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## EVOLUTION OF A NEW FINANCIAL ARCHITECTURE THROUGH THE LIBERALISATION OF FINANCIAL SERVICES

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### **Introduction**

The General Agreement on Trade in Services (the 'GATS') seek to liberalise the services sector and improve market accessibility throughout the world. Initial recommendations have been made during the earlier round of negotiations to achieve this purpose. As member countries attempt to commit themselves to the obligations under the GATS, reforms made to financial institutions, structures, and policies would lead to the emergence of a new financial architecture. It would be strengthened by a more prudent regulatory and supervisory framework.

The main objective of future round of negotiations is further deregulation of the services sector, enhanced rules on transparency, improvement in market accessibility particularly, the financial sector, and the "advancement of the neo-liberal agenda of regulatory reform".<sup>1</sup> These measures seek to prepare member countries to face the challenges of globalisation and the exponential growth in future world trade. The economic success of Australia, Singapore and Hong Kong has been facilitated by policies that promote an internationally oriented financial service sector. The rapid growth of the financial service sector in these countries is due to strong macroeconomic management and prudent financial sector regulation.

These pro-active measures were adopted in view of the impending changes to the global economy. It caters to the growth and development of transborder movement of investment capital. As financial markets around the world become more integrated due to technological development, market liberalisation and deregulation would improve access. It would lead to the emergence of a global financial architecture.

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<sup>1</sup>Arup C., *The New World Trade Organization Agreements: Globalizing Law through Services and Intellectual Property*, Cambridge University Press (Cambridge), 2000.

This transformation is further driven by the process of globalisation where the global networked economy becomes more inter-connected and inter-dependent. It is postulated that the new financial order would be characterised by a set of new features such as the “de-territorialization of economic and political affairs, the ascendance of highly mobile, transnational forms of capital, and the growth of global forms of governance”.<sup>2</sup> Countries would be able to benefit from the networked global economy if strategies are adopted to consolidate and re-structure their financial services industry. The existing set of regulation and supervision need to be strengthened to face the challenges of a more liberal financial market.

Since January 2000, more than 140 World Trade Organisation members have participated in a number of multilateral negotiations aimed at striving to achieve a progressively higher level of liberalisation in the global services industry, particularly, the financial services sector. This effort represents part of the continuing process that has been adopted previously by member countries to open and re-structure their service sector. The next round of negotiations would focus on more specific and detailed issues in trade services that are related to the principle of national treatment, market access, proportionality, harmonisation, recognition, and the most-favoured nation obligation in the various services sector.<sup>3</sup>

Earlier attempts on negotiations had remained incomplete following the Uruguay Round of negotiations in 1993. Subsequently, this was followed by a round of negotiations in 1995, which finally culminated in the signing of an Interim Agreement. There was some flexibility provided in the Interim Agreement as it allowed member countries to improve, remove, suspend or reduce their specific commitments in the future round of negotiations.

In 1997, the Agreement on Financial Services (the ‘Agreement’) was signed by 104 countries. The purpose of the agreement was to establish a multilateral rule-based framework for trade in financial services, market access and future liberalisation. It encompasses more

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<sup>2</sup>Weiss L., ‘Globalization and National Governance: Antinomy or Interdependence?’ (1999) 25 *Review of International Studies*.

<sup>3</sup>Trachtman J.P., ‘Trade in Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis’ (1995) 34 *Columbia Journal of Transnational Law* 37.

than 95 per cent of trade in banking, insurance, securities and financial information. As a result, the fundamental rules of non-discrimination espoused by the GATS would now be applicable to this sector of the economy. The Agreement also includes the most-favoured nation obligation, the principle of national treatment, individual country schedules of specific enforceable commitments on market access and national treatment, rules on transparency and a right to seek redress through an internationally agreed dispute settlement procedure.<sup>4</sup>

This discussion would examine the aim of the multilateral negotiations on trade in services set out in the GATS. It would consider the recent measures that have been adopted by some of the regional organisations to fulfil their commitments. It would also examine the reforms that have been recommended for the implementation of the GATS in respect of financial services. It would discuss the possible impact of these reforms on member countries. The economic crisis in countries such as Chile, Russia and in the Southeast Asian region have led to general reluctance on the part of some countries to commit themselves fully to the obligations laid down in the GATS.

