
TTIP and regulation of financial markets

Regulatory autonomy
versus fragmentation



IN-DEPTH ANALYSIS

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Liberalisation of financial services is a controversial chapter in the negotiations towards a Transatlantic Trade and Investment Partnership (TTIP). The financial crisis raised concern that trade liberalisation could have an adverse effect on the regulatory power of sovereign states. This analysis illustrates that trade agreements have thus far been able to ensure the regulatory sovereignty of states; however, this independence has naturally resulted in some regulatory divergence. Discussions on regulatory cooperation within TTIP negotiations are a challenge to transatlantic relations, as the United States fears that such cooperation may dilute its own regulatory reforms.

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EXECUTIVE SUMMARY

Trade in financial services is an important chapter in transatlantic trade negotiations. In 2013, the EU represented 38% of US exports in financial services (insurance excluded) and 48% of US imports of financial services (insurance excluded). Transatlantic financial services trade thus certainly represents an opportunity, but also yields several challenges.

On both sides of the Atlantic, reforms of prudential regulation have been undertaken since the 2007 subprime crisis, to rebuild confidence in their financial markets. In this context of substantial domestic reforms, NGOs are concerned about the potential impact of trade agreements (including the future TTIP) on these amended regulatory measures. However, discussions in TTIP go beyond the preservation of regulatory autonomy. Strong regulatory autonomy in the field and little incentive for harmonisation has resulted in significant regulatory divergence on both sides of the Atlantic. Stronger cooperation, it is suggested, would avoid transaction costs created by regulatory fragmentation.

Rules in trade agreements on financial services have traditionally been extremely flexible, giving substantial room to regulate. First, commitments on both market access and non-discrimination are set out by the parties in the dedicated schedules. Trade agreements then provide an exception safeguarding the right of states to undertake prudential regulation, known as the 'prudential carve-out'. This exception has been interpreted broadly, covering both macro- and micro-prudential measures. Prudential measures are also safeguarded from Investor-State disputes, ensuring that claims of indirect expropriation raised in connection with a prudential measure are dismissed. Finally, provisions were introduced to make the broadest possible range of actions for preserving the integrity and stability of the financial system (including exceptions for central bank actions and capital transfer restrictions) available to governments.

While regulatory sovereignty is protected under trade agreements, the challenges of regulatory fragmentation have not been tackled. Besides substantial differences in national implementation of international standards, domestic regulations often exhibit broad extraterritorial reach, thus creating duplication of compliance requirements for firms engaging in transactions with and under different jurisdictions. This analysis gives two examples of how US domestic regulation may increase costs for European banks: first, the recent federal regulation on enhanced prudential requirements for foreign banks, and second, the issue of the Volcker rule (which prohibits banks from undertaking proprietary trading and owning hedge funds or private equity funds).

The existence of contradictory requirements in EU and US regulatory frameworks may create new trade barriers. The current transatlantic forum for financial dialogue, the Financial Market Regulatory Dialogue (FMRD), is proving effective for discussing issues which create substantial trade barriers on both sides. One example relates to the different accounting standards adopted on both sides of the Atlantic. Another is divergence in derivatives regulation, which creates duplicative requirements for both sides. The EU – desirous of more systematic dialogue on unilateral problems relating to the legislation of the other partner state – proposes a new regulatory cooperation framework within TTIP. However, the US is not currently inclined to accept regulatory cooperation as part of TTIP negotiations as it fears that this will slow the pace of implementation of its own financial regulatory reforms.

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List of main acronyms used

CETA:	Comprehensive Economic and Trade Agreement
CFTC:	Commodity Futures Trading Commission
EMIR:	European Market Infrastructure Regulation
FBO:	Foreign banking organisation
FMRD:	Financial Market Regulatory Dialogue
FRB:	Federal Reserve Board
GAAPS:	General Accepted Accounting Principles
GATS:	General Agreement on Trade in Services
IHC:	Intermediate holding company
IFRS:	International Financial Reporting Standards
KORUS FTA:	South Korea–US Free Trade Agreement
MFN:	Most favoured nation
NAFTA:	North American Free Trade Agreement
NGO:	Non-governmental organisation
SEC:	Securities and Exchange Commission
TiSA:	Trade in Services Agreement
TTIP:	Transatlantic Trade and Investment Partnership
WTO:	World Trade Organization

Glossary

Bank holding: A corporation that holds at least a quarter of the voting stock of a commercial bank. One-bank holding companies led to the creation of leveraged bank holding companies.

Capital requirements: The standardised requirements in place for banks and other depository institutions, which determine how much liquidity is required to be held for a certain level of assets.

Central counterparties: Clearing houses, i.e. intermediaries that provide settlement for securities and derivatives transactions.

Swap: Traditionally, the exchange of one security for another to change the maturity (bonds), quality of issues (stocks or bonds), or because investment objectives have changed. Recently, swaps have grown to include currency swaps and interest rate swaps.

Liquidity requirements: Liquidity ratios attempt to measure a company's ability to pay off its short-term debt obligations; for these they measure the ability of the firm to turn its assets into cash. A firm can also have assets that are not liquid, i.e. cannot easily be transformed into cash.

Source: [Investopedia](#).

1. The importance of financial services in TTIP negotiations

In 2013, financial services accounted for €59 billion of extra-EU28 exports and for €23 billion of extra-EU28 imports, resulting in a trade surplus of €36 billion.¹ The service sector achieves the second highest surplus in extra-EU services, after other trade business services (€73 billion), and followed by computer and information services (€27 billion) and transport (€24 billion).² In 2013, the EU represented 38% of US exports in financial services (excluding insurance) and 48% of US imports of financial services (insurance excluded).³ However, while there is agreement in the EU, as in the US, on the fact that liberalisation of financial services is important and should be achieved, there is more concern as to how to ensure that trade in financial services does not affect the reforms introduced following the financial crisis.

Table 1 – US Exports and Imports in Total Financial Services in US\$ millions (insurance excluded)								
	Exports				Imports			
	2006	2007	2012	2013	2006	2007	2012	2013
All countries	47 882	61 376	76 605	84 066	14 733	19 197	16 975	18 683
European Union	20 131	24 644	28 785	32 009	8 166	11 091	7 821	8 989

Data source: [Bureau for Economic Analysis \(BEA\), October 2014](#).

Table 2 – US Exports and Imports in Total Insurance Services in US\$ millions								
	Exports				Imports			
	2006	2007	2012	2013	2006	2007	2012	2013
All countries	9 445	10 841	16 534	16 096	39 382	47 517	53 203	50 454
European Union	2 621	2 776	3 717	3 478	13 346	16 541	12 586	11 580

Data source: [Bureau for Economic Analysis \(BEA\), October 2014](#).

Following the financial crisis, both the US and the EU substantially revised their financial market regulations.⁴ In this context of substantial domestic reforms, NGOs have been concerned about the potential impact of trade agreements (including the future TTIP) on these amended regulatory measures. However, discussions on TTIP go beyond the preservation of regulatory autonomy. Strong regulatory autonomy in the field and little incentive for harmonisation has led to significant regulatory divergence between both sides of the Atlantic, and stronger cooperation has been suggested as a means to avoid transaction costs created by this regulatory fragmentation.

¹ Source: [Eurostat](#).

² Idem.

³ Source of data: [Bureau for Economic Analysis \(BEA\), October 2014](#): table on financial services and table on insurance services.

