

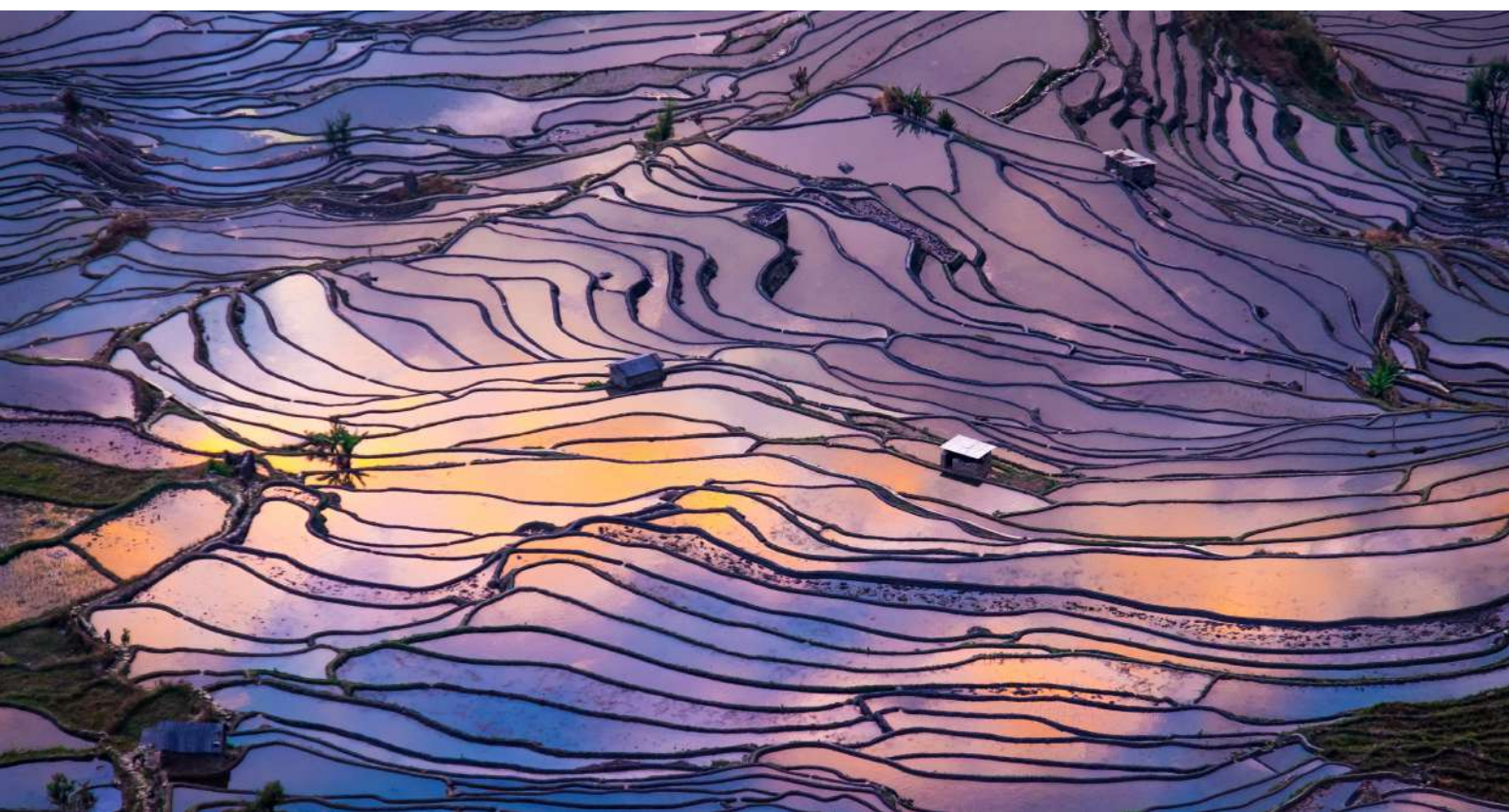


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WTO IMPLICATIONS ON BANKS IN CASE OF NO-DEAL BREXIT

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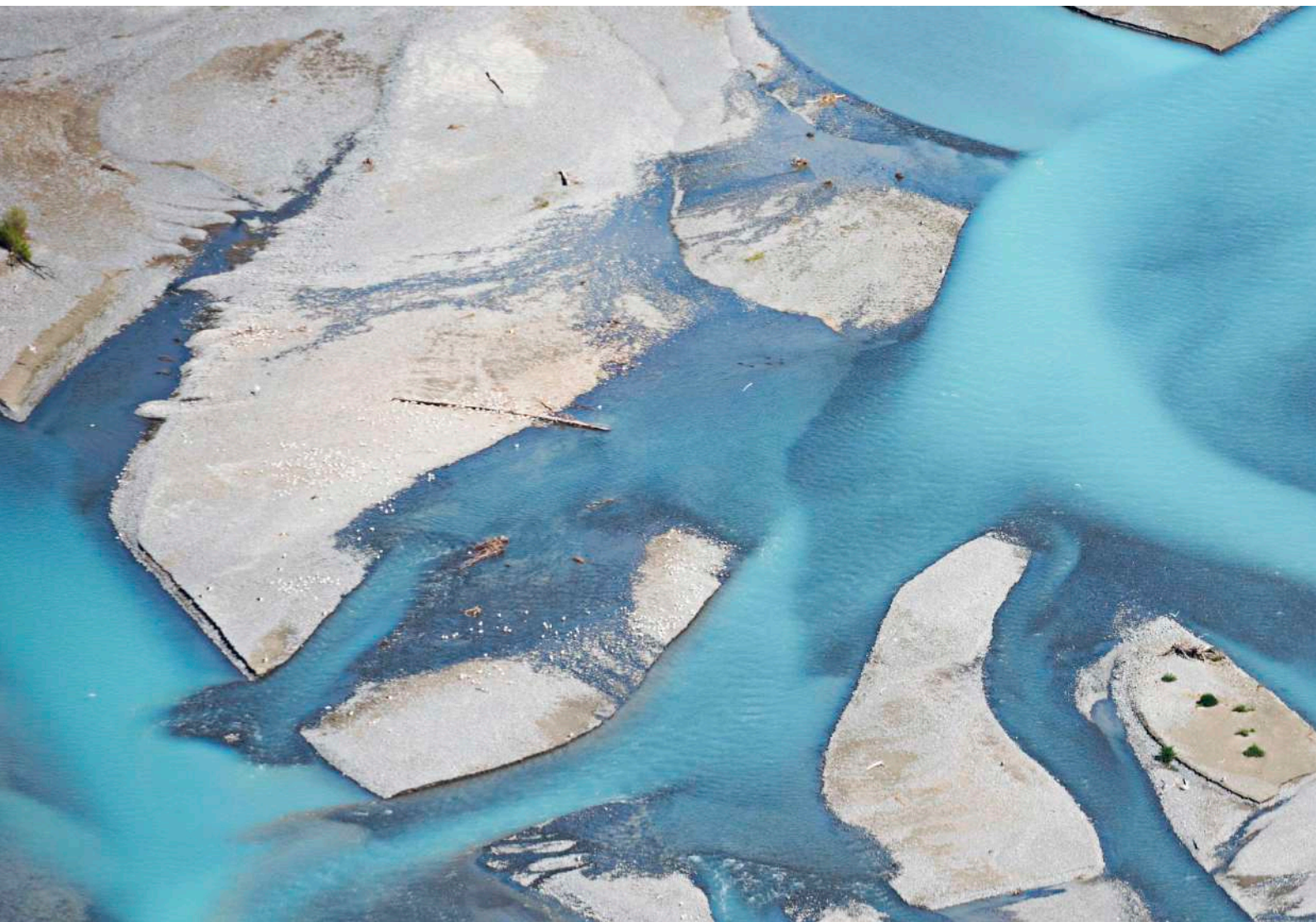


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1. Introduction

The risk of the UK leaving the EU without an agreement in place to regulate its trade relations with the EU (if only on a transitional basis) is currently very real. This scenario is often referred to as a "no-deal" Brexit which involves trading on WTO terms. Banks have been practically preparing for a possible no-deal Brexit – planning for the loss of passporting rights, assessing the need to provide services via establishments in the EU and taking numerous other measures. While they may have a sophisticated knowledge of the regulation on the ground, how WTO rules apply to the banking sector is not generally fully understood. This document provides an introduction to the role of the WTO in respect of the banking sector in case of a no-deal Brexit.