### **The General Agreement on Trade in Services**

The GATS consists of a set of rules and provisions that was established by the World Trade Organisation to govern trade in services. Although the member countries have yet to commit themselves fully to complete liberalisation of trade in services at this stage, nevertheless, it is a significant step towards the creation of a basic framework for future negotiations and ultimately, the attainment of the aim of GATS. The initial concern for the liberalisation of trade in services started in the 1980s.<sup>5</sup> It commenced when a group of multinationals persuaded the United States government to establish multilateral trade rules for services.<sup>6</sup> During the Uruguay Round of negotiations, members were faced with the issue of whether "services" should be incorporated into the existing agreement, the General Agreement for Trade and Tariffs

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<sup>4</sup>Wilkinson I., 'The Uruguay Round and Financial Services' (1994) *Butterworths Journal of International Banking and Financial Law*.

<sup>5</sup>Sapir A., 'The General Agreement on Trade in Services: From 1994 to the Year 2000' (1999) 38 *Journal of World Trade* 4.

<sup>6</sup>*Ibid.*

(GATT) or should a new separate agreement for services be established.<sup>7</sup> As Sapir noted:

"Within the economic sphere, this issue boiled down to two separate questions. The first was whether trade in services was considered as sufficiently similar to trade in goods to warrant simply replacing in the text of the GATT the words "goods" or "products" by "goods and services". The second question was whether contracting parties of the GATT had an interest in negotiating concessions within a large pool containing both goods and services instead of within two smaller ponds. Before the launch of the Uruguay Round, it became clear that the balance of arguments (among trade negotiators, although not necessarily among trade economists) tilted towards negative answers for both questions. Despite similarities with trade in goods, trade in services was considered idiosyncratic ... The result was two separate negotiating tracks for trade in goods and for trade in services, leading to two separate agreements."<sup>8</sup>

The issue was resolved when the members decided to introduce a new agreement that focussed primarily on trade in services alone. The GATS acknowledged that trade in services differs from the concept of services as it involved a degree of proximity between a supplier and a consumer.<sup>9</sup> The initial focus of the GATS is on three primary service sectors, namely, the financial services, basic telecommunications, and transport sectors.

A conducive set of domestic regulation fosters the growth of international transactions especially transactions that are mobile in nature. This view was further supported by the World Bank. Liberalisation of trade in services was important as services accounted for a large percentage of production in many countries. The value was estimated to be between 60 to 70 per cent in developed countries, particularly in the fast growing areas related to finance, health and telecommunications.<sup>10</sup> In its report, the World Bank estimated that the

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<sup>7</sup>*Ibid.*

<sup>8</sup>*Ibid.*, at page 52.

<sup>9</sup>The World Bank Group, *International Trade and Development: Trade in Services*. Available at: <http://www.worldbank.org/wbiep/trade/services.html>. [September 21st 2000]

<sup>10</sup>*Ibid.*

share of services in world trade and investment have been the fastest growing components of world trade since 1985 with an estimated value of more than US\$1.3 trillion in 1999.<sup>11</sup> The present 50 per cent of annual world foreign direct investment flow in services is expected to increase significantly in future.<sup>12</sup>

### Liberalisation of Financial Services

The basic foundation of an economy is determined by the strength of its financial market. Investment input from domestic and foreign savings is able to obtain optimal returns if a financial market is supported by a sound regulatory framework. This is vital as weak macro-economic management policies and practices would lead to the quick exit of investment as shown in the financial crisis in Southeast Asia. A prudent regulatory and supervisory framework needs to be established in view of the development of Internet technology, electronic commerce, and the emergence of new financial instruments such as derivative instruments. The expansion of credit, reduced costs of borrowing, and better risk sharing are some of the benefits from international trade in financial services fostered by an efficient financial market.

From the perspective of financial services, the GATS consists of three components, namely the:

- (i) general GATS obligations, disciplines and other provisions;
- (ii) GATS Annexes on Financial Services which takes into account the special needs of the financial sector; and,
- (iii) specific commitments related to market access and national treatment that are set out in the individual member schedules.<sup>13</sup>

According to the GATS Annex on Financial Services, financial services encompasses a wide range of services, that is :

- (i) activities that are conducted by a central bank, monetary authority, public entity in pursuit of monetary or exchange rate policies;

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<sup>11</sup>*Ibid.*

<sup>12</sup>*Ibid.*

<sup>13</sup>Finance Canada: Consultation Paper for the World Trade Organization Negotiations on Financial Services. Available at: [http://www.fin.gc.ca/gats/wto2000\\_1e.html](http://www.fin.gc.ca/gats/wto2000_1e.html). [September 28th 2001]

- (ii) activities that are a part of a statutory system of social security or public retirement plans; and
- (iii) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the government.<sup>14</sup>

The Annex also defined financial services as services that are related to banking, insurance and securities business. Insurance services are further divided into insurance and insurance-related services. Banking and other financial services comprise of previous traditional services and other international finances. Services are provided in four different ways:

- (i) through cross-border supply,
- (ii) consumption abroad,
- (iii) commercial presence, and
- (iv) the presence of natural persons.

