

DOMESTIC REGULATION

IAIS Observer Panel Presentation

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1. INTRODUCTORY

The Ninth Annual Conference of the International Association of Insurance Supervisors is an important moment at which to be offering some private sector views on international regulatory standards. The “conjuncture” is one which some powerful forces are working for international regulatory development. On the one hand, there is the importance of the IAIS’s own work. Not only does this work command increasing respect over a widening range of insurance regulators round the world; it is also achieving wider application, as – for instance – the basis for one of the yardsticks used in the IMF/World Bank Financial Sector Assessment Programme. And many of the early IAIS Core Principles are now being revisited. Other regulatory issues are also prominent at this time, notably the pressure for better governance following the recent scandals that have been revealed as one of the consequences of huge shifts in world markets. Finally, developments in world trade liberalisation – prompted by last year’s Ministerial Declaration at the start of the Doha Development Round – are also contributing to the development of fresh views on international disciplines for regulation and the role of multilateral bodies such as the WTO in upholding these.

This presentation is not the occasion for going into the tricky area of the dividing line between sectoral disciplines for regulation in particular fields, on the one hand, and multilateral disciplines applying to all domestic regulation, on the other. This difficult question will undoubtedly require resolution. But any solution is likely to be evolutionary rather than revolutionary: to be successful, it must command a broad level of respect, and it must embrace practical outcomes with which regulators are comfortable. This presentation offers some criteria for reaching a solution.

In this presentation I should like to set out some broad concepts that have been developed in the European Services Forum (ESF) as relevant to all areas of domestic regulation affecting internationally traded services. Much of the ESF’s thinking has been influenced by the need for private sector service providers to contribute their views in the debate on disciplines for domestic regulation that is currently taking place within the framework of the General Agreement on Trade in Services (GATS). In many ways, that is a very different framework from the architecture of Core Principles, Methodologies and Standards being developed in the IAIS. Yet the work of the IAIS has a central bearing on our area of international trade, namely insurance services. IAIS members, it is suggested, therefore need to be aware of approaches to the debate in the GATS, to which the international insurance sector is contributing.

1.1 Significance Of Domestic Regulation

Liberalisation of internationally traded services entails regulatory adaptation reaching deep into the internal legal systems of all countries. Key issues concern how to guarantee that services markets are effectively liberalised, by ensuring that regulation:

- Is necessary, reasonable, proportionate, transparent, and neutral;
- Is administered in a user-friendly way towards new market entrants, is conducive to market entry, and facilitates innovation;
- Is technologically neutral;

- Aims at reasonable equivalence of results in practice in different markets;
- Is funded by administrative fees that seek to recover no more than the costs of the competent authority in supervising the regulated entity;
- Paves the way for harmonised international standards.

These are points represent the broad features of the regulatory environment required by services providers operating internationally. Expressed more precisely, in language used in past and present GATS negotiations, the key requirements are that domestic regulation should meet accepted criteria of:

- transparency;
- legitimacy, necessity, burdensomeness and proportionality (the need for domestic regulation to be no more trade restrictive than necessary);
- consistency with GATS requirements on market access and national treatment.

1.2 The Provisions of the GATS

The GATS recognises the sovereign right of Member governments to regulate, and to introduce new regulations on, the supply of services within their territories in order to meet national policy objectives. This principle has been recently re-emphasized in last year's Guidelines and Procedures for the Negotiations on Trade in Services. The guidelines are comprehensive in their coverage, and embrace all sectors. The main disciplines for a transparent and fair regulatory system are in GATS Articles III and VI:

- Article III: Article III.1 provides for the prompt publication of measures affecting trade in services. Articles III.3 and III.4 provide for notification to the GATS Council and for prompt responses to (and enquiry points for) WTO member governments.
- Article VI: Article VI.1 requires that in sectors where specific commitments are undertaken, all measures of general application affecting trade in services be administered in a reasonable, objective and impartial manner: this is a central principle, vital for understanding the mutual rights and duties of the regulator and the sector being regulated. Article VI.2 includes a commitment to maintain judicial, arbitral or administrative tribunals or procedures. Article VI.3 requires regulators to inform applicants within a reasonable period of time and to give information on the status of an application. Article VI.4 calls on the GATS Council to develop disciplines to ensure that qualification procedures are based on objective and transparent criteria, and are not more burdensome than necessary to ensure the quality of the service. Article VI.5 applies these principles to sectors in which a Member has undertaken specific commitments.

