Banking by Border:
Preventing Prudence from Turning into Protection
in the New Financial Regulatory and Trade Framework

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February 19, 2013

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Executive Summary

This paper assesses the status of global financial regulation in the wake of growing dissent from standards promulgated by banking, insurance and securities regulators, determining the degree to which forthcoming trade-in-services negotiations can prevent the collapse of prudential rules into protectionist barriers. Increasingly, regulators and legislators are imposing impediments on financial institutions they deem risky regardless of home-country approval of their operating condition. Advocates of tough host-country standards argue their necessity in the absence of adherence to robust global standards, but distinguishing between prudent standards suitable for market protection and those that create protectionist barriers to entry is, at best, difficult and contentious. To date, the trade-in-services framework has eschewed judgments based on the prudential impact of home- or host-country regulation, focusing instead largely on the degree to which host countries accord "national" – that is, fair – treatment to entering financial institutions. However, fair does not necessarily mean safe, creating increasing dissonance between prudential rules and trade regimes with the potential inadvertently to promote the emergence of protectionist financial-regulatory policies.

This paper argues that, if this trend to what it calls "banking by border" continues, global finance will return to anachronistic nation-by-nation rules that undermine market efficiency in a manner comparable to tariff barriers for trade in manufactured and agricultural goods. Banking-by-border also creates perverse incentives to risk-taking because "shadow" financial activities would flow freely in ways that pose new risks even as more traditional banking services move outside stringent regulation to "safe haven" states. The risks of financial protectionism are thus worse than the very high ones associated with trade-in-goods protectionism because modern financial services – essentially data-driven operations – are far less bound by geography and markets than providers of physical goods and services.

To prevent renewed protectionism, this paper urges the U.S. Trade Representative to take the lead in newly-announced trade-in-services talks to address prudential regulatory matters in conjunction with the planned trade-in-financial-services agreement. Recommendations on how to balance home- and host-country concerns are provided, starting with an urgent focus by top U.S. policy-makers on a framework for safe and sound cross-border finance differentiated by each key industry sector. Public comment should be solicited on actions such as mutual recognition, "passporting" or other methods to protect U.S. markets without undermining their efficiency and innovativeness. U.S. trade-in-financial-services criteria should be based on global rules under the aegis of the Financial Stability Board, and this global body should turn as a priority matter to establishing terms and conditions for cross-border financial trade. These global criteria are akin to World Trade Organization standards by which nations can determine if barriers to entry or other restrictions violate accepted norms, taking

action as appropriate to remedy these host-country obstacles or, if need be, disciplining wayward nations.

Introduction

In September, 2012, Federal Financial Analytics, Inc. (FedFin) issued a detailed assessment of the status of global financial regulation.[1] We concluded that the framework established by the Basel Committee on Banking Supervision endorsed at each meeting of the Group of Twenty heads of state was, at best, frayed. Since then, events have confirmed our forecast: the Federal Reserve has joined other regulators in defining a host-country framework largely irrespective of global standards, even as Basel Committee capital and liquidity rules and the international Solvency II framework for insurers look increasingly like best-practice standards, not the binding edicts intended when they were initially issued. While global bank regulators are at least trying top-down prudential standards and naming the systemic banks to whom even tougher ones are supposed to apply, global securities and insurance regulators are moving at a far, far slower pace. Global standards to ensure orderly resolution without taxpayer support for banks, let alone other financial institutions, are also at best a work in progress.

In 2012, FedFin recommended a way to prevent global rules from becoming increasingly less meaningful as key nations go their own way. Our goal is to promote harmonized global financial regulation better suited for pragmatic application than the top-down mandate for homogeneous standards proving increasingly irrelevant as a policy construct for governments or as strategic drivers for cross-border financial-services firms.

Here, we update this approach to reflect recent global and national regulatory developments, all of which are pushing financial regulation inexorably to protectionism, not the long-sought improvements in financial-market safety and soundness. Our approach acknowledges the inevitability of heterogeneous, border-driven requirements, but preserves the best features of harmonized cross-border prudential standards to the greatest degree possible. It is based on the longstanding framework that governs trade in manufactured and agricultural goods, adapting it in the context of trade-in-financial-services accords and – most importantly – the hard lessons learned in the 2008 crisis and its aftermath.