### **The Initiatives of Regional Organisations**

Among the regional organisations, the Organisation for Economic Cooperation and Development (the 'OECD') appears to be at the forefront in the pursuit of liberalisation of trade services. The OECD's recognition of the importance of the financial market and financial services liberalisation was reflected in the implementation of the OECD Code of Liberalisation of Capital Movements ("the Code") in 1961.<sup>15</sup> In 1992, new liberalisation obligations pertaining to the provision of banking and financial services on a cross-border basis were incorporated into the Code. It constitutes legally binding rules, stipulating progressive, non-discriminatory liberalisation of capital movements, the right of establishment and current invisible transactions.<sup>16</sup> As a legally binding agreement, the Code also provides a framework for notification, examination and consultation.

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<sup>14</sup>*Ibid.*

<sup>15</sup>The OECD Code of Liberalisation of Capital Movements. Available at: <http://www.oecd.org/daf/investment/legal-instruments/codes.html>. [June 18th 2000]

<sup>16</sup>*Ibid.*

The OECD supports the effort of the GATS in encouraging the liberalisation of trade in services and movement of capital. This support finds concrete expression in the Code, which bind the member countries. The Code is a multilateral instrument that promotes the liberalisation of a full range of international capital movements. Members are engaged in the process of progressive liberalisation, which is similar to the GATS. In 1994, most of the OECD members had dismantled their controls on capital movements save for the new members, the Czech Republic and Hungary.<sup>17</sup>

Similarly, efforts have been made to liberalise financial services by the Asia Pacific Economic Cooperation group (the 'APEC').<sup>18</sup> One of the key objectives that have been agreed on by the APEC Ministers and Leaders was the deregulation and removal of impediments to trade in services. Liberalisation of financial services has been carried out by eliminating regulatory and administrative barriers. In 2000, APEC's strong commitment towards fulfilling the obligations set out in the GATS was reflected in the setting up of the APEC Committee on Trade and Investment and the implementation of the APEC Principles to Enhance Competition Policy and Regulatory Reform.<sup>19</sup> It would strive to publish annual reports detailing deregulation initiatives by member countries on the Internet.<sup>20</sup> The move for greater transparency in regulatory regimes is designed to strengthen the international financial architecture. It also attempts to improve the transparency of highly leveraged financial institutions. One of the priority areas that have been identified by APEC is the development of a safe and efficient capital market. Initiatives to preserve and strengthen market liberalisation remained as one of APEC's priorities in the September 2000 APEC meeting in Brunei.

Steps have also been taken by the Association of Southeast Asian Nations (the 'ASEAN') to liberalise trade in services. On 15 December 1997, the members signed a Protocol to implement the Second Package

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<sup>17</sup>*Ibid.*

<sup>18</sup>APEC, Introduction: APEC's Three Pillars. Available at: <http://www.apecsec.com>. [June 18th 2000]

<sup>19</sup>*Ibid.*

<sup>20</sup>*Ibid.*

of Commitments under the ASEAN Framework Agreement on Services (the 'Protocol').<sup>21</sup> The Annexes to the Protocol consist of horizontal commitments, schedules of specific commitments, and the most-favoured nation exemptions. The purpose of the Protocol was to eliminate all restrictions to trade in services, liberalise trade in services beyond the commitments under the GATS, and conduct rounds of negotiations related to specific commitments to market access, national treatment and other additional commitments.<sup>22</sup>

The Leaders of ASEAN have adopted a common position in reforming the international financial architecture. There is urgency in calling for wider involvement in the implementation of these reforms as some of its members gradually recover from the financial crisis. The members have committed themselves to reviewing the rules of the international financial industry and international regulatory bodies. Besides enhancing the ability to contain and resolve financial crisis through prudent regulation, the members realised that liberalisation in financial services would also lead to greater efficiency and stability.<sup>23</sup>

