European Journal of Risk Regulation (2024), **15**, 33–48
doi:10.1017/err.2023.70

CAMBRIDGE UNIVERSITY PRESS

MINI-SYMPOSIUM ON REGULATORY DEFERENCE

The Magnificent Seven: Exemption, Relief, Equivalence, Recognition, Substitution, Deference, Trust – Reducing Regulatory Duplication and Frictions in the Cross-Border Supply of Financial Services

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Abstract

A financial services supplier authorised in its home state that wishes to supply services cross-border into another state will, absent any relief, have in addition to meet the regulatory requirements of that host state to trade in it. Regulatory frictions including duplicative regulatory requirements are barriers to cross-border trade. This article considers certain techniques deployed to reduce such barriers, noting that trust plays a part in many of them. These techniques grant relief to incoming firms from obligations to comply with the regulatory requirements of a host state. They may take the form of unilateral arrangements, with or without any conditions. There may be assessments of equivalence as a basis for relief from compliance with the host state's rules: deference to the home state's regime, a basis for recognition, whether unilateral or mutual. Recognition may be given effect through a party's domestic laws or in international law under the General Agreement on Trade in Services (GATS) Article VII. A GATS Article VII agreement can relieve regulatory frictions in the financial services sector alone as there is no requirement for "substantial sectoral coverage" as required for regional trade agreements under GATS Article V. Mutual recognition agreements for financial services in international law are, however, few in number.

Keywords: Cross-border trade; financial services; GATS Article VII; mutual recognition; regulatory duplication

I. Introduction

Access for the UK's financial services firms to the single market through the European Union's (EU) passporting arrangements was brought to an end by Brexit.

The UK's domestic laws, relatively liberal, exempt the supply of some financial services into the UK from the need to comply with domestic authorisation or prudential measures. But exemptions, unilateral, could not provide a basis for UK suppliers to supply similar services into other jurisdictions. Developing access to other financial markets beyond the single market appears desirable.

Readers will be aware that the supply of financial services is typically highly regulated in the domestic laws of developed nation-states, the regulated sectors being specified in legislation. In order to lawfully supply financial services within the perimeter of such legislation, suppliers must typically be licensed (authorised) to do so. To obtain a licence, a supplier will have to satisfy a relevant regulator – the licensing body – that it meets specified standards. Once licensed, the supplier will be subject to supervision to ensure

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compliance, and enforcement action may be taken for non-compliance; outcomes may include fines or withdrawal of its licence.

The globalisation of markets, products and services leads to costs for suppliers in complying with large national differences in regulatory standards.[1] In the negotiation of free trade agreements (FTAs), it has been remarked that when it came to negotiation of financial services, trade negotiators took a back seat to financial regulators. Feketekuty has written of a need to "rid the environment of overregulation and restrictions on entry by foreign service providers".[2]

The reduction of regulatory barriers and duplication has obvious attraction in a post-Brexit world. Provisions for liberalising financial services in the UK's future trading arrangements might take a variety of forms of arrangement for access to other financial markets beyond unilateral exemptions in the domestic law of trading partners.

Provision for cross-border trade in financial services under FTAs has tended to concentrate on the establishment of financial institutions in the territory of the other party, a commercial presence in the host territory.[3] Cross-border supply of financial services was left more to domestic law.[4] Some more recent FTAs have not deviated much from such an approach.[5]

FTAs under the World Trade Organization (WTO) General Agreement on Trade in Services (GATS), Article V, are required to have "substantial sectoral coverage". GATS Article VII has no such requirement for mutual recognition agreements (MRAs). This may provide scope for ambitious arrangements for cross-border trade in financial services. "MRAs are like sector-specific preferential arrangements."[6] Recognition agreements may become of particular interest for the sector.

Recognition had been established long ago under the institutions of the Common Market[7] and for financial services more recently through harmonisation in the single market.[8] A search of the WTO's databases revealed numerous notifications of arrangements under GATS Article VII but few in the way of recognition of financial services, and that despite the articulation in the Annex on Financial Services (AFS) of its application to a Member's prudential measures.[9]

Review of legislation in other jurisdictions and the academic literature and conversations with academics and regulatory officials concerning relief for cross-border suppliers from licensing and supervisory regulation highlighted key terms time and again: exemption, relief, equivalence, substitution, recognition, deference. What was less clear was whether the same term meant the same thing to all, and conversely whether some different terms were understood nevertheless to carry the same meaning.

[1] This despite the activities of the global standards-setters: the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS).

[2] G Feketekuty, "Regulatory Reform and Trade Liberalisation in Services" in P Sauvé and RM Stern (eds), *GATS 2000, New Directions in Services Trade Liberalisation* (Washington, DC, Brookings Institution Press 2000).

[3] North American Free Trade Agreement, 1994 (NAFTA), Art 1403.

[4] See NAFTA, Art 1402.2 (part): "This obligation does not require a Party to permit such providers to do business or solicit in its territory." See also Art 1402.1 for the standstill provision regarding domestic law measures for cross-border services.

[5] See further below at Sections VI.2 and VI.3.

[6] A Mattoo "Comment" in P Sauvé and RM Stern (eds), *GATS 2000, New Directions in Services Trade Liberalisation* (Washington, DC, Brookings Institution Press 2000) p 320.

[7] The *Cassis de Dijon* case: Case 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein*. See below at Section VI.1.

[8] Progressing from minimum to maximum harmonisation directives and more recently to regulations. See, eg, in relation to investment services.

[9] For the meaning of prudential measures, see AFS para 2 and *Argentina – FS*, DS 453, panel report.

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In this regard Zampetti asks: "what does 'recognition' mean and imply?" He adds: "Who is competent to negotiate and enter into legally enforceable mutual recognition commitments? And who is responsible for ensuring their implementation?"[10] He thought there was uncertainty, some of it due to differences between service sectors: recognition of a diploma differs from the recognition of prudential measures in banking. There is, however, a common underlying element to most modes of cross-border regulatory relief: trust.