With the U.S. and twenty trading partners now planning to negotiate a new International Services Agreement (ISA), progress on an alternative cross-border financial

[1] FedFin, *Basel's Burst Bubble: How Basel Has Broken Apart and What Should Now Be Done to Fix Bank Regulation* (Aug. 27, 2012), *available at* http://www.fedfin.com/images/stories/client_reports/Basel%27s%20Burst%20Bubble.pdf.

regulatory framework becomes not just a market priority, but also an agenda item for government and industry decision-makers. Failing a new global prudential framework, protectionism is sure to become the operating principle of global finance – a very poor result from a market efficiency, regulatory integrity and financial-institution profitability perspective.

Where Prudence Plows into Protection

A recent blog post by the Federal Reserve Bank of New York (FRB-NY)[2] highlights the conundrum facing not only the Federal Reserve, but also financial-industry regulators around the world: how much can host-country regulators count on a home-country's regime to ensure parent firms are robust under normal conditions and serve as a source of strength under stress? The question is a vital one: if host-country regulators can trust the home-country regime, then they need not dictate standards that create potential barriers to entry and competitive concerns. However, if regulators do not trust home-country standards and fail to set host-country criteria, then they put themselves, their financial systems and even their economies at risk. To date, the Federal Reserve has, like most global financial regulators, counted on their cross-border peers, as much as laissez-faire trade policy permits open borders through which most goods and services pass without impediment.

Now, on grounds that prudent finance requires heightened protection, regulators including the Federal Reserve are raising the barricade, arguing that cross-border protections are needed prudential buffers, not undue, protectionist demands that discriminate against foreign financial-services firms. The issue has come to be a diplomatic concern in the European Union, which on February 4, 2013 formally notified member nations that "prudential" restrictions (e.g., on branch entry or inter-affiliate transactions to home-country banks) are having potential protectionist effect.[3]

The FRB-NY outlines many recent actions in which host-country regulators seek to insulate operations within their borders from potentially feckless activities elsewhere in a cross-border banking organization. Key to the analysis is a distinction between "financial protection" – good, the New York Fed argues – and "financial protectionism," which is not only an obstacle to needed cross-border activity, but also a violation of trade-in-financial-services agreements. Within the class of appropriate financial "protections" cited by the Fed are:

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[2] FRB-NY, *Ring-Fencing and "Financial Protectionism" in International Banking* (Jan. 9, 2013), *available at* http://libertystreeteconomics.newyorkfed.org/2013/01/ring-fencing-and-financial-protectionism-in-international-banking.html.

[3] Huw Jones, *EU Executive national bank supervisors over discrimination*, Reuters (Feb. 4, 2013), *available at* http://www.reuters.com/article/2013/02/04/us-eu-banks-regulation-idUSBRE9130IT20130204.

- the "Vickers" changes in the U.K. to ring-fence retail from investment banking;
- pending standards in Switzerland to ensure effective resolution of cross-border banks operating in that nation through measures such as "subsidiarization" – that is, legal separation – of activities in Switzerland from home-country operations;
- German supervision of cross-border banks to ensure adequate liquidity under stress;
- "net due to" requirements in the U.S., Argentina, Australia, China, Malaysia and Russia;
- "asset-maintenance" requirements in the U.S., Canada, Germany, Switzerland and Singapore; and
- perhaps most dramatic, the Federal Reserve Board's (FRB) pending proposal to rewrite the way foreign banking organizations (FBOs) and their branches may do business in the U.S.[4]

Many would dispute the FRB-NY's characterization of several of these standards as "protection," not protectionism. Indeed, several of the actions cited above seem to be those squarely in the European Commission's (EC) sights in the notice to members cited above. Even as these disputes continue, however, regulators are acting on additional initiatives. Reflecting the ring-fencing and subsidiarization measures favorably mentioned by the FRB-NY, as well as the U.S. "Volcker Rule," the European Union commissioned a group of experts to consider inter-affiliate barriers. The "Liikanen" report[5] in fact presses for significant walls between retail and investment banking, differing in some respects from the U.K. Vickers approach but building on it in important ways to lay out a ring-fenced framework for the European Union that will pose significant barriers to cross-border entry, especially by non-compliant nations.

Importantly, the Federal Reserve's FBO rule only heightened criticism of U.S. action. Pending proposals that may also barricade banking in the U.S. would limit the most favorable liquidity treatment only for U.S. obligations,[6] impose additional discrimination between U.S. and other sovereign obligations in the inter-agency Volcker standards,[7]

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[4] FRB, Proposed Rule, *Enhanced Prudential Standards and Early Remediation Requirements for FBOs and Foreign Nonbank Financial Companies*, 77 Fed. Reg. 76628 (Dec. 28, 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-12-28/pdf/2012-30734.pdf.