### **Reforms in Financial Services**

Generally, the GATS comprise of three tiers, that is:

- (i) firstly, the basic commitments and rules of general application,
- (ii) secondly, the horizontal and sectoral commitments contained in annexes, protocols, and Ministerial decisions, and finally,
- (iii) with respect to financial services, a combination of two annexes, two protocols, and a number of decisions on financial services.<sup>24</sup>

Financial services that are covered by the GATS fall into two categories, namely, insurance and insurance-related services and banking and other financial services. The round of negotiations which started

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<sup>21</sup>The Sixth ASEAN Summit Meeting, Hanoi, 1998. Available at: <http://www.asean.or.id>. [June 19th 2000]

<sup>22</sup>*Ibid.*

<sup>23</sup>*Ibid.*

<sup>24</sup>Simser J., 'GATS and Financial Services: Redefining Borders' (1996) 3 *The Buffalo Journal of International Law* 33.



prior to 1 January 2000 known as "GATS 2000" was aimed at improving "the institutional architecture of the GATS and the specific commitments contained in the national schedules".<sup>25</sup> Future negotiations are likely to be sectoral in nature rather than an across-the-board approach.<sup>26</sup>

The commitments laid down under the GATS include an agreement to allow financial service suppliers to expand their operations to other foreign jurisdictions. There is also a provision for member nations to remove barriers that prevent financial service suppliers from setting up branches, subsidiaries, and agencies in their local jurisdiction. Impediments such as refusal to grant licences to establish branches and other forms of indirect discriminatory barriers would be dealt with according to the principles of 'national treatment' and 'market access'.<sup>27</sup> Proponents of liberalisation argued that it would help to create a strong and stable global financial system as member countries are encouraged to pursue a more efficient macroeconomic and regulatory policy.

The liberalisation of trade in financial services is also aimed at creating a transparent and accountable public and private sector.<sup>28</sup> The reforms are necessary to create a sound regulatory framework that would establish a resilient domestic financial system, especially in view of the volatile nature of financial markets.<sup>29</sup> Although member states are responsible for the prudential supervision of their own domestic financial institutions, the contagion effect of weak regulation and supervision has also been experienced by other nations. An example is the repercussions from the collapse of the baht in Thailand where its effect spread to Malaysia, Indonesia, and Russia. Thus, any weaknesses and crisis that occur in one country would also trigger a chain reaction in other countries. Overall, the financial crisis resulted in the general slowdown of the global economy.

The objective of financial service liberalisation seems to contradict with the call for more regulation. Liberalisation and regulation appear to be two dimensions that contradict each other. On the one hand, liberalisation means the removal of regulations that impede free trade

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<sup>25</sup>*Supra* note 5.

<sup>26</sup>*Ibid.*

<sup>27</sup>*Ibid.*

<sup>28</sup>Key S.J., 'Trade Liberalization and Prudential Regulation: The International Framework for Financial Services' (1999) 75 *International Affairs* 1.

<sup>29</sup>*Ibid.*

in financial services. However, on the other extreme, liberalisation requires the support of a strong regulatory and supervisory framework.<sup>30</sup> These two contradictions would require a careful re-examination. It would probably form one of the critical agendas in future rounds of negotiations.

The liberalisation of financial services is aimed at enhancing international competition and efficiency in the banking, securities and insurance markets. Investors and consumers benefit from the wider choice of financial services at lower operational costs.<sup>31</sup> The GATS aspires to improve financial intermediation and investment opportunities. It strives to encourage countries to improve their macroeconomic management and related practices. Countries are able to benefit from the removal of discriminatory and non-discriminatory impediments if regulatory reforms adhere to stringent international standards.

In the earlier round of negotiations, many countries were reluctant to commit themselves to the GATS. A climate of doubt and suspicion seemed to prevail during such engagements. This is part of reality since any decision would have significant repercussions on a country's social, economic and political structure. However, Sauve reported that there has been a change of attitude among countries concerning the liberalisation of financial services. He observed that the round of negotiations of the GATS was conducted in a more positive atmosphere with a "relative lack of engagement and defensive posturing" by developing countries.<sup>32</sup> This change of attitude may augur well in future GATS round of negotiations as:

"These latter developments suggest that the GATS 2000 round of negotiations is likely to start on a much sounder footing than the Uruguay Round did. Indeed, the coming round will take place against the backdrop of a body of rules that is by now familiar to all GATS members. The complex language and geometry of GATS rules have by now been mastered. Moreover, and partly through experience

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<sup>30</sup>*ibid.*

<sup>31</sup>Liberalizing Financial Services Helps Economies without Compromising their Right to Regulate. Available at: [http://www.wto.org/english/news\\_c/pres97\\_e/pr76\\_e.htm](http://www.wto.org/english/news_c/pres97_e/pr76_e.htm) [August 15th 2000].