2. The WTO GATS: basic principles and application to financial services

The [General Agreement on Trade in Services](#) ("GATS") is the WTO Agreement that addresses trade in services matters. The scope of the GATS is wide, in principle applying to all services – including banking and other financial services. Services are only excluded from the GATS in narrowly defined circumstances. Thus, for example, services provided in the exercise of governmental authority are excluded, as are certain airline services.



2. The WTO GATS: basic principles and application to financial services

2.1 GATS trade in services: the 4 "Modes" of supply

As its name implies, the GATS applies to measures of WTO members that affect trade in services. Trade in services is defined as covering four

"modes" of supply of a service. In principle, the modes are distinguished, first, based on the location of the person providing the service and, second, based on where the service is supplied/delivered or whether it is a natural or legal person supplying the service.

MODE	ARTICLE I:2 GATS LANGUAGE	LOCATION OF THE SERVICE SUPPLIER	OTHER
Mode 1 – "cross-border supply"	The supply of a service from the territory of one Member into the territory of any other Member	Service supplier located in the territory of a WTO member but outside the territory of the WTO member whose GATS obligations are at issue (eg UK headquartered bank providing services to an EU legal entity)	Location of delivery/supply for Mode 1: Service supplied/delivered into/within the territory of the WTO member whose GATS obligations are at issue
Mode 2 – "consumption abroad"	The supply of a service in the territory of one Member to the service consumer of any other Member.		Location of delivery/supply for Mode 2: Service supplied/delivered outside the territory of the WTO member whose GATS obligations are at issue (eg because consumed abroad?)
Mode 3 – "commercial presence"	The supply of a service by a service supplier of one Member, through commercial presence in the territory of any other Member	Service supplier in the WTO Member with commitments	Supply by a legal entity (eg branch of an EU bank in the UK)
Mode 4 – "presence of natural persons"	The supply of a service by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member		Supply by a natural person (eg UK banker flying to India to advise on a corporate finance matter)

2.2 GATS MFN and recognition obligations

The most central obligation of the GATS is the so-called "most-favoured nation" obligation ("**MFN obligation**") which requires that services and service suppliers of WTO members are not treated less favourably than those of any other country. There is also a specific non-discrimination obligation governing the recognition of qualifications, standards and other requirements market access.

Both the MFN and recognition obligations are generally applicable obligations – which can only be subject to limited exclusions. The main exception for the MFN obligation is for regional trade agreements which satisfy certain conditions, most notably the need for wide sectoral coverage and a high degree of liberalisation. It is on this basis that EU countries are able to provide more favourable treatment to service suppliers from other Member States than to those from third countries.

2.3 GATS "opt-in" obligations

Most other obligations of the GATS only apply where there is a specific commitment for the service sector and mode of supply at issue. These are referred to as "opt-in" obligations.

Key opt-in obligations of the GATS include the obligation not to discriminate between the domestic services and service suppliers of the WTO Member making the commitment as compared services and service suppliers from other WTO Members ("**national treatment obligation**"). Another is the so-called "**market access obligation**" which does not, as its name suggests, prohibit any types of measures that limit market access but only specifically listed measures that can limit market access, namely restrictions related to:

- the number of service suppliers;
- the value of service transactions or assets;

- the number of operations or quantity of output;
- the number of natural persons supplying a service;
- the type of legal entity or joint venture; and
- the participation of foreign capital.

WTO Members "opt-in" to national treatment and market access obligations by recording their intention to do so in a Schedule of Specific Commitments. Commitments are made on the basis of mode of supply and service sector – and reading a Schedule can be a relatively technical exercise. Importantly, opt-in obligations in a Schedule can be subject to limitations. Hence, for example, a WTO Member can state that branches are banned for Mode 3 market access.

Once a WTO Member has "opted-in" to market access and/or national treatment commitments in a Schedule, several other GATS obligations become applicable. These include certain "domestic regulation" obligations, including the requirement to administer in a reasonable, objective and impartial manner.