⁴ For an overview of EU reform progress, see [the Commission website](#). On the EU and the US see also: E. V. Murphy, 'Who regulates whom and how? An overview of US Financial Regulatory Policy for Banking and Securities Markets', 30 January 2015, CRS.

Two divergent positions persist with respect to TTIP negotiations.⁵ On one hand, banks in the EU and, to a certain extent, the US, are more preoccupied with divergence in financial market regulation and the costs that regulatory fragmentation can bring. The European Commission has suggested bringing regulatory cooperation in financial markets to the TTIP negotiating table.⁶ On the other hand, NGOs and consumer associations are concerned that TTIP, as well as the inclusion of regulatory cooperation provisions, might affect the ability of both parties to regulate their financial markets autonomously.⁷ On top of these fears is the US Government's concern that including regulatory cooperation in TTIP might slow implementation of the US reforms in prudential regulation, and would lower the stringent levels of US requirements to match the more relaxed European standards.⁸ The US Congress's position⁹ might be more nuanced on the subject,¹⁰ while the EU position remains strong on the need for more cooperation. However, there is still debate on how to preserve strong regulatory autonomy and whether there is a need to further address in TTIP the regulatory fragmentation that may potentially result from diverging national regulations.

2. Financial services provisions in trade agreements

The first priority after the subprime crisis and the resulting and ongoing crisis in the financial markets was to reform the prudential regulation system in both the US and in the EU. So the first question asked by NGOs and governments was whether the prudential reforms and actions undertaken by central banks to react to the financial crisis were compatible with existing trade agreements and those under negotiation. Financial services liberalisation and commitments in trade agreements could have limited the room for manoeuvre enjoyed by states to regulate this area of their economies. This, however, is not the case, as trade agreements provide ample security for sovereign actions in regulating financial markets.

2.1. Liberalisation and regulation of financial services

2.1.1. Overview of liberalisation obligations

Rules and commitments regarding the liberalisation of financial services are ensured within the World Trade Organization (WTO) under the General Agreement on Trade in Services Framework Agreement (GATS),¹¹ complemented by a series of further

⁵ Madariaga Report, '[Financial Services and the TTIP: why is the EU insisting?](#)', 28 February 2014.

⁶ See documents on the EU negotiating position on financial services in TTIP on [the European Commission website](#).

⁷ On the concerns of NGOs with respect to trade agreements and financial markets regulation, see [resolution of the Transatlantic Consumer Dialogue, October 2013](#); this concern is also shared by some US Members of the House of Representatives, see the following article from the [Committee on Financial Services](#).

⁸ S. I. Akhtar, V. C. Jones, [Proposed Transatlantic Trade and Investment Partnership \(TTIP\): In Brief](#), 11 June 2014, CRS; M. N. Baily and D. J. Elliott, [Financial Services in the New Trade Negotiations with Europe, June 20 2013](#), Brookings.

⁹ For a detailed analysis of the Congress's position in TTIP negotiation, see: W. Troszczynska-van Genderen and E. Bierbrauer, [The Transatlantic Trade and Investment Partnership \(TTIP\): The US Congress's positions](#), 9 September 2014, Policy Department External Policy - European Parliament.

¹⁰ See, [Hearing on US-EU Trade and Investment Partnership Negotiations](#), Hearing before the Subcommittee on Trade of the Committee on Ways and Means – US House of Representatives, 16 May 2013.

¹¹ For the text of the GATS Framework Agreement, see [the WTO website](#).

documents, including annexes on Financial Services and the GATS Understanding on Commitments in Financial Services (hereafter, simply GATS).¹² The provisions of free trade agreements (FTAs) on financial services were certainly influenced by the GATS, but differ in significant ways in their approach to liberalisation. Both the GATS and FTAs remain extremely flexible with respect to sovereign regulations in this field. The GATS refer to service provisions following a four mode categorisation (see box). Often in FTAs a simple distinction is made between cross-border supply (covered by mode 1 and 2 under the GATS)¹³ and establishment. Moreover, while the GATS and earlier EU agreements approached services liberalisation under a common framework,¹⁴ complementing it with some specific provisions on financial services, the North American Free Trade Agreement (NAFTA)¹⁵ approach, currently used in more recent EU FTAs, also dedicates a specific chapter to financial services provisions.¹⁶

The four GATS modes of services¹⁷

- **Mode 1 ('cross-border supply')**: entails the provision of a service from one country to another, for example a German client makes a bank transfer from its German bank to pay a supplier in the US;
- **Mode 2 ('consumption abroad')**: a client from another country consumes locally, for example a Spanish client living in the US opens a bank account in the US for local consumption;
- **Mode 3 ('establishment')**: a foreign bank establishes a subsidiary or a branch in the country;
- **Mode 4 ('presence of natural persons')**: temporary travel of a professional to supply directly to a client who is resident in another country; for example a British portfolio manager from a big investment bank going to the US to discuss with a wealthy and important client.

Provisions on financial services in the GATS are divided between general obligations and specific commitments. General obligations apply immediately to all measures subject to the agreement, without the need for inclusion in the schedule of commitments. The main general obligation, which has considerable impact on the scope for liberalisation, is the Most Favoured Nation (MFN) requirement under Article II of the GATS. The MFN requirement grants the commitments concluded by a contracting partner in the agreement to all other contracting parties, without requiring the other party to reciprocate that commitment. The GATS does allow for some exceptions to the MFN rule, however.¹⁸

Specific commitments apply only to those services which the party concerned has agreed to liberalise. The GATS has specific commitments for market access and for national treatment obligations. There are two main approaches to specific

¹² For the text of the GATS Understanding on Commitments in Financial Services see the [WTO website](#).

¹³ For example [article 8.4 within the EU-Singapore FTA draft text](#) where the following definition is given to cross-border trade: for the purposes of this section, 'cross-border supply of services' means the supply of a service: (a) from the territory of a Party into the territory of the other Party; and (b) in the territory of a Party to a service consumer of the other Party.

¹⁴ See the example of the [EU-Singapore draft agreement](#) and [the EU-Korea FTA](#).

¹⁵ For the NAFTA text see [North American Free Trade Agreement](#).

¹⁶ See the [Comprehensive Economic and Trade Agreement \(CETA\) draft agreement](#).

¹⁷ See article I(2) GATS and the [WTO website](#) for further explanation.

¹⁸ MFN exceptions imposed by the EU: [the EU has one for the EU as a whole and an additional one for Italy's tax agreements](#).

commitments for liberalisation in services: the GATS approach (or positive commitment list approach), and the NAFTA approach (to cross-border supply) or negative list approach. The first indicates that no commitment has been made unless specified in the commitments list, while the latter makes explicit a general obligation to liberalise that is then restricted by a list of specific exceptions. The negative commitment approach obviously has a stronger liberalisation effect, as liberalisation is the rule and not the exception. In the discussions on a Trade in Services Agreement (TiSA), a hybrid approach for the scheduling of commitments has been proposed that would use a positive approach for market access and a negative approach for national treatment.¹⁹

Types of commitment approach

Market Access formulation in GATS and the positive commitment approach:

Article XVI(1) GATS: 'With respect to market access through the modes of supply, each Member shall accord services and service suppliers of any other Member *treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.*'

The NAFTA approach and negative commitment approach:

Cross-Border Trade, Article 1404(1) NAFTA: 'No Party may adopt any measure restricting any type of cross-border trade in financial services by cross-border financial service providers of another Party that the Party permits on the date of entry into force of this Agreement, *except to the extent set out in Section B of the Party's Schedule to Annex VII.*'