[5] European Commission, *High-level Expert Group on Reforming the Structure of the EU Banking Sector* (Oct. 2, 2012), *available at* http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf.

[6] FRB, Proposed Rule, *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies* 77 Fed. Reg. 594 (Jan. 5. 2012), *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-01-05/pdf/2011-33364.pdf.

[7] OCC, FRB, FDIC and SEC, Proposed Rule, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds* 76 Fed. Reg. 68846 (Nov. 7, 2011), *available at* http://www.gpo.gov/fdsys/pkg/FR-2011-11-07/pdf/2011-27184.pdf.

mandate top-down U.S. rules in the Commodity Futures Trading Commission's (CFTC) extraterritorial application of U.S. rules,[8] dictate the "push-out" of certain derivatives activities,[9] and impose several other recent U.S. actions. Combined, all of the U.S. proposals are not only emboldening other nations to wall off their own banking systems, but also leading to increased threat of retaliation against U.S. banking organizations.

Although the FRB-NY list is bank-focused, several of the critical U. S. initiatives noted above have wider market impact. For example, the CFTC extraterritorial principles cover the over-the-counter (OTC) derivatives markets, with the extent of this coverage soon to be expanded with forthcoming rules from the Securities and Exchange Commission (SEC). The CFTC and SEC are seeking to convert OTC-derivatives activities to those conducted principally on central counterparties (CCPs) under margin, transparency and similar prudential rules. The EC is seeking to implement similar standards, but facing significant obstacles that pose cross-border impediments within the European Union and across the scope of global financial markets. The International Organization of Securities Commissions (IOSCO) is also wrestling with how to govern the critical asset-securitization market across the globe,[10] finding that practices in key markets vary so widely as to warrant consideration of new certification or similar criteria in this sector.

Cross-border trade in insurance has been perhaps the least significant arena in global finance, but it too has become of increasing importance and, in the wake of AIG's collapse, growing concern. The Solvency II standards cited above[11] are capital standards designed to serve the same goals of the Basel capital rules (see below) – that is, prudential terms for sound cross-border operation. However, host countries are differing materially on how and when to implement Solvency II, perpetuating not only safety-and-soundness concerns, but also barriers to cross-border entry nations defend on prudential grounds. (e.g., as in the restrictions some U.S. states impose to entry by foreign reinsurance companies).

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[8] CFTC, Proposed Interpretive Guidance and Policy Statement, *Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act* 77 Fed. Reg. 41214 (Jul. 12, 2012), *available at*: http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16496.pdf.

[9] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111--203 (2010) § 716(f).

[10] IOSCO, *Principles for Ongoing Disclosure for Asset Backed Securities* (Nov. 27, 2012), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD395.pdf.

[11] Parliament and Council Directive 2009/138/EC on the taking up and pursuit of business of Insurance and Reinsurance (Solvency II) [2009] OJ L 335/1.

What Happened to Global Rules

Global financial-regulatory standards are supposed to establish a homogeneous framework that permits host-country regulators to count on home standards. The global framework is most developed with regard to banks because banking was the first and still is the most international of all financial services. Increasingly, however, securities, insurance and "shadow" financial firms are extensively engaged in cross-border operations that, as was all too evident in the Lehman Brothers bankruptcy, have significant prudential impact in host countries. As the above analysis shows, it is clear first that many nations have rules that govern host-country operations in ways opponents characterize as protectionism. It is also demonstrated that barriers to cross-border banking are rising fast. This may be most significant in the U.S., but evident in many other key banking markets. Just as banking was first across the borders, so it is now first among the financial services facing barriers. However, numerous initiatives in the non-bank sectors also pose significant cross-border concerns and, over time, will present barriers to entry that pose protectionist problems.

Perhaps the most fundamental tenet of global finance is the rules set by the Basel Committee. In December of 2010, it reached what is now widely called the Basel III Accord,[12] which comprises a revision to the Basel II capital rules and a new global liquidity framework covering internationally-active banks. In the two-plus years since these rules were finalized, the Committee has had to acknowledge that implementation of the capital standards is, at best, patchy. [13] Two key markets – the U.S. and European Union – have not finalized their versions of these standards and, when they do so, the rules will almost certainly be dramatically different in key respects. For example, the EU will likely not impose a leverage requirement, a core Basel III component for which the U.S. fought hard. Other nations are ahead of the U.S. and EU on the capital rules, but implementing them quite differently. Switzerland and the U.K. want far higher risk-based capital ratios, but they and numerous other nations (e.g., Japan) have yet to finalize the leverage rules. Even as nations advance Basel III – to the extent they do so – considerable question remains as to the extent to which the rules are truly comparable because, as the Basel Committee itself has observed,[14] nations have widely different views as to the risk weightings applicable within the scope of the global rules. These risk-weighting differences lead to dramatically-different capital standards, despite nominal Basel compliance.

