



Expert Meeting on
**THE IMPACT OF ACCESS TO FINANCIAL SERVICES,
INCLUDING BY HIGHLIGHTING THE IMPACT ON REMITTANCES ON
DEVELOPMENT: ECONOMIC EMPOWERMENT OF WOMEN AND YOUTH**

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**SESSION 6:
FINANCIAL INCLUSION, TRADE AGREEMENTS AND REGULATORY REFORM**

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Universal access in the financial sector: international regulatory challenges

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Focus of this contribution

- The enabling environment:
 - Some important issues of international and EU financial reforms
 - The dynamics and political economy of foreign banks in developing countries and in the context of an internationalised and competing financial sector

- Challenges from trade agreements to policy space for inclusive finance

International regulatory and supervisory context: why?



■ Financial stability:

- Still not guaranteed : narrow definitional of ‘systemic risks’
- Takes away attention to the need to include and regulate financial inclusion: even not in main mandate of supervisors (except : Core Principles of Supervision of Micro-finance institutions)

■ International initiatives to promote financial inclusion are **not legally binding** (e.g. G-20 GPFII Global Standard-Setting Bodies and Financial Inclusion for the Poor – Toward **Proportionate Standards** and Guidance; - UNPRI Principles for Investors in Inclusive finance)

■ Foreign banks operating in developing countries impact financial inclusion practices

→ if they fail = more people are excluded

Too big to fail banks operating in developing countries



- The 2014 global systemic important banks (G-SIBs) include:

HSBC, Barclays, BNP Paris Bas, BBVA, Deutsche Bank, JP Morgan, Goldman Sachs, Citigroup, Agriculture Bank of China, Bank of China, ING, Santander, Société Générale, Standard Charter, UBS, ...

- Still being reformed: additional conditions on G-SIBs to prevent crisis, e.g. :
 - additional buffers starting from January 2016 onwards
 - adequate 'Total Loss-Absorbing Capacity' (TLAC) by 2019 (!) : to be decided at 14-15 Nov. 2014 G20 summit

Important EU bank reforms for inclusive finance



- Bank resolution mechanisms: plans ('living wills') in case a bank fails, how to continue **basic bank services**

= access for bank services in times of crisis

- Bank 'restructuring': how to separate (not split!?) and protect **basic financial services** (not always legally defined!) against problems of speculative and investment banking activities

= no public money and guarantees for speculative activities

→ to be part of inclusive finance policy everywhere?

Political economy of internationalized financial sector

Globalization of finance, shaped by trade and investment agreements as well as national policies and corporate strategies: fierce (international) competition in the financial sector lead to financial sector business models that served more and more the rich and less and less the poor

- Foreign banks in developing countries sometimes dominate the sector, changing credit/services relationships, as they have strategies of e.g.:
- Cherry picking the richest clients and most profit making services: not serving or even closing rural area banking → local & public banks left to serve the poor, women, youth
- Not serving poor areas ('red lining'): impact on women
- Not providing enough productive credit e.g. for SMEs, farmers, women, indebting youth
- "Remittances" by the foreign banks:
 - Sending profits home and not reinvest in host country
 - Using host country savings for investment abroad
 - Trying not to keep financial reserves in the home country

Post 2008 crisis: challenge to inclusive finance policies and regulations



Very difficult it is to shape the financial sector in a way to serve public interest and society (economy, sustainable development):

- Inclusive finance (including tackling poverty) is not an integral part of the financial reforms/new legal obligations
- Additional financial buffer requirements = little lending to SMEs and service to the poor
- Strong financial reforms undermined by the **fear of losing competitiveness due to:**
 - **free trade & investment regime** and freedom of capital flow regime
 - Strong lobbying by financial sector, also in developing countries
- European banks and trade negotiators try to 'export' the EU crisis by pushing for expansion in growing economies.

Challenges from free trade agreements



- Free trade agreements continue to be negotiated as before the crisis:
 - same rules and more restrictive not less restrictive rules added
 - same objective of (only) free trade in financial services without guarantees for sufficient regulation or supervision,
 - same EU & US negotiation mandate largely based on protecting the interests of the large financial conglomerates,
 - same lack of transparency and accountability of the negotiations

- EU and the US use the trade negotiations for more access in their financial service industry, not better for quality, more universal access and more at service of sustainable economy

Which trade and investment agreements constraint Policy flexibility for inclusive finance?



- The **General Agreement on Trade in Services (GATS / WTO)**: covers trade AND investment in financial services
- The numerous bilateral or regional **free trade agreements (FTAs)** cover financial services: mostly based on the GATs model + increasingly protection of investment in FS
- **Trade in Services Agreement (TISA)**: negotiations by ca. 50 countries outside the WTO (not BRICS), incl. e.g. Pakistan, Costa Rica,
- **Bilateral Investment Agreements (BITs)**: protection to (FS) investors (incl. M&A, portfolio investment) vs host country policies or regulations

Trade and investment treaty obligations reduce policy space



- **Not only providing market access and establishment rights** to foreign financial service providers and their products
- Also **‘regulatory disciplines’**, when making commitments. which are particular rules that can restrict the policy and regulatory options for universal access to financial services.