(author's emphasis)

2.1.2. Market access provisions and regulations of financial services

Regulatory autonomy and freedom have certainly been at the centre of the GATS negotiations and also of FTA provisions for liberalising trade in services. The GATS uses a very flexible approach when dealing with the question of whether regulation could impact on market access. First, it introduced a series of general obligations for good governance, comprising requirements for transparency (Article III GATS) and for all measures of general application to be administered in a reasonable, objective and impartial way, as well as other procedural requirements (under Article VI GATS). Article VI GATS also imposes substantial requirements, such as requiring that qualification requirements and procedures, technical standards and licensing requirements 'do not constitute unnecessary barriers to trade in services' (Article VI(4) GATS). That requirement basically imposes a necessity and a proportional approach to licensing and technical standards requirements, i.e. these standards must be necessary to achieve a legitimate objective and must not be more restrictive than necessary to achieve the said objective. The GATS further imposes that recognition of standards between contracting parties may not be applied 'in a manner which would constitute a means of discrimination between countries in the application of its standards or criteria for the authorization, licensing or certification of services suppliers, or a disguised restriction on trade in services' (Article VII GATS).

Beyond these general requirements, the article on Market Access in GATS²⁰ contains a list of measures that should be prohibited. The latter are limitations that can directly restrict foreign competition in a market by imposing limitations on suppliers,

¹⁹ A. Lang and C. Conyers, [Financial Services in EU Trade Agreements](#), 2014, European Parliament.

²⁰ [Article XVI GATS](#).

transaction values and/or capital participations. The same list of measures is often repeated as such in market access provisions in FTAs (see table below).

Table 3 – Measures prohibited *a priori* by market access provisions

Prohibited measures	GATS ²¹	KORUS FTA ²²	EU-Korea ²³	EU-Singapore ²⁴	CETA ²⁵
Limitations on number of service suppliers	yes	yes	yes	yes	yes
Limitations on total value of service transactions	yes	yes	yes	yes	yes
Limitations on total number of service operations	yes	yes	Yes	yes	yes
Limitations on number of natural persons employed	yes	yes	yes	yes	yes
Requiring specific types of legal entity or joint venture in order to supply a service	yes	yes	yes	yes	yes
Limitations on foreign capital participation	yes	yes	yes	yes	yes

However the application of this list of prohibited measures has different effects, depending on whether market access is granted through a positive commitment approach or a negative commitment approach. In the former, the prohibition only applies to areas where market access is granted in the commitment schedules, unless the contracting party has scheduled otherwise in its commitment. In the negative commitment list approach, the prohibition stands as a general obligation, subject to the specified exceptions in the schedule of commitments. The draft Canada-EU trade agreement (CETA) specifies further derogations to those prohibitions (see box below). The CETA draft firstly reiterates the right of parties to issue conditions for the authorisation of establishment and expansion of service providers as well as clarifying that the law might require supply of certain services via specific legal entities. The latter is a clear reference to the much-debated issue of separation between commercial and investment banks.

²¹ Idem.

²² [Article 13.4 KORUS FTA](#).

²³ NB: [the EU-Korea FTA](#) has **two distinct market access articles** for cross-border and for establishment. There is a **limited list of prohibition found in Article 7.5 EU-Korea FTA for cross-border services** (including only the first three prohibited measures in the table). The market access article for establishment includes all the six prohibited measures (Article 7.11 EU-Korea FTA).

²⁴ NB: The same distinction between cross-border and establishment market access as in the EU-Korea FTA is made in [the EU-Singapore FTA](#). The limited list of prohibited measures for cross-border market access in Article 8.5 EU-Singapore FTA and the full prohibition list for establishment market access under article 8.10 EU-Singapore FTA.

²⁵ [Draft article 6 in chapter 15 of CETA draft Agreement](#).

Limitations to the prohibition included in market access provisions in CETA

Article 6 of chapter 15 on Financial Services:

'For greater certainty, a Party may impose terms, conditions and procedures for the authorisation of the establishment and expansion of a commercial presence in so far as they do not circumvent the Party's obligation under paragraph 1 and they are consistent with the other obligations of the Chapter/Annex/Agreement.

'For greater certainty, nothing in this Article shall be construed to prevent a Party from requiring financial institutions to supply certain financial services through separate legal entities where under the laws of the Party the range of financial services supplied by the financial institution may not be supplied through a single entity.'

Issues related to market access and regulations also concern the provision of new services. Market access is normally extended automatically to the provision of the same service via a new technology (e.g. online banking), but the question remains whether a provider established in a partner country can introduce a new service that they provide elsewhere but did not originally provide in the country in question. The GATS Understanding on Commitments in Financial Services, which does not have binding force unless it is inscribed in the schedule of commitments, proposed a very liberal provision, allowing for any new financial service (Section B8). Most probably in response to the role played by new derivative products in the financial crisis, the new generation of FTAs contain particular provisions on new financial services (see examples). These renew the right of the parties to regulate the new financial service, while at the same time ensuring that if authorisation is required, it can be refused only for prudential reasons.

New Financial Services – selected examples

The GATS Understanding on Commitments in Financial Services

'7. A Member shall permit financial service suppliers of any other Member established in its territory to offer in its territory any new financial service.'

Article 13.6 on 'New financial services' in the US-Korea Free Trade Agreement (KORUS FTA)

'Each Party shall permit a financial institution of the other Party to supply any new financial service that the Party would permit its own financial institutions, in like circumstances, to supply without additional legislative action by the Party. Notwithstanding Article 13.4(b), a Party may determine the institutional and juridical form through which the new financial service may be supplied and may require authorization for the supply of the service. Where a Party requires a financial institution to obtain authorization to supply a new financial service, the Party shall decide within a reasonable time whether to issue the authorization and the authorization may be refused only for prudential reasons.'

Article 8.53, draft EU-Singapore FTA

'Each Party shall permit a financial service supplier of the other Party to supply any new financial service that the first Party would permit its own like financial service suppliers to supply without additional legislative action required by the first Party. A Party may determine the institutional and juridical form through which the new financial service may be supplied and may require authorisation for the supply of the service. Where such a Party requires Such Authorisation of the new financial service, a decision shall be made within a reasonable time and the authorisation may only be refused for prudential reasons under Article 8.50 (Prudential Carve-out).'

2.2. The exception for prudential regulation

2.2.1. The prudential carve-out in GATS and FTAs

The main exception to safeguarding regulatory sovereignty is the prudential regulation exception, also known as the prudential carve-out. The prudential carve-out is found in Article 2(a) of the GATS Annex on Financial Services (see box below for the full provision). In the context of the financial crisis, two main issues arose with respect to the prudential carve-out.²⁶

GATS model for prudential carve out

Art. 2(a), Annex on Financial Services

'Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.'