Summarising all these GATS obligations, they fall into two groups, first vis-à-vis the WTO (i.e. to inform the Council on Trade in Services), and, secondly, independent from the WTO (i.e. to operate regulations in a transparent manner, in the domestic environment). The ESF considers that while work on the first group is important, any difficulties in this area may relate more to inadequate implementation than to the need for new disciplines. But the requirement that all WTO Members should publish promptly all relevant measures of general application is not enough to ensure the proper implementation of the transparency principle. The second group of obligations therefore raises essential issues of publication, consultation, fairness of application processes, appeals procedures and arbitration. All countries should seek to make the principle of domestic transparency more operational in its application through work to develop guidelines for regulators in some or all of these fields.

Along with these GATS Articles, the GATS Annex on Financial Services included a “prudential carve-out” and therefore provided that “notwithstanding any other provision of the Agreement, a member shall not be prevented from taking measures for prudential reasons, including for the protection of investors [and] policyholders... or to ensure the integrity and stability of the financial system.” It added that such measures must not be used as a means of avoiding GATS commitments. But the “carve-out” leaves financial services regulators free to take measures for prudential reasons, without being overly-restrained by GATS provisions.

1.3 The Approach to be Adopted

Against that background, a key issue for discussion is the development of a coherent approach to domestic regulation. Domestic regulation fulfils many purposes, and lies at the heart of the efficient functioning of the services sector. At the same time, domestic regulation of services may act as a barrier to trade. These two policy considerations have to be in proper balance, taking account of both the case for open markets and the case for regulation in the interest of ensuring that services meet acceptable standards. The aim should be to establish the extent to which formal principles may be necessary to support market access and national treatment while recognising the legitimate right of national governments and regulatory authorities to regulate. Domestic regulation is sensitive to the GATS principles of fairness (non-discrimination) and openness (transparency) and it needs to support and uphold (rather than negating) negotiated GATS commitments (effectiveness).

The ESF recognises that two parallel courses of action may be necessary to give effect to the principles outlined above. On the one hand, a “horizontal” (i.e. cross-sectoral) approach may be required, so that governments and regulatory authorities institute certain internationally agreed disciplines across all regulatory activity affecting internationally traded services. On the other, a “vertical” (i.e. sectoral) approach may also be needed, to ensure the presence of specific features to meet particular sectoral requirements. The balance between the two approaches is not necessarily straightforward, and is likely to require sector-by-sector solutions, matched to individual sectoral circumstances. In some cases (as with licensing procedures) the balance between “horizontal” and “vertical” approaches will need to take account of particular regulatory requirements (including prudential regulation); in others, other features, such as the disciplines necessary for regulating a profession, may be particularly relevant. The overall approach will need to be flexible, to accommodate these different requirements.

The following sections of this paper set out approaches to domestic regulation under the headings of:

- Transparency;
- Necessity;
- Consistency with GATS requirements on market access and national treatment (including sectoral approaches).

2. TRANSPARENCY

The provisions of GATS Article III on transparency are simple and self-explanatory. But they lack detail.

A transparent and fair regulatory system is a precondition for the liberalisation of services: the importance of transparency is recognised in the Preamble to the GATS which states that the Parties wish “to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalisation ...”. To promote that goal, the GATS contains a number of important rules regarding transparency. These rules benefit all WTO Members, but especially the country promulgating the rule, since a transparent and fair regulatory system is essential to continued expansion of a country’s service sectors.

To achieve these objectives, the ESF has proposed the Framework set out in **Annex 1**. Its rationale is that the GATS needs stronger disciplines to promote greater transparency across the board for all services. In particular service sectors, special sectoral agreements or scheduling can be used to set out additional transparency requirements for that sector, including broader regulatory reform as necessary and appropriate. Some sectors may need little supplementation, while other sectors may need many special rules tailored to that sector. The suggested approach (covering standard-setting (including prior consultation) the regulatory application process, and judicial, arbitral or administrative tribunals) will allow negotiators to respond flexibly to the particular needs of each sector while at the same time building on the transparency disciplines that apply across all sectors.