The aim of this article is to look at the various approaches that can be adopted by a jurisdiction (the host state) to reduce regulatory duplication and frictions so as to facilitate cross-border access for the incoming supply of financial services. In doing so, the article aims to shed some light on the meaning of the terms mentioned above. The different approaches are set out in the following sections and are summarised in Table 1. One apparent distinction is between autonomous recognition in domestic laws and mutual commitments in international law. A subsequent section considers whether GATS disciplines may apply to autonomous or unilateral recognition in domestic law.

As will be apparent, a common theme of these approaches is the disapplication of all or part of a host state's regulatory regime. This article does not purport to offer an analysis of the differing intensities of regulation of the laws and regulations disapplied.

Generally, in the instances considered here, the scope (or perimeter) of the permitted cross-border access is defined and limited by reference to a specified service to be supplied (or activity that may be carried on) by a specified class of service supplier to a specified class of client.

II. Domestic law: arrangements

Before turning to consider the various techniques in domestic law that enable a measure of cross-border access, it may be useful to touch on the nature of arrangements between regulatory bodies as non-state actors.

Arrangements between non-state actors often take the form of Memorandums of Understanding and may have differing aims or scopes: agreeing to share information, to act expeditiously to the benefit of the other jurisdiction's suppliers or to give some measure of relief via domestic law powers from the usual licensing or supervisory requirements. But they have a common purpose of enabling cooperation and trust between the parties. It will be seen further below that some form of arrangement is a typical requirement for a host party proposing to allow any cross-border access other than on an unconditional basis.

Zampetti has observed that, despite arrangements between professional bodies being drafted in the style of treaties, the signatures of such bodies "are not capable of entering into agreements that are binding under international law". Even if the organisations are created by domestic law, they are not generally part of the governmental structure.[11] Such arrangements, even if they are more than expressions of goodwill and the intention is to make them legally binding in nature, could not be regarded as more than contracts under (domestic) laws.[12]

[10] AB Zampetti, "Market Access through Mutual Recognition: The Promise and Limits of GATS Article VII", in P Sauvé and RM Stern (eds), *GATS 2000, New Directions in Services Trade Liberalisation* (Washington, DC, Brookings Institution Press 2000) pp 283–307 at 293–94.

[11] But see, eg, NAFTA Chapter, Cross-Border Trade in Services, at Art 1213.1:

> For purposes of this Chapter, a reference to a federal, state or provincial government includes any non-governmental body in the exercise of any regulatory, administrative or other governmental authority delegated to it by that government.

Such an inclusion of a non-governmental body within the definition of governmental bodies does not make it party to the agreement.

[12] Zampetti, supra, note 10, 295.

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Table 1. Summary of different approaches to the reduction of regulatory duplications and frictions.

Section	Technique/means of access	Law/ regulation	Keywords	Defer/trust
III	Non-application or unconditional disapplication	Domestic	Exemption	NA
IV	Conditional disapplication: supplier-by-supplier access subject to equivalence of supplier's home regulatory regime	Domestic	Exemption, equivalence, relief	No/limited
V	All suppliers, conditional on equivalence of home regulatory regime, optional commitments in arrangements (eg Memorandums of Understanding) between national regulators	Domestic	Equivalence, recognition, relief, deference, substitution	Yes with exceptions/yes
VI	FTAs and Article V of GATS	International	Harmonisation, deference	Limited/yes
VII.1	Mutual recognition arrangements and Article VII (financial services)	International	Equivalence, recognition, relief, deference, substitution	Yes; limited/yes
VII.2	Other mutual recognition arrangements	International	None	No/yes[a]

[a]In the conformity assessment bodies of the other party.
FTA = free trade agreement; GATS = General Agreement on Trade in Services.

III. Domestic law: unconditional exemption

Supply into the territory of a nation-state on an unconditional basis may be permitted typically by exempting suppliers from outside the territory from regulatory requirements of that nation-state. Specified activities are exempt by being (1) specifically exempted from the regulatory obligations that would otherwise apply or (2) kept outside the regulatory perimeter entirely. Thus, a supplier licensed and subject to the regulatory regime in its home state may supply into another (host) territory without the obligation also to obtain authorisation or meet other regulatory requirements of the host state in addition. Examples of this follow.

1. The United Kingdom

The Overseas Persons Exemption is an exemption from the UK's regulatory framework. It exempts certain activities, which would otherwise be regulated activities requiring the person carrying them on to be authorised.[13]

Another example of similar effect functions in a different way: the UK's regulatory perimeter for insurance. The UK has adopted a liberalised position in relation to

[13] See The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI 2001/544 (RAO), Chapter XVII Exclusions Applying to Several Specified Kinds of Activity, Art 72 Overseas persons. As examples, paras 1 and 5 of that article provide:

(1) An overseas person does not carry on an activity of the kind specified by article 14 by –
  (a) entering into a transaction as principal with or through an authorised person, or an exempt person acting in the course of a business comprising a regulated activity in relation to which he is exempt; or
  (b) entering into a transaction as principal with a person in the United Kingdom, if the transaction is the result of a legitimate approach.

(5) There is excluded from article 53 the giving of advice by an overseas person as a result of a legitimate approach.

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cross-border insurance, scheduling the classes of insurance specified in the GATS Understanding on commitments in financial services.[14] A foreign insurer may insure a policyholder or risk situated in the UK without the insurer being regarded as carrying on insurance business in the UK because of the location of the risk alone. Unlike many other jurisdictions, whether the activity so carried on falls within the UK's regulatory perimeter is determined not by the location of the risk insured but by whether a regulated activity is being carried on within the UK.