(author's emphasis)

The first issue relates to the scope of the prudential exception. The first sentence of the GATS prudential carve-out contains both the exception, 'a Member shall not be prevented from taking measures for prudential reasons', and a list of possible measures, 'including for...'. The main question is therefore whether this list should be considered an exhaustive list and whether new macro-prudential measures are covered by the carve-out or excluded from it. In reality, the list remains vague and should be considered open-ended. The prudential measures are characterised and defined by their objective, first to protect investors, depositors, etc., and in more general terms 'to ensure the integrity and stability of the financial system'. As the latter objective may cover a vast range of measures, the prudential carve-out is normally interpreted as having a very wide scope. Discussions on TiSA, to further define and develop the list of measures falling under the prudential exception, have been thwarted by negotiating parties (including Canada, the EU and the US),²⁷ as a clear list of measures could potentially reduce the scope of the carve-out (in particular if the list is interpreted as an exhaustive list of measures).²⁸

The second issue concerns the meaning of the second sentence of the GATS prudential carve-out, stating that: 'Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.' At first sight, this second sentence may appear to be ambiguous. While there has been no court case on the topic to refer

²⁶ I. Barbee and S. Lester, [Financial services in TTIP: making the prudential exception work](#), 2014 *Georgetown Journal of International Law* vol. 45; A. Lang and C. Conyers, [Financial Services in EU Trade Agreements](#), 2014, European Parliament; for a deeper discussion on the functioning of the prudential carve-out, and in particular the legal issue of burden of proof to prove claims under the prudential carve-out in the GATS system, refer to: C. M. Cantore, '[Shelter from the Storm: Exploring the Scope of Application and Legal Function of the GATS Prudential Carve-Out](#)', 2014 *Journal of World Trade* 48(6). For the text of the GATS Annex on Financial Services: [WTO website](#).

²⁷ I. Barbee and S. Lester, [Financial services in TTIP: making the prudential exception work](#), 2014 *Georgetown Journal of International Law* vol. 45, p. 963.

²⁸ See the European Commission comment during the Committee on Trade in Financial Services meeting held in June 2012: Committee on Trade in Financial Services, *Note by the Secretariat: Report of the Meeting Held on 27 June 2012*, 15, S/FIN/M/73, (30 July 2012).

to, the sentence has been widely interpreted as simply requiring legitimacy of the measure used. Indeed the second sentence aims at avoiding that the prudential measure exception is used as a means to circumvent Treaty commitments. It therefore requires that only measures that are genuinely required for prudential reasons may run counter to the commitments. This imposes a necessity test and proportionality test, *if* the measure is contrary to commitments.

The prudential carve-out has been more or less copied from GATS into FTAs. The KORUS FTA has changed almost none of the wording from the GATS formulation (see Article 13.10(1) of the KORUS FTA), whereas NAFTA has added a further description of a legitimate objective that prudential measures may pursue: 'the maintenance of the safety, soundness, integrity or financial responsibility of financial service suppliers' (Article 1410(1) NAFTA). This additional sentence found in NAFTA was added to the draft agreement between the EU and Singapore (Article 8.50) and the draft CETA (Article 15). The CETA draft goes on to give further examples, but clarifies that the list of measures is non-exhaustive by stating 'without prejudice to other means of prudential regulation'.

The second phrase of the prudential carve-out was completely removed in NAFTA and replaced with the adjective 'reasonable'. A similar approach was used in CETA. The draft EU-Singapore Agreement explicitly requires the measures taken to be proportionate and non-discriminatory:

'These measures shall not be more burdensome than necessary to achieve their aim and shall not constitute a means of arbitrary or unjustifiable discrimination against financial service suppliers of the other Party in comparison to its own like financial service suppliers or a disguised restriction on trade in services.'

CETA draft article 15 on prudential carve-out

'Nothing in this Agreement shall prevent a Party from adopting or maintaining reasonable measures for prudential reasons, including:

- the protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a Financial Institution, or cross-border financial service supplier or financial service supplier;
- the maintenance of the safety, soundness, integrity or financial responsibility of a Financial Institution, cross-border financial service supplier or financial service supplier;
- or ensuring the integrity and stability of a Party's financial system.

Without prejudice to other means of prudential regulation of cross-border trade in financial services, a Party may require the registration of cross-border financial service suppliers of the other Party and of financial instruments.

Subject to Article X (National Treatment) and Article Y (Most Favoured Nation Treatment), a Party may, for prudential reasons, prohibit a particular financial service or activity. Such a prohibition may not apply to all financial services or to a complete financial services sub-sector, such as banking.'

2.2.2. ISDS and prudential regulation

Within the debate on investor-state disputes, concerns have been raised with respect to prudential regulations and whether the latter can be challenged as an indirect expropriation. NAFTA already foresaw the necessity to protect regulatory sovereignty in prudential regulations from challenges under investment dispute settlement. For that reason, NAFTA includes a filter mechanism, which was then reused in other FTAs.

The filter mechanism in NAFTA (under Article 1415 of NAFTA) allows a claim to be dismissed if the measures challenged have been found to fall under the exceptions in Article 1410 (including the prudential regulation exception). The decision on whether a state could invoke Article 1410 is taken under NAFTA by the Financial Service Committee (Article 1412 NAFTA), however if the Committee cannot decide the matter within 60 days from receipt of the referral, then a decision on the matter is taken by an arbitral tribunal. Decisions of the Committee or the arbitral report are binding on the tribunal that should have decided the dispute. A decision, confirming that the exception article applies, means that proceedings on the dispute must be halted. In a case where the Committee has not decided the claim after 60 days and no panel was requested after 10 days, the matter reverts to the tribunal.

A similar filter mechanism has been introduced in the draft articles of the CETA (see Article 20 in chapter 15 of CETA). If the matter reverts to the tribunal because the Committee did not decide on the exception claim within the time limit set, the state can still bring the matter before the tribunal.

2.3. Other issues

2.3.1. Standstill clauses

The standstill clause is found in Section A of the GATS Understanding on Commitments in Financial Services. It prohibits issuance of any new regulation that might limit the commitments undertaken. Similarly FTAs may introduce a standstill clause and require that no new regulation is adopted beyond amendment of existing regulations. The EU recently introduced a clause in which it retains the right to introduce new regulations to meet legitimate policy objectives as long as it remains '*consistent with*' the provisions of the chapter on Services, Establishment and Electronic Commerce (chapter eight).

From standstill clauses to the right to new regulation

GATS Understanding on Commitments in Financial Services: Section A, Standstill:

'Any conditions, limitations and qualifications to the commitments noted below shall be limited to existing non-conforming measures.'

Draft Article 8.1 of Singapore-EU FTA:

'Consistent with this Chapter, each Party retains the right to regulate and to introduce new regulations to meet legitimate policy objectives in a manner consistent with this Chapter'.

2.3.2. Financial transaction tax

Capital movement restrictions are normally prohibited both in GATS (Article XI GATS) and FTAs, aside from temporary measures that are allowed because of problems with balance of payments (see balance of payments exception under GATS Article XII). This raises concerns regarding the legality of a Financial Transaction Tax (FTT) under international law.²⁹ As the prudential carve-out is a particularly wide exception, an FTT could easily fall within its scope. At the same time, the recent FTA model includes an exception that allows measures that limit transfers of capital, to achieve clearly defined objectives, including stability of the party's financial system (see box below).

²⁹ G. Dietlein, 'National approaches towards a Financial Transaction Tax and their compatibility with European law', 2012 *EC Tax Review* vol. 4.

Provision permitting capital limitations in the KORUS FTA

Article 13.10 KORUS FTA:

'A Party may prevent or limit transfers ... through the equitable, non-discriminatory, and good faith application of measures relating to maintenance of the safety, soundness, integrity, or financial responsibility of financial institutions or cross-border financial service suppliers. This paragraph does not prejudice any other provision of this Agreement that permits a Party to restrict transfers.'