<sup>32</sup>Sauve P., 'Developing Countries and the GATS 2000 Round' (2000) 34 *Journal of World Trade* 2.

gained in negotiations on services and investment conducted at the regional level, developing countries have largely reversed their rule-making deficit in the area. In some of the outstanding areas of GATS rule-making, notably the development of emergency safeguard provisions, developing countries are in fact assuming a leadership role.<sup>33</sup>

### Possible Impact of these Reforms

The liberalisation of financial services would promote the creation of a more efficient global financial market.<sup>34</sup> It fosters the expansion of credit facilities among international investors,<sup>35</sup> lowers the costs of borrowing, and enables a better degree of risk sharing.<sup>36</sup> It would also remove barriers to market access as countries open up their financial markets gradually according to their schedule of commitment. It would enable a more efficient allocation of resources as international capital investors seek optimum returns around the world. Ultimately, improved market accessibility would enable consumers to gain from their investments. In addition, the prudent supervision and regulatory framework that has been set up would enable the interests of investors to be protected.

At present, the value of financial transactions in international markets has been reported to be worth trillions of dollars. In 1994, it was estimated that the value of assets among banks in the world was worth about US\$40 trillion whereas the value of foreign assets was about US\$8.6 trillion in 1995.<sup>37</sup> On the other hand, the value of foreign

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<sup>33</sup>*Ibid.*, at pages 86-87.

<sup>34</sup>The World Bank Group, 'International Trade and Development: Trade in Services'. Available at: <http://www1.worldbank.org/wbiep/trade/services.html>. [August 19 th 2000]

<sup>35</sup>It has been estimated that the value of cross-border trade in services amounted to about US\$1350 billion in 1999. The figure constitutes almost 20% of total cross-border trade.

See [http://www.wto.org/english/tratop\\_e/serve\\_gats\\_factfiction1\\_e.htm](http://www.wto.org/english/tratop_e/serve_gats_factfiction1_e.htm) [October 9th 2001]

<sup>36</sup>*Ibid.*

<sup>37</sup>The Results of the Financial Services Negotiations under the General Agreement on Trade in Services (GATS). Available at: <http://www.wto.org> [January 10th 2001].

exchange turnover in the world was about US\$1.2 trillion in 1995.<sup>38</sup> The tremendous volume transacted among international financial markets, securities trading, and derivative markets exerts a significant impact on the growth of the financial sector. With improved market access in the future, the value of these transactions would increase exponentially when markets allow greater movement of international capital.

In the OECD, the process of deregulation of the financial services industry has been reported to have resulted in a number of benefits. There have been major gains in financial sector productivity, lower prices, improved quality, choice and variety of financial services available to OECD member countries.<sup>39</sup> Similarly, in a study entitled, "Open Markets in Financial Services and the Role of the GATS", the benefits of reforms in liberalisation include the enhancement of competition, improvement in sectoral efficiency, lower costs, a greater choice of financial services that are available, improved financial intermediation and investment opportunities, sound macroeconomic management, domestic policies, credit markets, financial sector regulation and supervision.<sup>40</sup>

Previously, the financial services sector was one of the most heavily regulated and protected service sectors. Governmental involvement and abundant regulations were created based on the justification that the financial sector is one of the most vital sectors of the economy. It determined the social, economic and political stability of the country. Protectionism was based on the excuse that any systemic failure would threaten the economic stability of the country. Most of the governmental involvements were in four areas, that is, in macro-economic policy management; prudential and non-prudential regulations; and trade restrictions related to market accessibility. The government played a vital role in maintaining a safe and sound financial system, which was

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<sup>38</sup>*Ibid.*

<sup>39</sup>Financial Markets: Regulatory Reform in the Financial Services Industry. Available at: <http://www.oecd.org/daf/financial-affairs/markets/regulatory-reform.html> [January 10th 2001]

<sup>40</sup>*Supra* note 31.

protected from market failure and systemic risk. Ultimately, it was the government that was responsible for the success or failure of its policies.