The UK's key regulated activity is that of effecting or carrying out a contract of insurance as principal.[15] An overseas insurer that does not carry on a regulated activity in the UK remains outside the regulatory perimeter and does not require UK authorisation. Thus can overseas insurers make significant cross-border supply into the UK. The regulatory perimeter for insurance business is complex, has been developed over a number of years by the domestic courts of the UK and is fact-dependent. The case law has set out tests for determining whether a particular state of affairs amounts to carrying on insurance business in the UK.

A leading case described what is required as some continuity or regularity of provision within the jurisdiction of activities that are an integral part of the way in which the insurer conducts its affairs.[16] That the decision to accept the risk is not taken in the UK is not determinative.

In FTAs, the scope for the UK has been described thus: "... insurance activities in the [specified] categories ... are included in the scope of the commitments only where a supplier is carrying on that insurance business entirely outside that Party's territory".[17]

2. *Australia*

In Australia, under the Corporations Act 2001 the Australian Securities and Investments Commission (ASIC) may grant relief from licensing requirements to certain foreign financial services providers (FFSPs) seeking to do business in Australia. ASIC exempted FFSPs from the requirement to hold an Australian financial services licence (AFSL) where

[14] The UK's GATS Schedule for the Financial Services Sectors states (in part):

1. The UK undertakes commitments on Financial Services in accordance with the provisions of the "Understanding on Commitments in Financial Services" (the Understanding).
2. These commitments are subject to the limitations on market access and national treatment in the "all sectors" section of this schedule and to those relating to the subsectors listed below.

The Understanding on Commitments In Financial Services specifies classes of insurance at para 3 under the heading "Cross-border Trade": <www.wto.org/english/tratop_e/serv_e/21-fin_e.htm> (last accessed 18 March 2023). The UK's GATS Schedule for financial services is at <www.gov.uk/government/publications/uk-goods-and-services-schedules-at-the-wto> pp 41 and 94 (last accessed 18 March 2023).

[15] RAO, Art 10.

[16] *Scher v Policyholders Protection Board* [1994] 2 AC 57, per Lord Goff; see also *Re a Company (No 007923 of 1994) (No 2)* [1995] 1 BCLC 594, Ch D, Knox J; and *Secretary of State for Trade and Industry v Great Western Assurance Company* [1997] 2 BCLC 685, Jonathan Parker J.

[17] Eg Australia–UK FTA, Annex 9A (Cross-Border Trade in Financial Services), footnote 3. The categories are:

(iii) credit and suretyship;
(iv) land vehicles;
(v) fire and natural forces;
(vi) other damage to property;
(vii) motor vehicle liability, except in relation to any liability which, in accordance with domestic law, must be insured by an insurer who is authorised under such laws;
(viii) general liability;
(ix) miscellaneous financial loss;
(x) difference in conditions and difference in limits, where the difference in conditions or difference in limits cover is provided under a master policy issued by an insurer to cover risks across multiple jurisdictions.

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the person providing the financial services is a supplier in another jurisdiction, deals only with wholesale clients and whose business is limited to conduct intended to or is likely to induce people in Australia to use the financial services it provides (known as limited connection relief).[18]

This relief has been variously extended, most recently until 31 March 2024, to allow for the outcome of the Australian Government's consultation about the regulation of FFSPs and then the lapsing of subsequent proposed legislation.[19]

IV. Domestic law: supplier-conditional relief

Supplier-conditional arrangements permit the cross-border supply of financial services by a supplier in another nation-state. In order to supply the service, the supplier (the individual entity) must typically satisfy the host state regulator on certain matters. There is no assessment by the relevant host state authority that the supplier's home state's regulatory regime has equivalent standards with a view to permitting access for that jurisdiction's suppliers generally.[20] The supplier itself may, however, have to demonstrate that its home state regulatory regime is of a sufficient standard. There may be a requirement that a cooperation arrangement is in place between the competent authorities of the countries concerned. The incoming supplier may accordingly be relieved of obligations to comply with relevant requirements of the host state.

1. The United Kingdom

A UK manager of alternative investment funds (AIFs) must be authorised by the UK's Financial Conduct Authority (FCA).[21] For a non-UK manager of AIFs, the UK's national private placement regime provides that it may market specified types of AIF in the UK providing it has notified the FCA of its intention to market in accordance with FCA rules and it meets the relevant conditions in the UK Alternative Investment Fund Managers (AIFM) regulation: it does not have to be authorised. There is also a requirement that a cooperation arrangement is in place between the supervisory authorities of the AIFM's home state and the FCA.[22]

Where a UK manager of an AIF wishes to delegate portfolio management functions cross-border to a supplier in another jurisdiction, the position is reversed. It is the UK manager who must satisfy the FCA that the delegate meets specified criteria (many of these are also required if the delegation is to a manager who is not in a foreign jurisdiction). The foreign supplier does not have to be authorised by the FCA.[23]

Recognition is the requirement for lawfully carrying on the regulated activities of an investment exchange. An overseas investment exchange may be recognised by the FCA without having to meet the requirements for recognition of a UK exchange or clearing house. The overseas exchange must, however, satisfy the FCA that there is equivalent protection for investors, safeguards in respect of contract failures, the ability and willingness to cooperate with the FCA and that there are adequate cooperation

[18] See ASIC CO 03/824 for the original Order. See also sufficient equivalence relief below.

[19] ASIC Corporations (Amendment) Instrument 2022/623. Treasury Laws Amendment (Streamlining and Improving Economic Outcomes for Australians) Bill.

[20] See Section V.

[21] RAO, Art 51ZC.

[22] See Chapter 3, National Private Placement, of the AIFM Regulations SI 2013/1773 as amended and FCA Handbook at FUND 10.5.

[23] See Regulation 26 of the AIFM Regulations SI 2013 No 1773 as amended; FCA handbook at FUND 3.10 for delegation of portfolio management functions.