Article 8.3 of the Korea-EU FTA:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on capital movements, nothing in this Chapter shall be construed to prevent the adoption or enforcement by either Party of measures:

- (a) necessary to protect public security and public morals or to maintain public order; or
- (b) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Chapter including those relating to:
 - (i) the prevention of criminal or penal offences, deceptive and fraudulent practices or to deal with the effects of a default on contracts (bankruptcy, insolvency and protection of the right of creditors);
 - (ii) measures adopted or maintained to ensure the integrity and stability of a Party's financial system;
 - (iii) issuing, trading or dealing in securities, options, futures or other derivatives;
 - (iv) financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities; or
 - (v) ensuring compliance with orders or judgements in juridical or administrative proceedings.

2.3.3. Subsidies and Financial Markets

A final issue regards subsidies to financial markets and other measures that could mean a discriminatory transfer such as bailouts or other measures taken by central banks.

The GATS system does not cover subsidies, while most FTAs explicitly allow subsidies in services (CETA draft Article 9 of chapter 15 or EU-Singapore draft Article 8.1). A specific exception covers measures undertaken by public entities in the pursuit of monetary and exchange policies (CETA draft Article 16 or chapter 15 of KORUS FTA Article 13.10).

3. Regulatory fragmentation and cooperation

Notwithstanding the existence of different international fora for global governance of financial markets, international standards (such as the Basel III prudential requirements) give a lot of discretion to states in the manner and detail of implementation.³⁰ Therefore, implementation of international standards often leads to substantial regulatory divergence across states.³¹ Divergence is particularly problematic for global banks, which are subject to different jurisdictions. Moreover, the recent financial crisis has shown how contagious financial instability can be, as the various cross-border transactions on which financial services rely can also constitute channels

³⁰ Basel III is a comprehensive set of voluntary reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector: current [Basel III requirements](#).

³¹ For more detailed information on the new rules introduced by the US for foreign banks and for the differences between [US and Basel III capital requirements](#).

of contagion. Because of financial market interdependence, and because full harmonisation of financial market regulation at the international level does not exist (rules often only set minimum standards), domestic regulation often has substantial extra-territorial impact.

Extra-territorial jurisdiction means that banks or agents outside the territorial jurisdiction of a state might be required to follow the laws of that state, if the transaction involves a bank or agent under that state's supervision. Sometimes extraterritoriality is even applied when transactions take place completely outside state territory, if the transaction has substantial economic impact in that state. However, this extensive interpretation of extra-territorial jurisdiction is rather rare. The main issue in this context appears when countries have different preferences as to the level of stringency applied. In the aftermath of the 2007 financial crisis, the US immediately chose to implement more stringent rules through the Dodd-Frank Act, enacted in July 2010.³² As the EU financial crisis was followed by a sovereign debt crisis, creating further instability and insecurity in the financial sector, the EU is still in the process of adapting its financial market regulation, but in many cases chose to follow the minimum standards closely, as defined in post-crisis debates in international fora. This creates divergence in the approach to regulating financial markets as borne out by the examples of enhanced prudential regulation for foreign firms and the Volcker Rule.

3.1. Enhanced prudential regulation of foreign firms in the US

3.1.1. *The Dodd-Frank Act and foreign firms*

The Dodd-Frank Act provides that foreign bank holding companies (see Section 165 in the box below) in the US of more than US\$50 billion are subject to enhanced prudential standards.³³ Those standards are required to be non-discriminatory (respecting a national treatment requirement) and should allow equality of competitive opportunities.

Legal basis for enhanced supervision of foreign financial institutions in the US

Section 165 of the Dodd-Frank Act: Enhanced supervision and prudential standards for nonbank financial companies supervised by the board of governors and certain bank holding companies

'(2) Standards for Foreign Financial Companies. – In applying the standards set forth in paragraph (1) to any foreign nonbank financial company supervised by the Board of Governors or foreign-based bank holding company, the Board of Governors shall –

(A) give due regard to the principle of national treatment and equality of competitive opportunity; and

(B) take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.'

This rule obliges foreign bank holding companies located in the US to comply with the same rules as their US counterparts. In consequence, foreign bank holding companies need to comply locally with US capital requirements and can no longer account for capital adequacy levels at the global parent level. This was done to ensure that foreign bank holding companies, large enough to create potential systemic threats, would not

³² The [full text of the Dodd-Frank Act](#).

³³ The [full text of section 165 of the Dodd-Frank Act](#).

be undercapitalised by global redistribution of their capital at parent company level. In response to this host based-approach (for foreign subsidiaries) instead of the group-based approach (traditionally applied to global US firms), and in view of the more stringent capital requirements under US law, two European banks were said to have de-registered their US-based bank holdings in order to avoid application of Section 165.³⁴

To avoid circumvention of the Dodd Frank act and ensure the aim of regulating foreign banks located in the US representing a potential prudential threat, the Federal Reserve Board (hereafter FRB), in charge of the implementation framework of the Dodd Frank Act, issued Federal Regulation YY applicable to foreign banking organisations (FBOs)³⁵ based upon broad interpretation of Sections 165 and 166³⁶ of the Dodd-Frank Act, on 18 February 2014.

3.1.2. *The Federal Regulation for foreign banks enhanced prudential standards*

Federal Regulation YY, implementing the enhanced prudential requirements applicable to FBOs, divides foreign banks into three groups.³⁷ Banks within category 1 (with global total consolidated assets between US\$10 billion and US\$50 billion) have to comply with home country stress tests.³⁸ If their stock is publicly traded, they need a proper risk management system in place (under subpart M of Federal Regulation YY). Banks in category 2 are also considered smaller foreign banking organisations, as their US assets remain below US\$50 billion.³⁹ The latter must comply with a series of prudential requirements from their home country and submit certification thereof to the FRB. Banks in categories 1 and 2 therefore have to comply with home country requirements; the FRB simply verifies that compliance has been ensured. This is because Section 165(1) of the Dodd-Frank Act only refers to **bank holdings of more than US\$50 billion**.

The third category includes banks that have consolidated US assets over US\$50 billion.⁴⁰ Here, Federal Regulation requires compliance with additional prudential requirements. If the large FBOs have total consolidated assets of US\$50 billion or more **and** non-branch US assets⁴¹ of US\$50 billion or more, they must create an Intermediate Holding Company (IHC). This requirement avoids circumvention of the Dodd-Frank requirements as described above (Figures 2 and 3 below illustrate how that requirement imposes the purview of the US regulatory system on all subsidiaries of the foreign bank). The effective date for establishing the IHC is

³⁴ D. Enrich and L. Stevens, [Deutsche avoids Dodd-Frank Rule](#), *Wall Street Journal* 22 March 2012.

³⁵ The [full text of Regulation YY](#).

³⁶ [Section 166 of the Dodd-Frank Act](#): imposes early remediation requirements, which means that at an early stage of decline in assets, the banking organisation subject to enhanced prudential requirement including the foreign bank organisation is required to respect more stringent limitations in terms of capital or liquidity requirements.

³⁷ For an overview of the enhanced prudential requirements for foreign banks, see: D. Polk, '[Foreign Banks: Overview of Dodd-Frank Enhanced Prudential Standards Final Rule](#)', 24 February 2014; See also this blog post from the [Harvard School of Law Forum on Corporate Governance and Financial Regulation](#).

³⁸ [12 C.F.R. §252.122](#).