Conversely, the economic gains from financial services trade liberalisation cannot be ignored. To a certain degree, liberalisation policies that are supported by an appropriate domestic supervisory and regulatory regime enable the domestic market to increase its competitiveness. International efforts to improve regulatory and supervisory standards across countries would improve and reduce risk. As countries commit themselves to the obligations set out in the GATS, there is a need to maintain a high standard of regulation and supervision. It is likely that more countries would give serious consideration to compliance with international standards and codes of good practice in both finance and accounting. Adherence to the international prudential standards would help the countries to establish a stable financial system as a corpus of sound and professional principles are stringently complied with.

Another impact of the reform is the systematic and progressive sequencing of the removal of restrictions. The agreement envisages gradual compliance with the commitments, as some countries are more prepared to liberalise their markets at a faster pace than others. Thus, the depth and timing of liberalising commitments must be negotiated carefully. Countries that have weak regulation and supervision would be exposed to tremendous risk. This was shown in the currency crisis that afflicted Southeast Asia and Russia. One of the reasons that gave rise to the crisis was the early liberalisation of their financial market. As a result, the countries were not prepared to face the sudden withdrawal of foreign capital. The reform requires proper planning and regulation of free movement of portfolio capital. It must allow both developed and developing countries to obtain optimal benefits. On the other hand, there is a fear that the benefits of comparative advantage enjoyed by developed countries would far exceed that of the developing countries. A sufficient level of protection should be provided at the initial stage as noted by Key in the following observation:

“At the same time, adequate prudential regulation and supervision must be put in place to enable the maximum benefits to be obtained from liberalization while minimizing the risks. That is, measures to

promote competitive markets must be complemented by measures designed to ensure the stability of the financial system and to provide adequate protection for consumers of financial services.<sup>41</sup>

Deregulation of the financial markets would require the implementation of a competition policy, as it is likely that financial service suppliers would be involved in anti-competition practices. The regulation and the removal of barriers are sensitive domestic issues as it involves "complex transitional issues and formidable challenges of regulatory redesign".<sup>42</sup>

A possible impact of commitment to the obligations of the GATS would be the removal of market access restrictions in emerging markets. The role of regional organisations such as APEC, NAFTA, ASEAN, and the OECD would become more important in the future. However, issues that concern impediments to trade in financial services such as the restriction of limits on licences based on quotas, the use of the 'economic means test', the imposition of moratorium or freeze on new bank licences due to reasons such as over-banking and excessive competition would become critical in future rounds of negotiation. Some of these issues involve political sensitivity.

The operations of domestic financial institutions would be influenced by the establishment of a number of foreign financial institutions. Local institutions have to raise their productivity and efficiency to compete with foreign investors who are endowed with a large capital reserve and innovative financial products. Efficiency and productivity would increase in the long term.

Previously, the number of domestic financial institutions was small and the regulatory framework was deemed to be adequate to deal with any form of malpractice. However, the liberalisation of financial markets would lead to an increase in the number of financial institutions. This increases the likelihood of conflict with domestic legislation. Such inconsistencies could be addressed with greater international coordination. A domestic center for dispute settlement that deals specifically with financial markets could be established, to resolve the dispute in a fast and effective manner.

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<sup>41</sup>*Supra* note 28.

<sup>42</sup>*Supra* note 24.

It is likely that the structure of financial services regulation would change when the GATS provisions are implemented. There would be a shift from the market-based decision-making approach to one that involves strict disclosure and compliance with international rules of accounting. Member countries must adhere to measures that promote full transparency and disclosure concerning the supply of financial services. It allows banks that intend to operate in foreign markets to know the precise domestic regulatory requirements.<sup>43</sup> As countries improve their standards of disclosure and transparency, there is a possibility that deregulation would be followed by re-regulation in terms of a stronger prudential and supervisory framework.<sup>44</sup>

At the international level, disputes are normally settled under a dispute settlement mechanism established by the World Trade Organisation. However, existing commitments can be withdrawn by members provided compensation is paid to their trading partners.<sup>45</sup> Although a country may participate in the GATS, nevertheless it may be argued that this does not reflect the true degree of commitment to improving market access.<sup>46</sup> As a measure to minimise incidents of backsliding, the structure of regulation at an international level has to be re-examined in the future.