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arrangements between the FCA and its home state regulator. In deciding whether to recognise, the FCA must have regard to the relevant law and practice of the exchange or clearing house's home state.[24]

2. The USA

A not wholly dissimilar approach was discussed in a seminal paper by Tafara and Peterson. It proposed granting relief on the application and at the level of a supplier but with the Securities and Exchange Commission (SEC) conducting an assessment of the other jurisdiction's regulatory standards. As such, it also has some similarities with the techniques discussed in the following section.

> ... the proposed framework relies on a system of substituted compliance with SEC regulations. Instead of being subject to direct SEC supervision and U.S. federal securities regulations and rules, foreign stock exchanges and broker-dealers would apply for an exemption from SEC registration based on their compliance with substantively comparable foreign securities regulations and laws and supervision by a foreign securities regulator with oversight powers and a regulatory and enforcement philosophy substantively similar to the SEC's. The SEC would still retain jurisdiction to pursue violations of the anti-fraud provisions of the U.S. federal securities laws. The comparability finding would need to be complemented by an unambiguous arrangement between the SEC and its foreign counterpart to share extensive enforcement- and supervisory-related information.[25]

This substituted compliance by exempting a foreign firm from SEC registration would "rely primarily on the SEC's exemptive authority".[26]

Granting an exemption would require as a prerequisite an assessment by the SEC of the comparability of the entity's home jurisdiction regulation and the ability of home jurisdiction regulation to achieve the same objectives as mandated by federal securities laws. The objective of the assessment would be to ensure that the regulatory oversight of the two different systems is sufficiently similar.

V. Domestic law: equivalence-conditional relief

Where a nation-state's laws allow it or its competent authority to exercise discretion to carry out an assessment as to whether another nation-state's regime is equivalent, it may, if it so concludes, recognise the other nation-state's regime as such. Accordingly, it may defer to the authorisation (licensing) or prudential measures of the other nation-state, thus granting relief from its requirement to hold a licence and from compliance with the related prudential and supervisory obligations. The effect is that compliance with the other jurisdiction's regime is substituted for compliance for its own, so that a supplier need comply only with the rules of a single (home state) regulatory regime.

Equivalence decisions typically require a regulatory cooperation agreement or similar. This section considers some examples of the use of equivalence techniques as conditions for

[24] Financial Services and Markets Act 2000 Part XVIII Chapter I, ss 287, 288, 289, 292; FCA Handbook at REC 6.

[25] E Tafara and RJ Peterson, "A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework" (2007) 48(1) Harvard International Law Journal 31. SEC-substituted compliance comparability assessment would contain, at a minimum, a comparative assessment of laws and regulations in some fourteen areas, including authorisation; consumer and investor protection, capital requirements, disclosure requirements and corporate governance.

[26] ibid, 54. "Congress has granted the SEC considerable interpretive and exemptive authority about how many aspects of the federal securities laws should be implemented." ibid, 52.

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allowing supply cross-border into the host state's territory. As measures in the domestic laws of a Member, they are unilateral measures of the host state. Whether such unilateral measures may engage certain disciplines set out in GATS Article VII is explored further below.[27]

1. Australia

In 2003 and 2004, ASIC made instruments that conditionally exempted FFSPs from the requirement to hold an AFSL when providing specified financial services when:

(1) the financial services are provided to wholesale clients only;
(2) the provision of the financial services by the FFSP is regulated by an overseas regulatory authority;
(3) the regulatory regime overseen by the overseas regulatory authority is sufficiently equivalent to the Australian regulatory regime;
(4) there are effective cooperation arrangements in place between the overseas regulatory authority and ASIC; and
(5) the FFSP meets all of the relevant conditions of relief contained in the relevant instruments.

It will be observed that one of these requirements was that the foreign regulatory regime be "sufficiently equivalent".[28] This relief has been variously extended, most recently until 31 March 2024, to allow for the outcome of the Australian Government's consultation about the regulation of FFSPs and then the lapsing of subsequent proposed legislation.[29]

2. The USA and Australia

Not long after Tafara and Peterson's article was published, an arrangement was entered into between the USA's SEC, ASIC and the Australian Minister for Superannuation and Corporate Law. A key aim of the arrangement was to provide exemptive relief for specified financial services suppliers: "Each Authority expects to take into account the SEC and ASIC staff assessments in considering exemptive relief, as permitted under each Authority's Laws and Regulations, to certain Market Participants."

The Arrangement did not "provide rights to any Person or alter the rights of any Person under the Laws and Regulations of the Authorities".

The Arrangement relied on the domestic laws of the parties' respective jurisdictions to provide exemptive relief.[30] It did not create rights or obligations in international law. It was supported by a memorandum of understanding between the SEC and ASIC.[31]

[27] National unilateral equivalence arrangements (and the EU's various equivalence measures) are not well evidenced in the WTO's database as amounting to recognition arrangements under GATS Article VII. And see Section VIII.

[28] ASIC Class Orders were made in respect of firms regulated by the UK's then regulator the Financial Services Authority (CO 03/1099), US SEC (CO 03/1100), US Federal Reserve and Comptroller of the Currency (CO 03/1101), Monetary Authority of Singapore (CO 03/1102), Securities and Futures Commission of Hong Kong (CO 03/1103), US Commodity Futures Trading Commission (CO 04/829) and German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin; CO 04/1313).

[29] ASIC Corporations (Amendment) Instrument 2022/623. Treasury Laws Amendment (Streamlining and Improving Economic Outcomes for Australians) Bill.

[30] The Mutual Recognition Arrangement between the United States Securities and Exchange Commission and the Australian Securities and Investments Commission, together with the Australian Minister for Superannuation and Corporate Law, paras 20 and 24, Washington, DC, 25 August 2008.