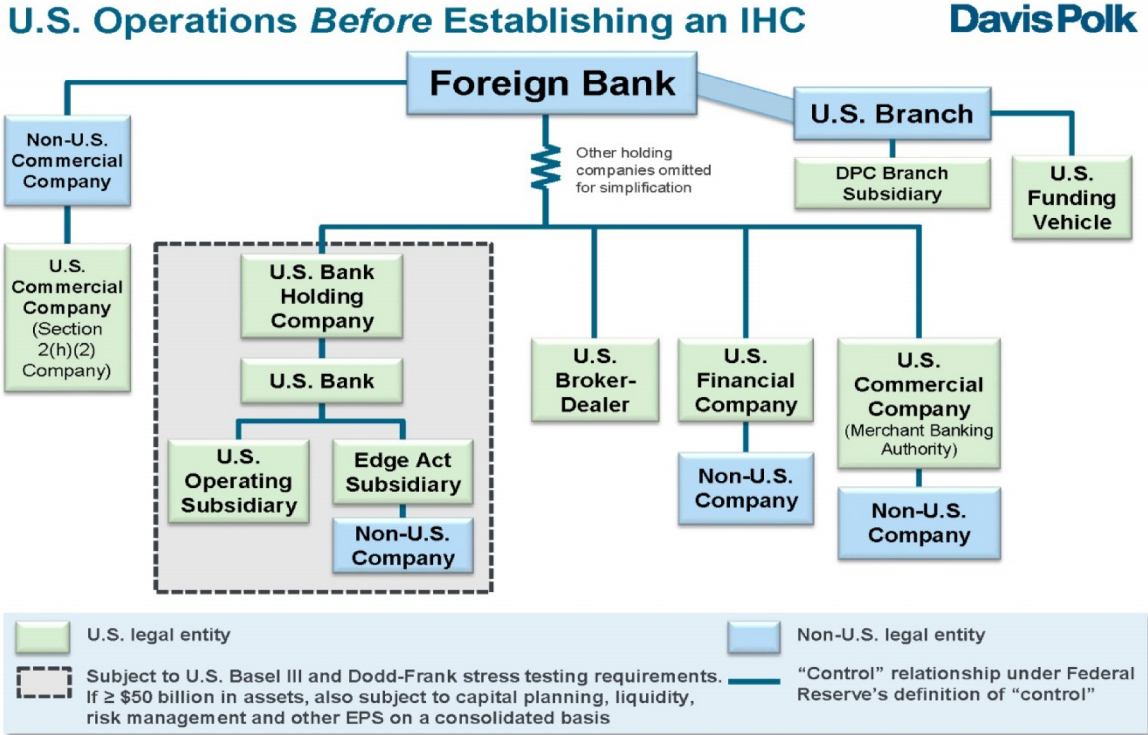
³⁹ [12 CFR §252.140](#) and subsequent provision in Subpart N of Regulation YY.

⁴⁰ [12 C.F.R §252.150](#).

⁴¹ US non-branch assets are defined as the sum of the consolidated assets of each of the FBO's top-tier US subsidiaries, excluding branch and agency assets, see [12 C.F.R. §252.152](#).

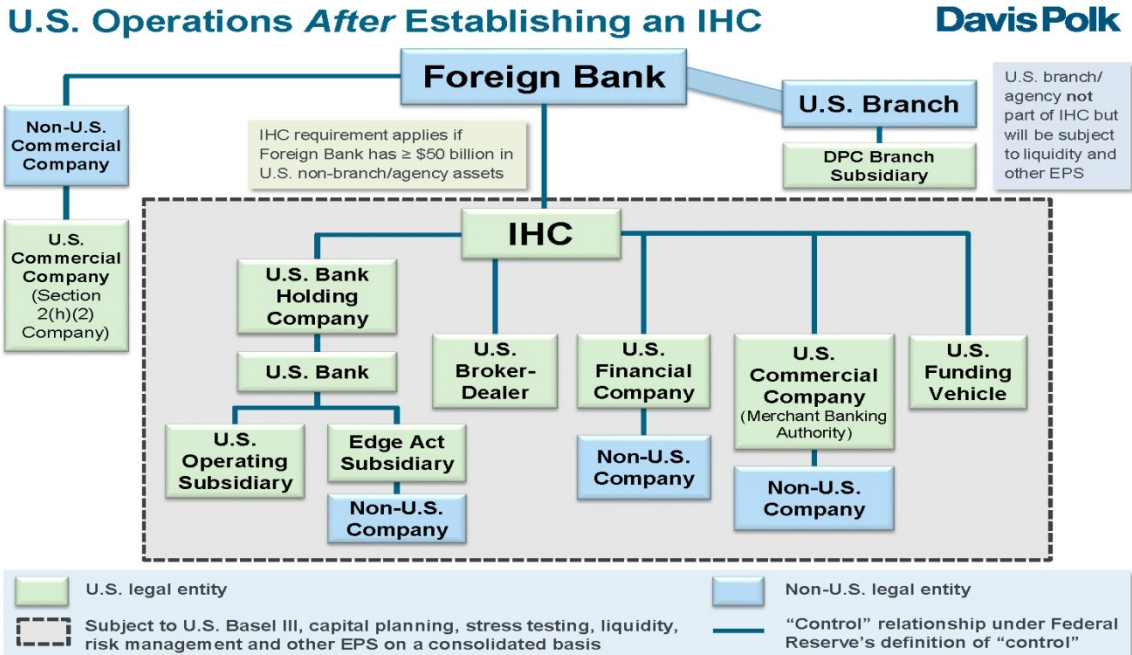
1 July 2016, however FBOs falling under this requirement had to submit an implementation plan to the FRB by 1 January 2015. The IHC will have to meet US Basel III requirements⁴² and comply with the Dodd-Frank Stress Test and liquidity standards.

Figure 2 – Foreign bank organisation before the new Federal Regulation



Data Source: HLS CorpGov.

Figure 3 – Foreign bank organisation after the new Federal Regulation



Data Source: HLS CorpGov.

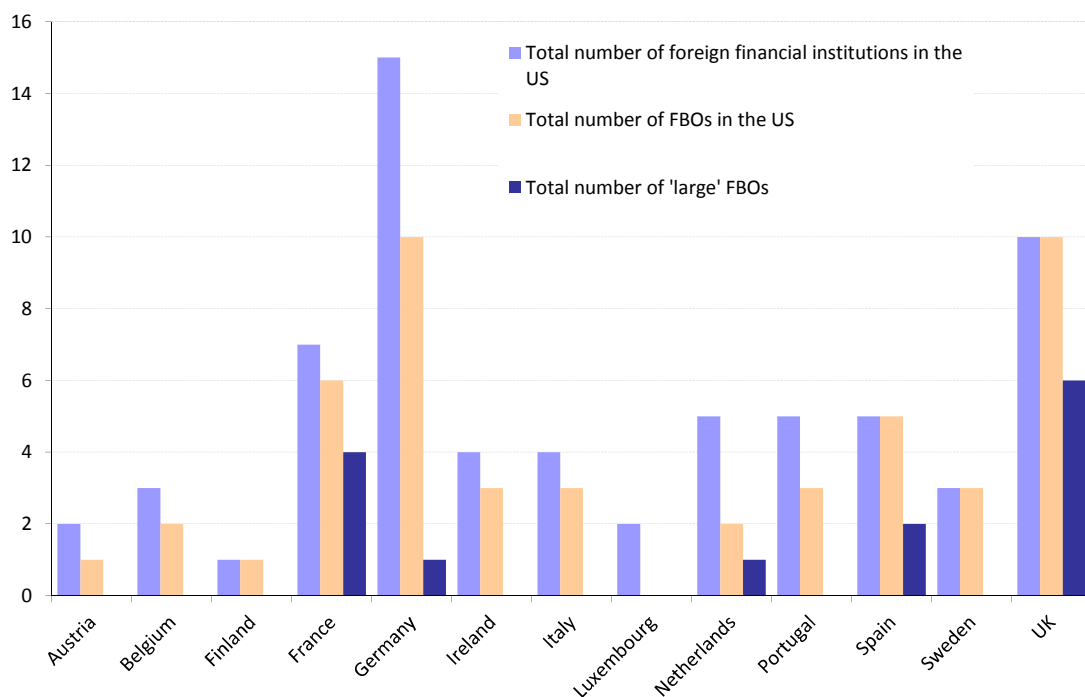
An IHC is an expensive requirement for some banks. Royal Bank of Scotland obtained a waiver from submitting plans for their IHC and will downsize its US operations in order