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[12] Basel Committee, *Basel III: A global regulatory framework for more resilient banks and banking systems* (Dec. 16, 2010), *available at* http://www.bis.org/publ/bcbs189_dec2010.htm.
[13] Basel Committee, *Report to G20 Finance Ministers and Central Bank Governors on Basel III Implementation* (Oct. 29, 2012), *available at* http://www.bis.org/publ/bcbs234.pdf.
[14] Basel Committee, *Regulatory Consistency Assessment Programmed (RCAP) – Analysis of Risk-weighted Assets for Market Risk* (Jan. 31, 2013), *available at* http://www.bis.org/publ/bcbs240.pdf.

The path to the global liquidity rules is even more uncertain. In early January of 2013, the Basel Committee was pushed by its governing body to compromise on continuing disputes to preserve the 2010 construct. It thus issued substantive revisions to the standards.[15] These acknowledge some analytical problems in the 2010 rules, but also create an alternative liquidity approach (ALA) with several options for countries that do not think the global rules appropriate for them, slowly phase in the global rules, put off action on other key provisions and leave open the prospect for still more sweeping changes to the liquidity rules. The Federal Reserve has already gone its own way on liquidity, as detailed above; now, Basel has cleared the path for other nations to do the same even as many nations have yet to make clear if they will agree to any type of liquidity rule.

Another key tenet of global financial regulation is the desire to regulate firms that pose cross-border risk – so-called systemically-important financial institutions (SIFIs), especially if their risk is global (G-SIFIs). The FSB has finalized a list of global systemically-important banks (G-SIBs)[16] and the FRB plans to implement higher capital and other standards for G-SIBS domiciled here.[17] However, other nations are again going very much their own way. Some – e.g., Switzerland – have already imposed surcharges akin to those planned for G-SIBs on the largest banks within their borders; others (e.g., Japan) have not made clear their plans to follow Basel's lead. And, despite global agreement that SIFIs should be subject to surcharges regardless of whether or not they are banks, the standards for insurance companies are very much a work in progress and those for global investment banks even farther behind.[18]

As we assessed in detail in our 2012 paper, these and other differences result from a fundamental schism in global financial regulation: some nations think their SIFIs should be subject to market rigors and fail to the greatest extent like other firms, while others either want or must support SIFIs with state funds when the firms come under stress. Resolution frameworks for SIFIs thus vary across national regimes – some protect depositors, but not shareholders; others protect shareholders or debt-holders, but not depositors, while others protect pretty much everyone pretty much all of the time. Crafting cross-border prudential rules that protect national interests cannot be accomplished when national interests vary so materially on so critical a criterion of financial policy.

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[15] Basel Committee, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (Jan. 6, 2013), *available at*: http://www.bis.org/publ/bcbs238.pdf.

[16] FSB, *Update of group of global systemically important banks* (Nov. 1, 2012), *available at* https://www.financialstabilityboard.org/publications/r_121031ac.pdf.

[17] FRB, Proposed Rule, *Enhanced Prudential Standards and Early Remediation Requirements.*

[18] FSB, *Increasing the Intensity and Effectiveness of SIFI Supervision* (Nov. 1, 2012), *available at* http://www.financialstabilityboard.org/publications/r_121031ab.pdf.

How International Services Trade Talk Can Make Global Rules Walk

The 2012 FedFin paper contains an extensive discussion of the manner in which trade-in-goods global protocols can be applied to the existing trade-in-financial-services framework to insulate financial markets from imprudent practice without conceding to protectionism. Now that the U.S. has announced its intention to pursue the International Services Agreement noted above, we turn to specific recommendations for inclusion in the U.S. negotiating position related to financial services.