[31] Memorandum of Understanding concerning Consultation, Cooperation and the Exchange of Information related to Market Oversight and the Supervision of Financial Services firms, Washington, DC, 25 August 2008.

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3. The United Kingdom

In this instance, a supplier in a foreign jurisdiction may supply financial services cross-border into the UK where an equivalence determination of the foreign jurisdiction's regulatory regime has been made in domestic legislation, in provisions that have effect following transitional arrangements upon leaving the EU.[32]

A central counterparty (CCP) in a foreign jurisdiction may provide clearing services to clearing members or trading venues established in the UK. To do so, it must obtain recognition from the Bank of England. A prior requirement is an equivalence decision made by the Treasury (the UK's finance ministry) by regulation recognising that the legal and supervisory arrangements of the foreign jurisdiction ensure that CCPs authorised there comply on an ongoing basis with legally binding requirements equivalent to the requirements for CCPs laid down in Title IV in onshored EMIR.[33] There are other requirements. Broadly, the Bank of England then determines whether the CCP is a Tier 1 or Tier 2 (systemically important) CCP. A Tier 1 CCP will be primarily supervised and regulated by its home authority[34]; a Tier 2 CCP will only be supervised by its home authority if it is granted "comparable compliance" by the Bank. Thus, although the Bank may permit a CCP to be supervised by its home regulator, reliance on home state regulator supervision is at the instance of the Bank and dependent on its view of the firm and its home state regulator.

4. The European Union

EU secondary legislation contains provisions for some ten sectors under which the European Commission can determine a third country's regulatory regime to be equivalent. It has made equivalence decisions in respect of thirty-nine countries.[35]

In February 2017, the Commission Services published a Staff Working Document. It provided a comprehensive assessment of equivalence in financial services and described the Commission's approach to equivalence as outcomes-based, on the assessment of the equivalence of regulatory and supervisory results, not sameness of texts.[36] In 2019, it restated that the assessment was one of overall policy context and the extent to which the

[32] The regime described is that which will supersede the UK's Temporary Recognition Regime (TRR), currently extended until 31 December 2024 (and further extendable), which allows eligible non-UK CCPs to continue to provide clearing services in the UK before recognition is granted, on conditions including application for recognition. See <www.bankofengland.co.uk/eu-withdrawal/information-on-the-effect-of-the-uks-withdrawal-from-the-eu-on-fmi-supervision> (last accessed 22 March 2023).

[33] Art 25 of 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, [2012] OJ L 201, 1 (EMIR, the European Markets Infrastructure Regulation) as "onshored", ie amended by the Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2020/646 Pt 4 reg.20.

[34] If a Tier 1 CCP meets certain criteria, the Bank will carry out a Level 1 informed reliance assessment to determine whether it can rely on the CCP's home authority's regulation and supervision. *The Bank of England's approach to tiering incoming central counterparties under EMIR Article 25*, Statement of Policy, June 2022, p 3 <www.bankofengland.co.uk/-/media/boe/files/paper/2022/boes-approach-to-tiering-incoming-central-counterparties-under-emir-article-25-sop-jun-22.pdf?la=en&hash=A74E9C66FC1797C14605C7A326C30AA91C75A043> (last accessed 4 April 2023). Described as to "defer its supervision in these areas to the home authorities" in *The Bank of England's approach to tiering incoming central counterparties*, News release, 8 November 2021, "defer" is not used in the Bank's Statement of Policy. The arrangement seems closer to discretionary reliance on rather than deference to the home state regulator, at least in the sense used elsewhere in this article; see <www.bankofengland.co.uk/news/2021/november/the-boes-approach-to-tiering-incoming-central-counterparties> (last accessed 4 April 2023).

[35] <https://finance.ec.europa.eu/eu-and-world/equivalence-non-eu-financial-frameworks_en> (last accessed 2 April 2023).

[36] <https://finance.ec.europa.eu/system/files/2017-02/eu-equivalence-decisions-assessment-27022017_en.pdf> (last accessed 31 March 2023).

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regulatory regime of a third country achieves the same outcomes as the EU's rules. It went on to remark: "A positive equivalence decision, which is a unilateral measure by the Commission, allows EU authorities to rely on third-country rules and supervision, allowing market participants from third countries who are active in the EU to comply with only one set of rules."[37]

5. France and Hong Kong

In 2017, two financial regulators, the Securities and Futures Commission of Hong Kong and the French Autorité des Marchés Financiers, entered into a memorandum of understanding to promote reciprocal market access for fund providers by facilitating cross-border offering, marketing and distribution of certain funds to retail investors in France and to the public in Hong Kong.[38] The memorandum of understanding also provides for supervisory cooperation between them. This arrangement does not appear to be based on a decision of equivalence as such under the laws of the parties' respective jurisdictions but on their "common understanding of their regulatory and supervisory frameworks concerning their respective management companies and collective investment schemes".[39]

Supervision of the financial services suppliers and financial services remains with the home authority. There is a streamlined one-month process for authorising covered funds for offering, marketing and distribution in the host jurisdiction, and covered management companies are permitted to offer, market and distribute in the host jurisdiction covered funds they are authorised to manage in their home jurisdiction, subject to conditions set out in the memorandum of understanding. The memorandum of understanding does not create legally binding rights or obligations.[40]

VI. International agreements: free trade agreements and GATS Article V

GATS Article V provides for economic integration agreements by way of a carve-out: GATS "shall not prevent any of its Members" from entering into an agreement liberalising trade in services; however, such an agreement must have substantial sectoral coverage and provide for the absence or elimination of substantially all discrimination between or among the parties in the covered sectors. Such FTAs can only provide for liberalisation of financial services as part of a wider scope.