⁴² Implemented under [12 CFR Parts 324, 325, and 362](http://12CFRParts324,325,and362).

to bring their business below the US\$50 billion US asset threshold.⁴³ In general, European banks consider that US requirements increase costs for larger EU firms operating in the US.⁴⁴ Many banks are planning to reduce their US activities to avoid the rules. Some firms have stated that the treatment of foreign banking organisations under Federal Regulation YY is more stringent than the treatment afforded to similar US banks under the Dodd-Frank Act (mainly because of its host-based approach to the capital requirement for large FBOs).⁴⁵ Further study could analyse whether the regulation of large FBOs does impose a greater regulatory burden than the regulations applied to similar US firms, thus violating the national treatment requirement stemming from Section 165 of Dodd-Frank.

Figure 4 shows the total number of financial institutions from EU Member States located in the US, the number of EU FBOs in the US (i.e. only those institutions that qualify under US law as an FBO)⁴⁶ and the number of EU FBOs with at least US\$50 billion of assets in the US and therefore that would qualify as a 'large' FBO under Regulation YY. The largest FBOs appear to come from France, Germany, the Netherlands, Spain and the UK (see figure 4).

Figure 4 – Total number of financial institutions in the US



Data Source: [List of Foreign Banking Organisations](#) on the FRB website (September 2014); author's calculations.

⁴³ M. Arnold, [Fed gives RBS waiver on foreign bank rules](#), *Financial Times*, 13 January 2015.

⁴⁴ [List of Foreign Banking Organisation and related assets](#) (September 2014).

⁴⁵ For an overview of Dodd-Frank Act requirements for US Banks, see: D. Polk, [US bank holding companies: overview of Dodd-Frank Enhanced Prudential Standards Final Rule](#), 24 February 2014.

⁴⁶ The relevant regulation giving the definition of Foreign Banking Organisation in the US is contained in [Regulation K](#).

Figure 5 – Total assets of EU FBOs in the US⁴⁷

Nationality	Total assets of EU FBOs in the US (in \$US million)
Austria	2 152
Belgium	13 247
Finland	30 499
France	489 955
Germany	285 128
Ireland	2 496
Italy	16 138
Netherlands	93 011
Portugal	2 591
Spain	200 015
Sweden	98 494
UK	520 775

Data Source: [List of Foreign Banking Organisations](#) on the FRB website (September 2014).

3.2. The Volcker rule in the US

Another controversial issue in US-EU financial market regulations relates to the US Volcker rule (see box).⁴⁸

The US Volcker Rule General Prohibition

SEC. 619 Dodd-Frank Act:

'(1) PROHIBITION—Unless otherwise provided in this section, a banking entity shall not—
(A) engage in proprietary trading; or
(B) acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund.'

The Volcker rule, named after Paul Volcker, the economist who originally proposed it, prohibits proprietary trading by banks. Proprietary trading (also 'prop trading') occurs when a firm trades stocks, bonds, currencies, commodities, or their derivatives, or other financial instruments with the bank's own money, as opposed to depositors' money, with the aim of making a profit for itself. Essentially, the firm has decided to profit from the market rather than from commissions from processing trades. The main issue with the proprietary trading prohibition within the Volcker rule is that proprietary trading is part of risk management, allowing banks to hedge against risks. However, a possible connection may exist between speculative trading and proprietary trading. On account of the need for risk management activities, the Volcker rule has introduced

⁴⁷ This table only gives the total asset of the reporting FBOs from EU Member States. Financial institutions not qualifying as FBOs were not obliged to report their assets to the FRB and therefore their data did not appear. This is the reason why Luxembourg does not appear on this table, as none of the Luxembourg institutions listed fell under the definition of FBO in Regulation K (see footnote 47).

⁴⁸ The [full text of the Volcker rule](#).

several exceptions (including an exception for sovereign bonds) that complicate its implementation.⁴⁹

The second prohibition under the Volcker rule is on the acquisition and retention of equity, partnership or ownership interest in hedge funds or private equity. Volcker thus requires a clear-cut separation of owner, between commercial and investment funds such as hedge funds and private equity partnerships.

Several differences exist between the Volcker rule and the Glass-Steagall Act (Banking Act 1933),⁵⁰ enacted after the Great Depression, which prohibited commercial banks from participation in investment banks. The Glass-Steagall Act restricted commercial banks from dealing in underwriting and distributing certain securities but did not restrict proprietary trading, which is the focus of the Volcker rule. Volcker allows dealing in certain securities otherwise prohibited under the Glass-Steagall Act. Clearly the two rules arose from a desire to protect commercial banks from more risky operations, conducted within investment funds, and thus to protect commercial banks' customers.

The Volcker rule poses several issues in transatlantic relations. Due to extra-territorial application of the Volcker rule, any foreign bank with a connection to the US or cross-border transactions involving a US entity and falling under its purview must comply with Volcker. Of the several exceptions introduced, one in particular allows for proprietary trading involving US government bonds.⁵¹ A parallel exception for foreign sovereign bonds⁵² was afforded under specific conditions only to foreign entities trading in the bonds of the country in which their parent is regulated or to foreign affiliates of US entities. These restrictions are considered to be discriminatory, as a bank is not allowed to engage in proprietary trading of sovereign bonds of a comparable risk level to the US government bond.

Finally the extraterritorial reach of the Volcker rule poses problems in transatlantic relations, because EU Member States and the EU itself have taken a different approach to the problem of separating commercial and investment bank activities. The EU Member States' approach has largely been influenced by the Vickers rule in the UK.⁵³ While Volcker insists on owner separation between commercial and investment banking activities, the Vickers approach suggests a functional separation (or 'ring-fencing') between the two banking activities. Vickers dictates particular prudential requirements in order to protect commercial banking operations from the risk-taking activities of investment banks. There are several differences in the Vickers-type approach used by EU Member States (with varying scope in the prohibition and different definitions of functional separation). The Commission proposal for a regulation on structural measures improving the resilience of EU credit institutions⁵⁴ – still under discussion in the EP's Economic and Monetary Affairs Committee after the

⁴⁹ See [12 CFR Parts 44, 248, and 351 and 17 CFR Part 255](#).

⁵⁰ See: [Banking Act 1933](#).

⁵¹ [12 C.F.R. §351.6\(a\)](#).

⁵² [12 C.F.R. §351.6\(b\)](#).

⁵³ See the [2013 Financial Banking Act](#).