FedFin's approach reflects the current state of play in global financial regulation summarized above, as well as U.S. statutory and policy considerations. Many of these drove the Federal Reserve in the FBO regulation for banks, set the CFTC's goals in the extraterritoriality statement cited above, and underpin recent statements from the new Treasury Federal Insurance Office.[19] However, there is to date no clear or final U.S. financial-services trade policy that reflects these supervisory objectives and the complexity of cross-border finance (including the ability of single firms to engage in diverse financial activities under different regulatory frameworks in home and host countries). If the United States Trade Representative (USTR) proceeds to negotiate financial trade as it has in the past – focusing principally on ensuring national treatment – it will inadvertently contribute to an increasingly fragmented global financial system. National treatment ensures fairness within orders – an essential trade-policy concern – but it does not otherwise harmonize cross-border financial activity. Now that national rules are departing so materially from each other and global efforts to harmonize them are helpless to reverse the trend, trade policy must establish cross-border criteria for finance akin to customs barriers for unsafe manufactured or agricultural goods.

> RECOMMENDATION ONE: USTR should convene a high-level working group of federal and state regulators under the rubric of the Financial Stability Oversight Council (FSOC). FSOC is chaired by Treasury and comprised of key regulators and thus creates a ready-made venue in which to craft the financial-stability and regulatory considerations USTR should take into account as the ISA advances.
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> RECOMMENDATION TWO: This USTR/FSOC process should be open to public input and launched through an invitation for comment on key questions. These include:
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> - ways to advance transparent criteria for trade-in-financial-services entry into the U.S. that meet relevant statutory

[19] Federal Insurance Office Director Michael McRaith, *Remarks at Property/Casualty Insurance Joint Industry Forum* (Jan. 10, 2012), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1393.aspx.

requirements and regulatory-and-supervisory concerns in each key financial-industry sector;

- terms and conditions the U.S. deems necessary in other nations to ensure fair and prudent trade in financial services; and
- the degree to which mutual recognition, passporting and other procedures can ensure fair and prudent trade in financial services in the absence of consistent prudential standards.

RECOMMENDATION THREE: Based on the process outlined above, the USTR, in consultation with other U.S. agencies under the FSOC, should present a proposed framework for trade-in-financial-services that reflects regulatory desires to protect U.S. financial markets in concert with open, fair and non-discriminatory cross-border financial operations. To limit the degree to which financial-services firms are forced to "subsidiarize" – that is, operate through separately-incorporated entities in each country in which they do business – the framework should create standards for branched operations based on transparent criteria.

Because the U.S.-developed framework will necessarily reflect U.S. interests, it is a vital opening point for meaningful global negotiations, but unlikely to prove the final agreement. Happily, the Group of Twenty (G-20) heads of state has organized in the wake of the crisis to coordinate global financial-regulatory policy, among other matters. G-20 nations include many involved directly or indirectly through the European Union in the ISA. Thus, the overall framework it has established for global financial-services regulation creates the parameters within which the ISA should work. For example, if the G-20 has endorsed Basel III global-capital standards (as it has)[20] then G-20 nations should base their ISA negotiating stand on the G-20 principle. That is, terms of cross-border branch entry should be home-country compliance with global prudential-regulatory standards endorsed by heads of state.

To be sure, G-20 agreements are often light on details, complicating meaningful trade-in-financial-services negotiations once past general principles. However, the G-20 has also endorsed an over-arching global financial regulatory authority, the Financial Stability Board (FSB), giving it more top-down standard-setting and peer-review powers at the most recent heads-of-state summit.[21] Most nations now entering the ISA are directly or indirectly members of the FSB, which is also working hard to craft its rules to anticipate potential concerns in emerging nations that will well serve the ISA as it reaches out to additional signatories. As a result, FSB statements and standards should

[20] G20, *Seoul Summit Document* (Nov. 2010).

[21] FSB, *Statement on Plenary Meeting in Zurich* (Jan. 28, 2013), *available at* http://www.financialstabilityboard.org/press/pr_130128.pdf.

be referenced wherever appropriate within the ISA to differentiate between appropriate prudential protection and sanctioned protectionism.

Where are FSB standards appropriate? Again, structural and statutory differences make full cross-border application complex, if not impossible. For example, it is not practical to expect FSB resolution standards to become a global template due to the substantive differences in national financial regimes outlined above. However, resolution is not a regulatory standard critical to cross-border trade in financial services, vital as it is to prudential regulation. Nations may handle failure in idiosyncratic ways, but harmonious cross-border finance can occur as long as each host country reflects the risk of home-country disorderly failure or seizure of the resources needed to promote home-country finance at the cost of host-country operations. Under the aegis of the FSB, so-called "crisis management groups" are already working on ways to handle such cases and the U.S. and U.K. have even reached a formal understanding in this area.[22]

> RECOMMENDATION FOUR: Based on the work of crisis management groups, national resolution authorities (e.g., the FDIC in the U.S.) should reach formal, public agreement with other nations in which their financial-services firms have significant operations or where major firms active in the host country are based. The ISA should stipulate that financial-services firms operating in an acceptable cross-border resolution regime based on home/host agreement should be granted favored-nation status for purposes of trade in financial services. This term should be defined by USTR and FSOC for U.S. purposes and expressly included in the ISA.