1. The European Union

Under the Treaties of the European Union, secondary legislation has brought about substantial harmonisation whereby financial services firms can provide services in EU Member States other than their own in a single market, on the basis of establishing a commercial presence in another Member State, or on a "services" basis, supplying services cross-border from one Member State to another.[41]

This is not to diminish the significance of the recognition aspect of the legal framework of the EU. Nicolaidis has described it thus:

[37] <https://ec.europa.eu/commission/presscorner/detail/en/ip_19_4309> (last accessed 31 March 2023).

[38] Memorandum of Understanding (MoU) between the Securities and Futures Commission of Hong Kong and the French Autorité des Marchés Financiers of 10 July 2017 concerning Mutual Recognition of Covered Funds, Management Companies and related Cooperation, Art 2.1.

[39] ibid, Preamble, para 2.

[40] ibid, Art 2.3; see Zampetti, supra, note 12.

[41] See, eg, MiFID II, Directive 2014/65/EU and MiFIR, Regulation (EU) No 600/2014; EMIR, Regulation (EU) No 600/2014.

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> [The EU's] laws and regulations are about the national policies, rules, standards, supervision mechanisms, certification procedures, accreditation processes, and the likes that will, under certain conditions and to different extent, be recognized by the other Member States.[42]

Whilst ever closer harmonisation is the thread running through the single market in financial services through successions of directives and regulations, the European Court of Justice long ago settled mutual recognition as the basis for free movement of goods in the *Cassis de Dijon* case.[43]

Beyond the EU, the following examples of FTAs show less ambition in the provision of cross-border financial services.

2. *The European Union–Canada Comprehensive Economic and Trade Agreement*

Chapter 13 of the EU–Canada Comprehensive Economic and Trade Agreement (CETA) covers financial services and addresses commercial presence (via the definition of "financial institution of the other party") and cross-border services.[44] The chapter contains typical provisions for most favoured nation (MFN), national treatment (NT) and market access (MA) for cross-border supply of financial services; Article 13.7 applies the MFN, NT and MA provisions from Chapter 9 (Cross-Border Services). The financial services that may be supplied cross-border are specified in Annex 13 – A, which contains Annexes of Canada and of the EU. Broadly covering wholesale marine, aviation and transport (MAT) insurance, limited banking services and portfolio management services, the schedules provide for different commitments by each party (including different commitments by different Member States of the EU). Overall, this does not provide an ambitious level of cross-border access to each other's markets.

The chapter also makes explicit provision for recognition of the prudential measures of a third country (reflecting the provision in paragraph 3 of the GATS AFS) unilaterally, by harmonisation or other means or based on an agreement or arrangement with a third country, leaving open the option of more liberal cross-border arrangements with a third country than under CETA.[45]

3. *The UK–Japan Comprehensive Economic Partnership Agreement*

The UK–Japan Comprehensive Economic Partnership Agreement makes general provision for cross-border services.[46] Financial services are set out under Section E, Regulatory framework, under which the domestic regulation of the parties may apply. Thus, parties may apply their domestic licensing or authorisation procedures provided that they shall "not in themselves be a restriction on the supply of a service".[47] Recognition of the parties' licensing or authorisation measures is left for the possibility of a future MRA in accordance with GATS Article VII. Prudential measures are referenced only to clarify that the MFN obligation is not intended to oblige a party to extend to the other party's suppliers the

[42] K Nicolaidis, "Mutual Recognition: Promise and Denial, from Sapiens to Brexit" (2017) 70(1) Current Legal Problems 4.

[43] ibid, 17.

[44] CETA, Art 13.2(1).

[45] CETA, Art 13.5 – Recognition of prudential measures. See <https://finance.ec.europa.eu/system/files/2023-03/overview-table-equivalence-decisions_en.pdf> (last accessed 31 August 2023) for EU equivalence decisions for Canada at 11 November 2022. And cf the equivalence decisions of the EU referred to in Section V.4.

[46] United Kingdom–Japan Comprehensive Economic Partnership Agreement, Chapter 8 Trade in Services, Investment Liberalisation and Electronic Commerce, Arts 8.14–8.19.

[47] ibid, Arts 8.31(2) and 8.35(1).

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benefit of any treatment resulting from "existing or future measures providing for recognition of qualifications, licences or prudential measures as referred to in Article VII of GATS or paragraph 3 of its Annex on Financial Services".

The seemingly broad language – "A Party shall, wherever practicable, defer to the regulatory and supervisory frameworks of the other Party"[48] – thus appears limited to regulatory cooperation: recognising the provision of cross-border financial services by financial services providers will require a further agreement. The agreement does little to reduce duplicative regulatory measures or regulatory frictions for cross-border financial services.[49]

VII. International agreements: mutual recognition agreements and GATS Article VII

1. Mutual recognition agreements in financial services

GATS Article VII and the AFS at paragraph 3 provide a framework for mutual recognition that not only covers licensing and authorisation but also prudential measures. The latter term can be taken to carry a broad meaning given the description in paragraph 2 of the AFS.[50]

In his substantial analysis of the literature and practice of MRAs, Verdier took the view that

> [bilateral mutual recognition] ... will likely be workable only between states with very close levels of financial market development, as well as similar regulatory objectives and capacities. ... mutual recognition arrangements require familiarity on the part of participants with the other country's regulators, markets and firms. Therefore, it is more likely to succeed between countries with preexisting financial links and similar legal systems.[51]

This seems to be reflected in the agreements mentioned in the following subsections: a case may also be made out for similar regulatory objectives and practice. Of the four agreements mentioned, three are between states with similar legal systems (two common law, one German civil law) and only one is between a common law jurisdiction and a civil one.

a. UK–Swiss Confederation on direct non-life insurance

The object of the agreement is to lay down conditions for undertakings of each party to establish agencies and branches in the other party's territory for direct non-life insurance. Except for points specifically covered by the agreement, domestic law applies. The agreement contains a non-discrimination provision.