2.4 GATS Annex on Financial Services: recognition of prudential measures and the "prudential carve-out"

The general GATS rules discussed at 2.2-2.3 above apply to financial services but the GATS Annex on Financial Services also sets out more specific provisions on financial services, including banking services.

Among other things, the Annex elaborates specific requirements for recognition of prudential requirements (which is generally applicable) and the so-called "**prudential carve-out**" which allows WTO members to justify measures otherwise inconsistent with the GATS if they are taken for prudential reasons (so long as they are not used as a means of avoiding the Member's commitments or obligations under the GATS).

2.5 The Understanding: a template for "opt-in" financial services commitments

The so-called "[Understanding on Commitments in Financial Services](#)" ("**Understanding**") also relates to the WTO GATS and commitments of WTO members on banking and other financial services. This is a text that was negotiated following the establishment of the WTO in 1995. It is not a legal part of the GATS, but it becomes legally binding on WTO members to the extent incorporated into their GATS Schedule.

The Understanding establishes that WTO members accepting it should provide market access for banking and other financial services in the form of commercial presence (eg via a subsidiary or branch) and on non-discriminatory terms vis-à-vis local suppliers (ie there is a national treatment obligation). However, commitments which broadly correlate with mode 1 services are mostly limited to certain insurance sectors and entirely excluded for banking. By contrast, services involving residents purchasing services in the territory of another member (broadly correlated with mode 2 services) are subject to extensive commitments.

2.6 Mode 1 and 2 financial services

As indicated at 3.1 above, mode 1 and mode 2 services are supplied from a service supplier located outside the territory of a WTO member making commitments.

Within the WTO it has been recognised that distinguishing between Mode 1 and Mode 2 services is increasingly complex in the area of financial services (and other services) where physical movement of a consumer is not always needed, especially where services are provided electronically. Hence, for example, it has been noted:

"The much fuller and continuous interaction now possible in a wide range of services between a consumer and a supplier located abroad raises the question of whether such services are supplied "into the territory" of the consumer (mode 1) or "in the territory of the foreign supplier (mode 2). In this latter case the consumer, although not physically present in the supplier's territory, might in some circumstances be considered to consume the service abroad."¹

¹ Quotation from WTO Document (S/C/W/304).




3. Overview of EU and UK GATS commitments on banking (Modes 1-3)

The EU-28 GATS commitments are set out in a recently consolidated Schedule approved within the WTO. Although the commitments are set out in a collective document, they are defined at both EU and Member State level. As such, ascertaining the current banking commitments of any Member State requires a holistic consideration of the Schedule, including whether any commitments in principle are subject to certain limitations.

This said, commitments of the EU-12 Member States² (which entered into their financial services commitments at the same time) are broadly similar in terms of their basic banking commitments and they follow the basic principles of the Understanding. Thus, they generally exclude Mode 1 commitments for banking but broadly accept Mode 2 commitments for the same sector. Further, there is a general acceptance of Mode 3 commitments, although there are more limitations in this context (in particular, for market access). Most specifically relate to securities and investment but, for example, Portugal reserves the right to make establishment of banks subject to an economic needs test.

In general, in line with the Understanding, all commitments of these Member States include basic national treatment obligations. Further, these Member States undertake additional commitments related to licensing, according to which, *inter alia*, they commit to "make their best endeavours to consider within 12 months complete applications for licenses to conduct banking activities, through the establishment in a Member State of a subsidiary in accordance with the legislation of that Member State, by an undertaking governed by the laws of a third country."

EU-12 banking commitments

MODE 1		
MODE 2		BUT MUST ALWAYS CHECK LIMITATIONS!
MODE 3		

As the UK is leaving the WTO, it has notified a [Schedule](#) that will apply when it leaves the EU. For financial services, it has largely sought to replicate its commitments as an EU Member State but taking into account its new status as a separate WTO Member. Hence, the banking commitments are like those described above (liberal for modes 2 and 3 but not mode 1) but do not, for example, include limitations pertaining to passporting.

Outside the EU-12 Member States (including the UK), banking commitments are more heterogeneous. For example, Hungary makes no mode 2 banking commitments and the Czech Republic and Slovakia impose significant limitations on mode 2 banking services.