The following questions will undoubtedly arise:

- Prior consultation: some WTO members have stated categorically that there is no place in their constitutions or domestic legal regimes for prior consultation. In others, there is a question of whether, or how, to implement prior consultation provisions at sub-national levels, in parallel with implementation at the national level - an issue of potentially crucial importance.
- Privacy and commercial confidentiality: regulators have pointed out that, while regulatory requirements should be transparent, there may be operational occasions where the need to protect the individual or commercial confidentiality arises.
- Emerging markets: it is recognised that developing countries may have specific problems. It would be reasonable to expect them to set out both the problems they face, with proposals for and how they might be overcome. It would also be reasonable for them not to face disproportionate costs.
- WTO notifications: it might be helpful before creating any new notification obligations to analyse the extent and practice followed by members in respect of existing obligations. This could point both to the need for improvements and help any assessment of whether (and, if so, which) further transparency provisions are needed.
- Special Sectoral Disciplines: Every regulated service sector has unique features that may require different rules regarding a transparent and fair regulatory system. These are covered in the final section of this paper.

3. NECESSITY

The key GATS provision on necessity is Article VI. In approaching the question of necessity in domestic regulation, the ESF takes the view that the matter should be split, both for analytical and practical purposes, into four key elements:

- legitimacy of regulatory objectives;
- the necessity of the regulatory measure in question;
- a proportionality test, to ensure that domestic regulation is not more trade restrictive than necessary;
- periodic review of the three elements above.

These elements are taken in turn in sections 3.1 – 3.4 below.

3.1 Legitimacy

The ESF is aware that debate in the WTO is tending to move away from seeking agreement on a list of legitimate objectives. Such a list is certainly not worth pursuing if majority sentiment is against it. Similarly, there should be no attempt to establish a list of non-legitimate objectives: this would inevitably be long, and could play into the hands of those WTO Members that would prefer not to focus on necessity at all.

3.2 Necessity

In considering the question of necessity, disciplines developed under GATS Article VI:4 need not extend beyond the five listed features, i.e. qualification requirements, qualification procedures, technical standards, licensing requirements and licensing procedures. There is a strong case for any necessity principle to apply on a horizontal basis, bearing in mind that its purpose would be to clarify the necessity concept in a way compatible with most WTO Members' wish to avoid forced clarification through a Dispute Settlement procedure. But this would not preclude – and might even require - variations in the implementation of the same necessity principle in different sectors: depending on the circumstances, a measure acceptable in one sector might be considered too trade-restrictive in others.

There is a further issue relating to necessity, as set out in Article VI.5 (b) of the GATS, recognising that account shall be taken of international standards or relevant international organisations. The general objective must be that domestic regulation should be developed in accordance with international standards. But care needs to be taken to strike an appropriate balance: it is essential for the international standards themselves to have adequate regard to transparency, necessity and proportionality, if conformity with international standards is to be used as a justification for the necessity of any particular element of domestic regulation. Assuming that the IAIS has regard to those criteria in its work, it would probably be fair to assume, as a general rule, that measures adopted in accordance with international standards such as IAIS Core Principles, Methodologies and Standards comply in principle with the necessity test.

3.3 Proportionality

To the extent that proportionality is considered useful, the focus should be on how to make this principle operational. Measures taken in pursuit of a legitimate objective should not be applied in an arbitrary way or become a disguised barrier to trade in services. The aim should be to develop the proportionality principle into a form of guidance to assist regulators them in their domestic regulatory functions.

The following are suggested general principles that ought to apply:

- Technical standards, and licensing and qualification requirements and procedures, should not create unnecessary barriers to trade. In determining whether a measure is in conformity with this, account should be taken of internationally recognised standards of relevant international organizations applied by that Member.
- The regulator should act independently, i.e. the decisions of and the procedures used by regulators should be impartial with respect to all market participants.

In addition in the field of licensing requirements and procedures, specific principles would need to apply¹.

¹ The following are suggested as specific principles for licensing requirements and procedures:

- Criteria and procedures should be the same for domestic and foreign applicants, unless a distinction has been justified according to the principles of good regulation.
- Criteria should be proportional to the aims pursued, i.e. to assess the competence and the ability to supply the service.