Opening a branch or agency is subject to authorisation by the host supervisory authority on terms set out as a commitment in the agreement, in place of deference to the home authority.[52] A right to unilaterally amend domestic legislation is express.[53]

[48] UK–Japan Comprehensive Economic Partnership Annex 8-A Regulatory Cooperation in Financial Services.

[49] Nicolaidis, supra, note 42, 1, 4, offers eight "takes" describing mutual recognition – not all of them positive: here, "shunned" might be the most apt.

[50] And see the analysis of "prudential" in the panel report of the *Argentina – FS* case, DS 453.

[51] P-H Verdier, "Mutual Recognition in International Finance" (2011) 52 Harvard International Law Journal 96.

[52] Arts 10 and 11.

[53] Art 39.

https://doi.org/10.1017/err.2023.70 Published online by Cambridge University Press

b. UK–USA Insurance and Reinsurance Agreement on prudential measures

The UK–US Insurance and Reinsurance Agreement continues (and replaces) the EU–US agreement, reducing regulatory burdens based on mutual recognition of equivalent prudential standards. In particular, local presence requirements and collateral requirements for cross-border reinsurance (under specified conditions) are eliminated, and prudential group supervision is done by the supervisor of the worldwide parent undertaking. It also provides for information exchange between supervisors. An example of easing regulatory frictions in cross-border supply, it is relatively narrow in scope.

c. Trans-Tasman Mutual Recognition Arrangement

The scope of the Trans-Tasman Mutual Recognition Arrangement is to implement mutual recognition principles between the parties relating to the sale of goods and the registration of occupations, and its objective is to remove regulatory barriers to the movement of goods and service providers. It sets out mutual recognition principles in Recital G (a good legally saleable in one party's territory may be legally sold in the others; and a person registered to practice an occupation in one party's territory may lawfully practice it in the others) and in the Australian and New Zealand Draft Bills annexed to and agreed by the parties as being consistent with the MRA.

There is thus an agreement to legislate domestically to give effect to the arrangement; the domestic legislation is thus subject to an international commitment.

It extended to securities offerings in 2008 by the Mutual Recognition of Securities Offerings Agreement, which allows an issuer to offer specified financial products in Australia and New Zealand to investors in the other country using one disclosure document prepared under the fundraising laws of its home country.[54]

d. Swiss Confederation–Liechtenstein direct insurance and insurance broking agreement

The Swiss Confederation–Liechtenstein direct insurance and insurance broking agreement provides freedom of establishment and services for insurers and for insurance brokers to pursue their activities in the territory of the other party.

It contains a declaration by the parties that their legal systems for the supervision of insurers and insurance brokers contain equivalent provision for consumer protection, authorisation, supervision, insolvency, legislative breaches and other business irregularities. There is no mention of a framework or criteria for a decision that there is equivalence or sufficient similarity to agree deference. It may be easier to arrive at such a declaration without explicit reference to criteria and assessments given the closeness of the parties' economic relations and legal systems. The agreement nonetheless appears to recognise the domestic autonomy of the parties to legislate in this area as it provides for review whenever there is a change in domestic law.[55]

2. *Mutual recognition agreements in other sectors*

Space permits no more than brief reference to one agreement to illustrate an approach taken to recognition in other sectors.

[54] See <https://ministers.treasury.gov.au/ministers/nick-sherry-2007/media-releases/world-first-comprehensive-mutual-recognition-securities> and <www.fma.govt.nz/assets/Guidance/Offering-financial-products-in-New-Zealand-and-Australia-under-mutual-recognition.pdf> (both last accessed 10 April 2023).

[55] Arts 4 and 11.

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a. UK–USA Mutual Recognition Agreement

The UK–USA Mutual Recognition Agreement may have something to say about structure and flexibility. Interestingly, it relies on definitions of other bodies: the International Organization for Standardization (ISO). The purpose of the agreement is by means of conformity assessment to provide effective market access between the two nations for the products covered by the agreement. The agreement lays down the conditions for acceptance and recognition.

The principle it lays down is: the "host" (importing) party accepts and recognises the results of assessments by the conformity assessment bodies of the "home" (exporting) party that a product confirms to the laws, regulations and procedures of the "host" party in assessing conformity to the "host" party's requirements.[56] This is the basis for a product produced in the "home" party to be lawfully imported into the territory of the "host" party. The conformity assessment procedures are specified in sectoral annexes.

There is no equivalence here, then, and trust only in the exporting ("home") party's conformity assessment bodies to assess in accordance with the importing ("host") party's rules, not in the "home" party's rules themselves.[57] Sovereignty is retained by such arrangements. Changes to domestic law effect contemporaneous changes to an annex.[58]

b. Conformity for financial services?

Applying such a conformity assessment approach to financial services would seem to require the home state to supervise a host state's rules in respect of the supply of services to clients in the host state. This is the reverse of the approach set out by Tafara and Peterson or the EU where the single set of rules applying are those of the home state. Given the volume and complexity of financial services regulation in many jurisdictions, it is hard to see how this could be a practical model for financial services.

VIII. Domestic laws and autonomous recognition in GATS Article VII

A Member may recognise licences or prudential measures of another country for the purpose of meeting its own standards for authorisation and/or in determining how (or whether) to (dis)apply its own prudential measures. The preceding section considered some MRAs. Under GATS Article VII, a Member may also accord recognition autonomously.[59] It is useful to consider whether the article may be engaged by the class of autonomous decisions under Members' domestic laws discussed in Section V.

GATS applies to measures by Members affecting trade in services. Measures can be "in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form".[60] "[M]easures by Members" are measures taken by central, regional or local governments or authorities and by non-governmental bodies in the exercise of powers delegated by such governments or authorities.[61] Measures by financial regulators that are non-governmental bodies may therefore be within scope.