² Belgium, Germany, Denmark, Spain, France, Greece, Italy, Ireland, Luxembourg, the Netherlands, Portugal, and the UK.

4. Practical impact of the GATS in case of a no-deal Brexit

To be sure, the GATS will not replicate the existing EU regulatory framework in case of a no-deal Brexit. Further, the GATS does not require that passporting be allowed for branches of UK companies in the EU (this is due to a specific limitation in the EU GATS Schedule). Nevertheless, while the GATS does not replicate EU membership, it will still play an important role in any no-deal Brexit. How specifically will the GATS help?

4.1 The GATS will provide a baseline of protection

At the most fundamental level, the GATS will in principle not allow the EU (or the UK) to discriminate against EU/UK banking services and service suppliers as compared to like services and services suppliers from other WTO members (except those with which they have a WTO compliant free trade agreement covering services). While this does not amount to preferential access, this basic principle also excludes retaliation and provides a basic level of protection. It is emphasised that this obligation generally applies in all circumstances, even where there are no "cross-border" commitments.

The baseline protection for GATS opt-in obligations will depend on a close reading of the relevant GATS Schedule. However, where services are provided through a commercial presence (ie establishment), discrimination as compared to local suppliers will only be permitted where there are specific limitations in a Schedule. Further, where there are relevant commitments, outright bans on services will in principle be prohibited. Thus, for example, Sweden can require that the founder of savings bank in the country be a natural person resident in the EU because there is a specific limitation for this in the EU Schedule.

While the prudential carve-out can allow measures otherwise contrary to the GATS for prudential reasons, discriminatory treatment and bans on services can be more difficult to justify – and therefore unfavourable different treatment will not necessarily be accepted. It is notable that in the one WTO case addressing the prudential carve-out to date, the WTO member concerned (Argentina) was not able to justify discriminatory legislation on the basis of the prudential carve-out.

4.2 The GATS establishes key rules on recognition of prudential requirements

Until recently, GATS rules on recognition have been little talked about. This is in part because they are not well-tested and therefore the precise contours are subject to some debate.

The WTO does not require a WTO member to recognise the prudential requirements of other members. However, where it does, it must offer adequate opportunity to other WTO members for similar treatment. This is a type of non-discrimination obligation.

Slow progress in adopting recognition/equivalence decisions, engaging in equivalence discussions or even unilateral withdrawals of recognition can in principle fall within the scope of and therefore fall afoul of this obligation.

Although no WTO challenges have been brought in relation to these provisions to date, equivalence issues are expected to become especially important in the case of a no-deal Brexit and so these rules will take on increased importance.

In relation to recognition matters, it is also important to understand that recognition can provide an alternative to a comprehensive free trade agreement. While many aspects of banking services are not subject to equivalence regimes on the EU side today, if there is political willingness, opening up equivalence regimes would be a WTO compliant way for both the EU and the UK to continue close cooperation. For this reason there has been recent debate around enhanced equivalence regimes in a post-Brexit world.

4.3 Mode 2 commitments will need to be considered

As discussed, the general situation is that WTO banking commitments for at least the EU-12 Member States subscribing to the Understanding (which includes the UK) are wide in relation to Mode 2 but not for Mode 1. The lack of market access commitments for Mode 1 (within the meaning of the EU Schedule) has led to the prevailing view that the WTO cannot provide any basis for a right in principle (even if it could be subject to a certain level of authorisation or regulatory oversight) to be able to provide banking services from the UK into the EU (or vice-versa).

Although the WTO establishes a general framework for distinguishing between Mode 1 and 2 services as discussed (see 2.1 above), as also discussed (see section 2.6), there is also lack of clarity surrounding the distinction between the two, especially when it relates to financial services, including banking services, provided remotely to customers. It is notable, however, that WTO discussions make clear that the distinction between Modes 1 and 2 does not correspond to the "reverse solicitation" concept often employed to determine whether foreign services are allowed (in particular, because this concept does not take account of where a service is supplied). As such, in many cases where EU Member States with Mode 2 commitments only allow banking services in the context of reverse solicitation, it can be questioned whether they are banning services contrary to their WTO commitments. Similarly, where there is a complete ban on foreign services, it can be questioned whether at least some services should be allowed.





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