> RECOMMENDATION FIVE: Under specific instructions from the G-20 as needed, the FSB should prioritize its work to focus on prudential standards best suited to ensure free, fair and prudent cross-border trade in financial services. Much of FSB's work to date has highlighted fears about competitive disadvantage and/or regulatory arbitrage resulting from inconsistent application of prudential standards formulated by the Basel Committee and international insurance and securities regulators. Building on this work, FSB should prioritize requirements home countries should implement to ensure ready access by their financial-services firms to host countries, using peer reviews to provide home and host countries with transparent assessments on which to base entry decisions and under which global trade negotiators (e.g., the World Trade Organization) may settle disputes brought under the ISA. The FSB should also as a priority matter set criteria by which nations and the WTO may

[22] FDIC, Bank of England, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012), *available at* http://www.fdic.gov/about/srac/2012/gsifi.pdf.

differentiate nations setting more stringent prudential standards to protect national markets in a manner akin to customs barriers based on risky goods from those set principally to protect host-country markets. It is vital that the FSB work to promote highest-common-denominator global rules, not allow nations to use seemingly-tougher requirements in fact to isolate host-country financial markets.

Importantly, the FSB is now focusing not only on prudential standards for banking, insurance and securities firms, but also on those for "shadow" banks – that is activities outside express financial regulation that mimic banking and, thus, pose potential systemic risk as rules are tightened for regulatory firms. Most recently, the FSB has outlined a set of sectors and activities it thinks need additional governance to prevent migration of regulated activities to the "shadows."[23] After comments are received, the FSB has a work plan under way to present additional recommendations to the G-20 at its summit later this year.

RECOMMENDATION SIX: As the FSB shadow-bank regime takes shape, its prudential standards should govern cross-border trade in cited financial activities. USTR should ensure that the ISA is not so sector-specific as to exempt non-banks from appropriate home-country regulation and prevent host-country barriers from discriminating against U.S. firms. Again, the FSB should set the parameters of highest-common-denominator financial regulation.

Conclusion

The ISA will fail to ensure free and fair trade-in-financial-services if it does not take fully into account the lessons of the 2008 crisis and the regulatory framework emerging from it. If financial regulators continue on course as in the U.S. and European Union, financial services will not be free because of prudential cross-border barriers and it may well not be fair if the construct of national treatment that now guides trade-in-financial-services policy is discarded in favor of host-country protection. If regulators demur from current initiatives out of fear of complicating cross-border financial activity, then the hard lessons of the recent crisis will not govern international financial-services activity, sowing seeds of the next round of systemic risk.

Current trade-in-financial-services protocols are focused principally on preventing discriminatory treatment, i.e., ensuring "national treatment." However, this construct is based on the premise that national treatment is largely comparable across borders, just

[23] FSB, *A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* (Nov. 18, 2012), *available at* http://www.financialstabilityboard.org/publications/r_121118a.pdf.

as most manufactured-goods markets are roughly comparable within individual nations. A key distinction in manufactured-goods trade is recognition that border-crossing products need to be safe for the consumers who purchase them. Most nations thus have inspectors and similar agents at their ports to ensure that manufactured and agricultural goods comport with relevant purity and similar requirements, with authority to reject shipments based on these grounds in full compliance with WTO requirements as long as it can be demonstrated that entry prohibitions based on safety-and-soundness allegations can be substantiated under applicable international protocols.

The framework outlined above constructs a similar regime for trade-in-financial-services – that is, determining the degree to which barriers to entry may be erected based on global regulatory standards for safety and soundness. It is clear that nations determined to ensure prudent finance will in fact limit cross-border access based on prudential considerations and, if standards for doing so are not quickly determined, this will undermine recent efforts to craft cross-border prudential standards for banking organizations and those under way for insurance and securities companies. Banking will go back behind national borders and, following it, so too will other financial services. In a world of global capital flows and instant-fire cross-border communications technology, this is a truly perverse and counter-productive result of prudential regulation. It is, however, a sure and certain one if a definitive, transparent trade-in-financial-services framework is not quickly developed taking fully into account the hard lessons of the recent crisis.