[56] USA No. 5 (2019) at Art 3.2: "The first Party shall, as specified in the Sectoral Annexes, accept or recognize results of specified procedures, used in assessing conformity to specified legislative, regulatory, and administrative provisions of the first Party, produced by designated conformity assessment bodies and/or authorities in the territory of the second Party."

[57] Art 4.3 is specific on this point: "This Agreement shall not be construed to entail mutual acceptance of standards or technical regulations of the Parties." Note the different position on equivalence in the Sectoral Annex for Pharmaceutical Good Manufacturing Practices.

[58] See, eg, Section VII, para 5 of the Sectoral Annex for Electromagnetic Compatibility.

[59] GATS Art VII.1; AFS para 3.

[60] GATS Art XXVIII(a).

[61] GATS Art, I paras 1 and 3.

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A WTO Member (A) seems to accord recognition autonomously where, by a unilateral domestic measure, it grants access to foreign suppliers after determining their home jurisdiction's (B's) authorisation and prudential measures to be sufficiently equivalent: it relieves them from compliance with (elements of) the host territory's (A's) rules and permits compliance with a single set of rules.[62] In such circumstances, what then are Member A's obligations, if any, under GATS Article VII? In considering requests or applications for equivalence and recognition from other Members (C and D), should Member A give adequate opportunity to C and D to negotiate accession to its domestic equivalence regime? And in reaching equivalence decisions, does a similar question arise regarding the non-discrimination provision in GATS Article VII.3?[63] Does the exercise of discretion to take domestic unilateral equivalence decisions, once the legislation is in play, become subject to the disciplines of GATS Article VII.2 and AFS paragraph 3(b), as well as Article VII.3?

The particular framing of a measure providing for the equivalence of other jurisdictions' regulatory regimes may well be said to be within the scope of the recognition of the right of Members to regulate and introduce new regulations to meet national policy objectives[64] and as such not within the scope of the GATS Article VII disciplines. The interesting question of interpretation on the interaction between Article VII and the Preamble is as follows: does the object and purpose of GATS, given the text and context, limit the scope of Article VII disciplines by the right of Members to regulate?[65]

IX. Some concluding observations

First, on the language of rules and regulation: from the examples considered, simple exemption from authorisation and prudential measures is relief from regulations that would otherwise apply. Once the exemption becomes subject to conditions regarding the home state's regulation of the incoming firm – typically whether there is sufficient equivalence – then the relief flows from the deference granted through recognition of sufficient equivalence. Substituted compliance of the host state's rules for those of the home state is deference to the latter. Recognition – typically based on a determination of sufficient equivalence – is the key that unlocks the door to deference.

Second, where does trust fit in? Only where domestic law offers unconditional access is relief for cross-border firms not dependent on trust in a trading partner. Once domestic law introduces conditions for granting relief, whether to a single supplier or more generally in a determination that a foreign regime is equivalent, in addition to consideration of the standards of a supplier's home state regulatory regime, a typical requirement is the existence of a cooperation arrangement between the relieving jurisdiction and the supplier's home state regulator. Such arrangements establish trust between the relevant actors. Trust is a necessary component in the process of reducing regulatory frictions and limiting duplication of regulatory requirements.

Third, it is questioned whether the right to regulate articulated in the GATS Preamble excludes the unilateral provisions of domestic laws from the scope of autonomous

[62] As discussed above, a measure under GATS Article VII, paras 1 and 3 and GATS Art XXVIII(a).

[63] "3. A Member shall not accord recognition 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."

[64] GATS Preamble.

[65] See the Vienna Convention on the Law of Treaties 1969 (VCLT), Art 31, noting sub-para 2. MH Hulme, "Preambles in Treaty Interpretation" (2016) 164 University of Pennsylvania Law Review 1281 at pp 1296–305: "... one relatively uncontroversial role for preambles ... is to limit ... the possible interpretations of a term in question".

https://doi.org/10.1017/err.2023.70 Published online by Cambridge University Press

arrangements contemplated in GATS Article VII.1, or in any event from the application of the disciplines in Article VII.2 and VII.3: "reasonable opportunity"; and avoiding discrimination against other Members. If a decision that appears inconsistent with Articles VII.2 or VII.3 were open to challenge, a challenge before the WTO may be of lesser attraction, if one before a domestic court were an option. In any event, rational grounds for refusal may include consideration of less easily quantifiable geopolitical considerations, including whether any deference can continue to function effectively in a trust-based relationship carried on in good faith.[66] Though a challenge would not seem impossible, any such basis for refusal may present a considerable hurdle to overcome.

Fourth, arrangements (whether or not between states parties) based on domestic laws appear more prevalent than recognition agreements in international law made between states parties. Is this because a unilateral arrangement is a measure over which that Member has the substantial regulatory autonomy that is recognised in the GATS Preamble? It has the benefit of being unilaterally terminable, albeit that domestic transparency requirements including consultation for any change in the law may apply, and that questions of acquired rights may arise under customary international law. Termination of an international agreement would be additionally subject to the withdrawal disciplines of the agreement.

Last, does a MRA under GATS Article VII bring any benefits for financial services? Clearly, one such would bring mutual commitments in and disciplines of international law, including a duty to perform them in good faith. Perhaps simply stated, the expectation on the parties to trust and perform the agreement in good faith can achieve a more stable and enduring expression of recognition and deference. That is of no little importance in a sector where the services can be arrangements for the longer term.

Competing interests. The author declares none.

[66] *Pacta sunt servanda* (Art 26 VCLT) may have no place in a unilateral domestic measure.

Cite this article: JRM Foster (2024). "The Magnificent Seven: Exemption, Relief, Equivalence, Recognition, Substitution, Deference, Trust – Reducing Regulatory Duplication and Frictions in the Cross-Border Supply of Financial Services". *European Journal of Risk Regulation* **15**, 33–48. https://doi.org/10.1017/err.2023.70

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