crises and bankruptcies, a set of rules was already in place. The industry prevented politicians, central bankers and regulatory bodies from having the burden of drafting some new market architecture, differently from the 1930s. Using consecrated formulas as basic inspiration for regulating financial services, within national borders and in the international arena, has been a normal and effective practice.

Private initiatives like the Core Principles for Effective Banking Supervision formulated by the Basel Committee for Banking Supervision, the Objectives and Principles of Securities Regulation formulated by the International Organization of Securities Commissions (IOSCO), and standards developed by the Committee on Payment and Settlement Systems (CPSS), the International Association of Insurance Supervisors (IIAIS), and the International Accounting Standards Committee (IASC), are examples of market agents that act closely, influencing governments in a decisive manner.

Considerations on the unification of financial practices and market regulation aiming at restructuring this industry necessarily lead to the International Monetary Fund’s (IMF) raison d’être. The IMF, as well as the World Bank, has played a substantial role in helping regulation converge and enhancing market discipline, especially in less developed countries. This work has prevented the IMF from suffering harsh criticism regarding ready formulas and biased political choices, being accused of fostering moral hazard. OECD’s influence in the world’s financial liberalisation architecture has also been extremely relevant, serving as an inspiration for multilateral bodies.

Despite many sad stories, it is highly positive that “the unification of law is sought to be achieved through the use of international institutions specifically intended to promote the unification of law. Programs of international organisations with broader objectives also frequently seek to generalise or standardise legal rules and practices, for example, in the European Community.” Although democratic deficits still persist in some multilateral and regional areas, convergence programs have largely succeeded in enhancing regulatory standards and savings protection.

Financial regulation has experienced cyclic and successive phases, from protection, de-regulation (thus creating conditions for a freer market, disintermediation and transaction cost reduction, increase in investment banking activity), competition increase, re-regulation (mainly in prudential and supervisory areas), excess capacity (high communication costs) to consolidation.

When too much market freedom proved to weaken a brand new global financial arena – at the sake of several economic set-backs, which caused fears of a possible re-edition of 1929’s economic crisis – discussions on multilateral liberalisation of financial services within the WTO and the need to establish new supervisory rules in high levelled fora, once again, searched for market inspiration.

Hence, two financial services regulation levels have become evident. One related to a set of transactions (international private law) and another related to international and domestic public order (international and domestic public law). Revolving doors policy, enabling professionals to switch from public to private practice, has also - when bad faith was absent – enabled better and market tuned regulation.

Today’s scenario is composed of products offered within the financial services industry which are mostly standardised. Banks, securities and insurance firms adopt very similar product structures, with almost imperceptible variations, backed by commercial laws and in the principle of freedom of contract. Such products are sold worldwide, this contractualisation of the sectors serving as a safety net, ensuring a real unification of rules, turning them into stone. These become sources of international financial (via a lex mercatoria rationale), and although they present some variations in different countries, economies of scale are securely achieved and, most of the time, shared with customers, by means of the reduction of transaction costs.

Self-regulation has been the motto of financial services for a long period of time, and until very recently the industry regulated and supervised itself. As increasing savings remains the principal goal in our economy society (as true homo economicus), as they finance not only consumption, but also investments, research and welfare, public intervention in times of high powered money and...
global transactions cannot be neglected.

Not so well organised as financial services players, and having different goals in time and in scope, nations — representing populations — are demanded to deal with the global services phenomenon in different regulatory levels. Apart from the unification performed as necessary by market agents, states are obliged to respect their very own needs with regards to international inclusion, as well as their internal welfare generation capacity. In this sense, cross-sectoral convergence (banking, securities and insurance sectors) in market practice and in regulatory approaches has been occurring quite naturally.

Harmonisation of rules have become, besides unification implemented by the market, an acceptable answer to address the complex and ever growing financial services industry. As a matter of fact, concentration in the financial services industry, as a result of a globalised economy, has somehow eased the task of regulators, in the same way that Glossators have, in the Guild Age, identified commercial common grounds.