⁵⁴ [Proposal for a Regulation of the European Parliament and of the Council on structural measures improving resilience of EU credit institutions](#), COM(2014)043 final.

draft report submitted by [rapporteur Gunnar Hökmark](#) (EPP, Sweden)⁵⁵ was rejected in a vote in the Committee on 26 May – takes a mixed Volcker-Vickers approach. The main problem is how the many different approaches can be reconciled with the extraterritorial reach of the US Volcker rule without impacting on transatlantic trade in financial services.

3.3. Towards regulatory convergence?

The current international standards for financial markets allow for substantial divergence in implementation, and lead to regulatory fragmentation, which can create new costs for transatlantic trade in financial services. For this reason, the European Commission wanted to strengthen transatlantic regulatory cooperation by including financial market regulation in the TTIP negotiation.

3.3.1. *The Financial Market Regulatory Dialogue (FMRD)*

The current framework for transatlantic cooperation is the Financial Market Regulatory Dialogue (FMRD) established in 2002. It brings together representatives of the European Commission, the European Supervisory Authorities (ESAs – the European Banking Authority, European Insurance and Occupational Pensions Authority, and European Securities and Markets Authority) and the US Treasury and independent regulatory agencies, including the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission (CFTC), Federal Deposit Insurance Corporation, and Securities and Exchange Commission (SEC). The members of the EU-US regulatory dialogue regularly exchange information on regulatory developments on both sides of the Atlantic.⁵⁶

One of the main areas of success was to reach agreement on mutual recognition of the different accounting systems used in the EU (the International Financial Reporting Standards, IFRS) and in the US (the US Generally Accepted Accounting Principles, US GAAP) and start a process of convergence.⁵⁷ A decision from the SEC allows EU banks to report in the US using IFRS.⁵⁸

More recently, discussions have covered securities regulation and, in particular, divergence regarding regulation of cross-border swaps transactions. New security regulations feature extraterritoriality both in the US system (under title VII of the Dodd-Frank Act)⁵⁹ as well as in EU rules (EMIR).⁶⁰ EMIR rules have extraterritorial jurisdiction

⁵⁵ See, [draft report on the proposal for a regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions](#) (COM(2014)0043 – C7-0024/2014 – 2014/0020(COD)), 22.12.2014

⁵⁶ [See the European Commission.](#)

⁵⁷ On the process of convergence see the following [European Commission](#); Mutual recognition was granted to US GAAP in 2008 on the basis of the [Commission Decision of 12 December 2008 on the use by third countries' issuers of securities of certain third country's national accounting standards and International Financial Reporting Standards to prepare their consolidated financial statements \(notified under document number C\(2008\) 8218\) \(Text with EEA relevance\) \(2008/961/EC\).](#)

⁵⁸ See the following press release: [Accounting standards: the Commissioner Charlie McCreevy welcomes the US Securities and Exchange Commission's move to end reconciliation to US GAAP](#), 15 November 2007, Brussels, IP/07/1705.

⁵⁹ See also: [CFTC Issues Final Extraterritoriality Guidance Respecting Title VII of the Dodd-Frank Act and Provides Time-Limited Exemptive Relief to Certain Non-U.S. Market Participants](#), 26 July 2013, Linklaters.

⁶⁰ [Regulation \(EU\) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories](#), OJ 201, 27.7.2012, 1-59; see also Columbia

for transactions between an EU and a non-EU entity as well as for transactions between two non-EU entities that may have substantial and foreseeable effects on the EU. Risk of duplication and conflicting compliance in cross-border trade is therefore extremely high, and both the EU and US are actively searching for a solution. To avoid duplication of regulatory requirements, the EU has already decided on equivalence for the regulatory regime of central counterparties with Australia, Hong Kong, Japan and Singapore.⁶¹ However, US agreement on equivalence has been more difficult to achieve. The possibilities discussed at the last FMRD in January 2015 included the application of substituted compliance.⁶² Substituted compliance does not require full equivalence but only an assessment of comparability of the regulatory requirements. Substituted compliance, as foreseen in the US, would allow non-US persons to choose to comply with their home-country regulation (in this case the EU) instead of the rules applied in the US.

3.3.2. Beyond the FMRD: the EU TTIP proposal and related fears

In both accounting standards and the derivatives regulatory issues the two sides are actively interested in finding a mutual solution. The proposal of the Commission to add financial markets to the TTIP negotiation was intended to ensure a stronger commitment to finding that mutual solution.

The EU's initial plan for cooperation in TTIP went beyond the traditional trade agreement provisions encouraging regulatory recognition from GATS (annex on financial services) to CETA (see draft CETA Article 5 of Chapter 15).⁶³ Indeed recognition of regulatory standards and prudential measures are often encouraged in trade agreements, however the standards required and the procedures to obtain such mutual recognition of standards often vary across domestic regulations and may be extremely demanding, making decisions on 'equivalence' of standards very difficult to achieve. For this reason, the EU TTIP proposal⁶⁴ originally included discussions regarding the introduction of provisions aiming at more systematic cooperation and facilitating the negotiation process toward recognition, such as:

1. timely adoption of international standards;
2. mutual consultation before adopting new measures;
3. joint examination of existing rules;
4. assessing possibilities for equivalence.

The second measure proposed by the European Commission, suggesting mutual consultation before adopting new measures, might be particularly controversial for the US. Such an ex-ante mutual consultation could be seen – by some US observers – as a potential imposition of a delay in the process of implementation of the Dodd-Frank Act. While it is certain that the US will want a strong commitment to financial market liberalisation within TTIP and a strong exception for prudential regulatory sovereignty, they will oppose anything that could slow down the pace of reform undertaken in the

Law School: E. F. Greene and I. Potiha, [Issues in Extraterritorial Application of Dodd-Frank's Derivatives Rules: Update with focus on OTC Derivatives and Clearing Requirements](#), 2013

⁶¹ The [draft Commission Implementing Decisions](#).

⁶² [US-EU Financial Markets Regulatory Dialogue Joint Statement of January 2015](#).

⁶³ For a broader discussion of recognition in international finance, see: P-H Verdier, [Mutual Recognition in International Finance](#), 2011, *Harvard International Law Journal*, vol. 52.

⁶⁴ [The EU proposal for Financial Service Regulation Cooperation in the TTIP](#).

field, or that would push for lower standards in prudential regulations. In other words they will oppose anything that might impose a limitation on their regulatory autonomy in the field.

For the moment, the EU has been forced to take financial services regulation off the TTIP negotiating table.⁶⁵ However the Commission still hopes to get agreement on regulatory cooperation within TTIP for financial markets.⁶⁶

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⁶⁵ J. Crisp, [Financial services off the table at next round of TTIP talks](#), Euractiv, 13 June 2014.

⁶⁶ Commissioner Jonathan Hill, speech on '[The transatlantic relationship in financial services: a force for positive change](#)', Brookings Institution, Washington DC, 25 February 2015.

Financial services trade is currently one of the most controversial service chapters in the Transatlantic Trade and Investment Partnership negotiations. One of the main concerns is how the trade agreement may affect the ongoing reform of domestic financial regulations.

Trade agreements ensure regulatory independence in the field. However, regulatory independence has also led to substantial divergence in regulatory requirements. Regulatory fragmentation and the extraterritorial reach of domestic financial regulation have been shown to result in potential conflict, which might raise transaction costs in transatlantic trade in financial services. The US is currently opposed to negotiating stronger cooperation within TTIP, as they fear that the cooperation framework proposed by the EU could slow their domestic reform process.

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