In addition, there are some imbalances that have to be addressed by member countries. An example is the imbalance in the negotiation of leverage between developed and developing countries. As such, remedial strategies have to be used to resolve the issue of national priorities. Some flexibility is required in the next round of negotiations to accommodate these differences.

The liberalisation of financial services would mean that state control over the movement of transnational capital has diminished. The advent of Internet technology, electronic mail, and electronic commerce enables cross-border movement of trillions of dollars daily. In 1989, the volume of transactions on the foreign exchange was estimated to be about

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<sup>43</sup>*Ibid.*

<sup>44</sup>Eichengreen B., *Toward a New International Financial Architecture: A Practical Post-Asia Agenda* (1999) Institute for International Economics, Washington D.C.

<sup>45</sup>*Supra* note 28.

<sup>46</sup>*Ibid.*

\$640 billion a day.<sup>47</sup> In the early 1990s, the value exceeded \$1.2 trillion a day.<sup>48</sup> The porosity of national borders indicates that any efforts to monitor the electronic movement of capital are futile. The role of the State and its physical boundaries tend to become less relevant today.<sup>49</sup> States seem to have lost their autonomy and sovereignty. On the other hand, critics have argued that what has actually happened is the contrary. The role of the State has, in fact, increased rather than retreating. According to Gray, it is the State that creates a free and liberal market.<sup>50</sup> He argued that "the truth is that free markets are creatures of state power".<sup>51</sup> It is the State that provides the authority to allow greater market accessibility. This argument was supported by Helleiner's analysis of the evolution of global finance where he states that "financial globalization has also been heavily dependent on state support and encouragement".<sup>52</sup>

A further impact of the reforms would be the consolidation of present market opportunities in the world's major financial markets.<sup>53</sup> The new multilateral agreement would provide a higher level of certainty concerning access to financial markets, as the signatory countries are not allowed to introduce new restrictions in the areas that they have made a commitment.

### Limitations

The liberalisation of financial markets and services require financial, technological and innovative planning. A high level of technological development is required to meet the demands of the electronic age.

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<sup>47</sup>Greider W., *One World, Ready or Not: The Manic Logic of Global Capitalism* (1997) Penguin Books (London).

<sup>48</sup>*Ibid.*

<sup>49</sup>*Supra* note 24.

<sup>50</sup>Gray J., *False Dawn: The Delusions of Global Capitalism* (1998) Granta Books (London).

<sup>51</sup>*Ibid.*, at page 17.

<sup>52</sup>Helleiner, 'Post-globalization: Is the Financial Liberalization Trend Likely to be Reversed?' cited in Clark I., *Globalization and International Relations Theory* (1999) Oxford University Press (Oxford) at page 47.

<sup>53</sup>Wilkinson I., 'The Uruguay Round and Financial Services' (1994) *Butterworths Journal of International Banking and Financial Law*.



Some countries will be required to upgrade their technological resources to integrate their economy into the global market.<sup>54</sup> An example is China, where domestic reform and modernisation, particularly in the financial services sector, would require the import of equipment and technology that have been estimated to be about US\$250 billion a year.<sup>55</sup> Countries that have limited economic and technological resources would not be able to derive optimum benefits from the reforms recommended in the GATS.

The volatile nature of the flow of capital presents a tremendous risk. Some member countries are reluctant to make a firm commitment to liberalising their markets according to the obligations set out under the GATS due to the level of risks involved. The high degree of risks was evident in the financial crisis in Mexico, Chile, Russia, and in Southeast Asia. The effects of a financial crisis such as massive unemployment, social and political unrest threaten the stability of a nation.

In 1988, the value of foreign investment in Asian stocks was US\$2.5 billion and by 1993, it rose to US\$38.9 billion.<sup>56</sup> Between 1975 to 1994, the South Korean stock market rose to 1604%, Malaysia was 1733% and Thailand, 1711%.<sup>57</sup> The collapse of the financial market in Mexico served as an early warning to the impending Southeast Asian crisis. However, it was ignored by the authorities and legislators. In Thailand, the decline in exports, increase in foreign debt, and the downturn in the property market were some of the reasons that accounted for the collapse of the economy. It was aggravated by hedge fund activities that speculated on the Thai baht. Similarly, in Russia, the financial crisis led to the flight of capital to "the security of U.S. Treasuries".<sup>58</sup> The above examples showed the ability of international

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<sup>54</sup>Financial Stability in Emerging Market Economies: A Strategy for the Formulation, Adoption and Implementation of Sound Principles and Practices to Strengthen Financial Systems. Available at: <http://www.bis.org/publ/gten02.html>. [February 27th 2001]

<sup>55</sup>*Ibid.*

<sup>56</sup>*Far East Economic Review*, July 18, 1996 cited in Henderson C., *Asia Falling?: Making Sense of the Asian Currency Crisis and its Aftermath*, McGraw-Hill Book Co., Singapore, 1998.