Note:

GATS does not oblige developing countries to make commitments in financial services but many have done so especially regarding e.g. “lending of all types”, “acceptance of deposits”;

FTAs that are obliged to have a “substantial sectoral coverage” of services (GATS Art. 5) but financial services might be exception

Some exemptions from some GATS or FTA disciplinary rules are possible at the time of making commitments, not afterwards (or compensation likely)

Statutory financial inclusion obligations under threat

- The requirement that the number of branches that a bank may be licensed to open is linked to the number of branches that the bank opened in rural areas;
- Mandatory lending to small and medium enterprises (SMEs);
- The obligation applied to all banks to provide a particular amount/percentage of its credit (lending quotas) to low-cost housing by poor households;
- Priority sector lending policy such as agricultural loan commitments;
- A scheme of different interest rates: loans to people below the poverty line are at a much lower interest rate with easy repayment rates and no profit margins;
- Prohibition to refuse basic financial services to poor clients;
- Prohibition of 'red lining' (not servicing particular areas because it has many poor people);
- Community re-investment law.

Most Favoured Nation clause (MFN)

- = MFN: foreign (financial) services suppliers have to be treated equally, even if no commitments have been made !
- a country cannot be selective and choose the bank with best financial inclusion record to be allowed to enter the market of a country + to adhere to principle & strategy that diversity of financial services and financial are better for inclusive finance policy.
- a country cannot selecting foreign providers of universal financial services providers from different home countries in order to reduce vulnerability from the financial instability in a particular home country

The 'domestic regulation' rule

= **'least trade restrictive' principle** : requires that qualification and licensing requirements or technical standards should not constitute unnecessary barriers to trade in services. This rule applies to countries that made financial services commitments.

- no priority can be given to universal access licensing requirements (e.g. compulsory opening of rural branches) over least trade restrictive measures (e.g. subsidies)
- each legal universal access obligation can be challenged for constituting an unnecessary barrier to trade ('chilling effect').

= **no new** qualification and licensing requirements or technical standards can be introduced if they "could not have been reasonably been expected of that [country] at the time the specific commitments were made" (GATS).

- No new licensing requirements with universal access obligations can be imposed after foreign service providers diminish the access to financial services following the implementation of a free trade agreement -which is often the case

'Market access' rules

= do not allow a country that made commitments in financial services (except if a country has made exemptions) to:

- Apply an **economic needs** test before a foreign financial service provider is allowed to operate, which could identify that a foreign bank is not fulfilling a country's need for financial inclusion improvement
- Impose **limits to foreign ownership**: in principle the entire financial sector of country can become in foreign hands but foreign banks often do not increase universal access, and experience of universal access initiatives show the need to develop the full potential of local and national solutions to universal access
 - E.g Indonesia: new law to restrict foreign ownership to limit foreign domination; foreign banks increased micro-finance but without needed accompanying literacy etc. services
- Require or restrict **particular types of legal entity** or joint venture e,g, to split basic services from speculative services

'National treatment rule'



= equal treatment **between foreign and national** service suppliers when made commitment without exemptions:

- in principle promote that all financial players, foreign or national, are subject to the same universal access obligations
- national service providers of universal access cannot be prioritized over foreign ones.

= 'treatment **no less favourable** than accorded to national service providers'.

E.g. India: New inclusive finance initiatives and earlier policies to open up more branches in unbanked areas do not apply to foreign banks

= in GATS, FTAs BITs,

= in new **TISA** negotiations : all (financial) services will be subject to this national treatment rule (if no exemptions made = positive list)

More regulatory disciplines in TISA negotiations



- will include more liberalisation of financial services
- aims at increasing the “regulatory disciplines” related to amongst others:
 - ‘domestic regulation’ rules,
 - market access rules,
 - national treatment rule: positive list
- Include a **“standstill clause”**: more trade restrictive rules cannot be introduced any more
- **“ratchet clause”**: Future elimination of discriminatory measures will automatically be part of the trade agreement unless an exemption is listed

Negotiations can result in deregulating universal access laws

EU requested universal access rules by developing countries to be removed, due to dominance of the financial sectors interests in negotiation mandates, e.g.

- EU requested during the GATS negotiations that South Korea removes the requirement of mandatory lending to small and medium enterprises (SMEs).
- The EU raised questions about the requirement applied to all banks in Malaysia to provide (lending) quotas for low-cost housing

= Measures to provide poorer families and SMEs with the financial resources are not considered falling under the GATS "right to regulate", but rather as a trade barrier

Conclusion

- Need for careful assessment of affect on inclusive finance and its policies whther or not to negotiating trade agreements
- When negotiating commitments in financial services: assess, coordinate policies, include exemptions and long term reforms
- Need for developing countries to have better voice in international regulatory decision-making (G20, Financial Stability Board)
- Need for developig countries to be part of supervisory bodies of the banks that operate in their countries

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THANK YOU !

For more information (sorry I have to leave early):

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