Searching for inspiration at international fora, looking for alternatives in multilateral organisations and private associations, as well as borrowing concepts from other systems, are the most common forms of legal change. De Cruz reminds us, however, that “transplantations may or may not be successful”, depending on a country’s particular conditions for receptivity.

International Financial Services Law

Regulation of financial services relates to the structure, conduct (with impacts on price) and operation (also called prudential). Barriers for financial services liberalisation are regulatory, fiscal, structural and cultural (in the way that states are involved). Usury, gaming and gambling laws severely affect such sector, and also consumer, banking, insurance and tax laws, as well as exchange controls.

Trade in financial services also present different forms, entailing the transfer of information, the movement from supplier towards clients and vice versa, clients moving towards suppliers. Regulation must take into account that information

asymmetry is a fact, which affects the nature of the financial business environment. Not all participants have the same quality assessment, which generates quality deterioration, adverse selection, market failure and political constraints.

The IMF has laid down a code on Transparency in Monetary and Financial Policies, which was adopted by the interim committee in Sept 26, 1999. Aiming at strengthening the architecture of the international monetary and financial system, the IMF was called to develop a code of transparency practices for monetary and financial policies, in cooperation with appropriate institutions. The Fund, working together with the Bank for International Settlements, where the Basel Committee on Banking Supervision, and in consultation with a representative group of central banks, financial agencies, other relevant international and regional organizations, and selected academic experts, has developed a Code of Good Practices on Transparency in Monetary and Financial Policies.

The main goal of this unified action was to unify financial services treatment. As stated in the code, “transparency by financial agencies, particularly in clarifying their objectives, should also contribute to policy effectiveness by enabling financial market participants to assess better the context of financial policies, thereby reducing uncertainty in the decision-making of market participants. Moreover, by enabling market participants and the general public to understand and evaluate financial policies, transparency is likely to be conducive to good policy-making”. The justification for such unified strategy has been helping “to promote financial as well as systemic stability. Transparent descriptions of the policy formulation process provide the public with an understanding of the rules of the game. The release of adequate information to the public on the activities of financial agencies provides an additional mechanism for enhancing the credibility of their actions. There may also be circumstances when public accountability of decisions by financial agencies can reduce the potential for moral hazard.”

As stressed by the working group, transparency in the financial services industry is indicated in order to avoid market disruptions. In this sense, “with regard to informing the public about monetary and financial institutions and their policies, an important issue concerns the modalities that these public disclosures should take. In particular with regard to monetary policy, should transparency practices have a legislative basis in a central bank law, or be based in other legislation or regulation, or be adopted through other means? The Code takes a pragmatic approach to this issue and recognizes that a variety of arrangements can lead to good transparency practices. On matters pertaining to the roles, responsibilities, and objectives of central banks (and for principal financial regulatory agencies), it recommends that key features be specified in the authorizing legislation (e.g., a central bank law). Specifying some of these practices in legislation gives them particular
In a globalised world populations are faced with the dilemma of being global citizens or global consumers. Information technology has imposed flexibility on all societies, forcing them to adapt to a new environment, immaterialised such as in financial services. It is a current say that rigid economies and societies – be it in regulation, negotiating methods, moral habits permeated by religion - may not survive, or may remain parias.

Financial services treatment and liberalisation cause worries about managing wealth, making it easily movable. Recent trends confirm the option towards unilateral or bilateral, instead of multilateral, decisions taken mainly by industrialised nations, the US in the forefront.

As Stiglitz has well clarified, "globalisation has meant that there is increasing recognition of arenas where impacts are global, It is in these arenas where global collective action is required – and systems of global governance are essential. (...) The most fundamental change that is required to make globalisation work in the way that it should be a change in governance".

On the other hand, in a global economy market participants become gradually intolerant to regulatory disparities. Home countries undertake market players’ sides, helping shape policies aimed at attaining only profit-increasing, short-termed, objectives. This generates a strong movement towards maintaining self regulation afoot, in detriment of genuine public intervention for defending public interest.

If the world community cannot escape globalisation – which it should not - it surely can shape it.