<sup>57</sup>Henderson C., *Asia Falling?: Making Sense of the Asian Currency Crisis and its Aftermath*, McGraw-Hill Book Co., Singapore, 1998.

<sup>58</sup>Buckley R.P., 'Lessons from the Globalisation of the Emerging Debt Markets' (2000) 5 *J.I.B.L.*

capital to make a fast exit during corporate distress. On the other hand, it also revealed the vulnerability of a weak financial market. It stressed the urgent need for countries to adopt a serious approach towards regulatory reform. This was stated by the U.S. Treasury Secretary Robert Rubin, that "excessive capital flows ... can be indicative of broader failures in transparency and risk management".<sup>59</sup> In the long run, market intervention and distortion by governments with a weak structural policy will be subject to the unpleasant discipline of the market.

Research on trade in services is limited since this component was recently introduced by the World Trade Organisation. As a result, there are some conceptual and empirical difficulties. The members tend to focus only on the movement of suppliers and consumers rather than cross-border delivery, trade barriers, standards, impediments to capital and labour. There is a paucity of data on international transactions in services.<sup>60</sup>

Domestic legislation may remain undeveloped and ambiguous. Some countries may continue to maintain an indirect means of restriction. These include ambiguous licensing requirements, restrictions related to foreign ownership, nationality and residency requirements, and foreign remittance. These limitations would hinder the move towards a more open and accessible financial market.

## Conclusion

Measures to liberalise and internationalise the global financial services sector have been progressing since the signing of the GATS. Although the pace of these efforts differ among the members, the overall policy framework established by the GATS serves as a guide to ensure that these efforts converged in one common direction. Transparency and full disclosure are the key elements enunciated in the move towards the creation of a prudent regulatory and supervisory framework.

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<sup>59</sup>Robert Rubin, "Treasury Secretary Robert E. Rubin Remarks on Reform of the International Financial Architecture to the School of Advanced International Studies", *Federal Department and Agency Documents*, April 21, 1999 cited in Buckley R.P., 'Lessons from the Globalisation of the Emerging Debt Markets' (2000) 5 *J.I.B.L.* 106.

<sup>60</sup>*Supra* note 34.

The international framework related to regulation of the financial services sector would become more coherent as the future rounds of negotiation focus on more specific commitments. Nevertheless, a strong, stable, and efficient domestic financial system that adheres to international standards and practices is vital to cope with the risks of internationalisation. The impact of these reforms would be evident only if governments are fully committed to the liberalisation of domestic financial markets. It is only then that a new financial architecture would emerge.

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## SECTION 150(1) OF THE INSURANCE ACT 1996: ITS INTENDED APPLICATION AND A CASE FOR FURTHER REFORM

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### Introduction

The enactment of the Insurance Act 1996<sup>1</sup> among other things resulted in the repeal of the Insurance Act 1963 and simultaneously introduced new laws regulating the insurance industry and the relationship between the insurer and the insured.

Section 150(1) is one of those new laws that seek to regulate the relationship between the insurer and the insured.

However there are those who believe that section 150(1) in real effect is not a new law but merely a refined statutory pronouncement of the existing common law pre-contractual duty of disclosure owed by the insured to the insurer.

To date there is yet no local judicial pronouncement on the application of section 150(1) nor is there any accompanying explanatory notes on this section.

Presumably it is hoped that section 150(1) was in fact enacted to remedy the existing weaknesses that are inherent within the common law duty of pre-contractual disclosure.

If section 150(1) has in fact addressed the weaknesses inherent within the common law duty of pre-contractual disclosure in full or in part at the very least, then it is submitted that section 150(1) is in fact a new law and this is what this article will seek to demonstrate.

However the question remains whether section 150(1) as it stands will in fact be effective in resolving all the problems associated with the common law duty of pre-contractual disclosure.

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<sup>1</sup>Act 553.