The general principle should be that domestic regulatory measures have to be “proportionate to the objective pursued”. But there is a second proportionality test to be met, relating to the “trade restrictiveness” or “degree of burdensomeness” of domestic regulatory measures. To meet this second test, domestic regulatory measures must be “least trade restrictive”. In practice it is recognised that an absolute test would be extremely difficult to apply: the guiding principle should be that, if faced with a number of practical regulatory options, all of which might be thought “not more burdensome than necessary”, regulators should evaluate the options against the criterion of being “least trade restrictive”; and the option that meets this criterion, - or a freshly identified option, if all existing options fail to do so – should be preferred.

3.4 Periodic Review

Any criteria of legitimacy, necessity and proportionality can only be satisfied if domestic regulatory measures are subject to periodic review to test whether they continue to meet the criteria. The reasons for this are self-evident. To the extent that it does not already do so, the IAIS may wish to build in the concept of periodic review into its approach to international standard-setting.

4. CONSISTENCY WITH GATS REQUIREMENTS ON MARKET ACCESS AND NATIONAL TREATMENT

In addition to horizontal principles applicable to domestic regulation of all services sectors, particular sectors will need to elaborate specific principles and particular features that are relevant to:

- commitments to market access and national treatment in those sectors;
- “best practices”, which may take the form of “additional commitments under Article XVIII of the GATS”.

Such special rules should be provided for in future GATS sectoral agreements or in sectoral schedules. This was the approach used in the GATS Annex on Telecommunications and the Basic Telecommunications Reference Paper.

As regards market access and national treatment, past experience of GATS negotiations has shown that commitments offered by WTO Members may contain gaps and ambiguities. In many cases, these do not necessarily reflect deliberate reservations by a WTO Member as regards specific commitments to be offered. Rather, they result from the absence of any known “model” setting out, for reference purposes, the range of commitments that might desirably be included, for purposes of consistency and comprehensiveness. In certain services sectors, therefore, it will be valuable to give greater specificity and predictability to those commitments that are important to the sector. In addition, it will be useful to set forth obligations not clearly addressed, such as the obligation to fulfil a staged commitment within a specified timeframe, or an obligation to protect acquired rights (“grandfathering”).

As regards “best practices”, these may take the form of “additional commitments” under Article XVIII of the GATS, and may address those aspects of domestic regulation that are not covered by market access or national treatment provisions (i.e. non-discriminatory regulation). Such aspects may reflect regulatory obligations that exist for both foreign and indigenous suppliers of services. In such cases,

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- Application procedures and the related documentation should not be more burdensome than necessary to ensure that applicants fulfil qualification and licensing requirements.
 - Where an examination is required, such examinations should be scheduled at reasonably frequent intervals.
 - Fees for lodging and processing an application should be proportional to the administrative costs of the competent authority in processing the application.

the objective may well be for “best practices” to be adopted, on a uniform basis, by a critical mass of WTO Members.

Conceptually, commitments to market access and national treatment, on the one hand, and wider “additional commitments” on the other, serve the same objective. Both address the need to secure effective market access and national treatment. But they have to be considered separately, because of the way in which the GATS is structured.

Among financial services, it is recognised that the securities and insurance industries will need special rules. Examples of relevant approaches are provided by the Securities Industry Association’s work on Fair and Transparent Regulation and by the insurance industry text identifying Pro-Competitive Regulatory Principles, which have been codified in the “Model Schedule”. In addition, policy co-operation between WTO members and global service sector/professional associations would help to achieve a more coherent and transparent approach when specific regulations on individual sectors are introduced. Other industries may request some special rules, and new services that develop in the future may also necessitate special rules. These requirements and the dynamic nature of new industries, should be recognised by establishing a negotiating framework that has the flexibility to accommodate the unique nature of individual service sectors.

5. CONCLUSION

A presentation of this kind cannot set out, in a definitive manner, all the objectives which the private sector, as represented in the European Services Forum, would wish to see achieved. But the ESF hopes that the broad principles and regulatory approaches outlined in this paper will help to guide negotiations in the GATS framework towards developing criteria and practices in the field of domestic regulation that will be market-friendly and promote a competitive world market in the provision of services, subject to fair application of the rules that the GATS rules-based system provides. Insurers have an obvious interest in this process, in which multilateral standard-setting bodies such as the IAIS have an important role to play.

ESF PROPOSAL FOR A TRANSPARENCY FRAMEWORK

The ESF proposes a Framework for the ongoing negotiations in the WTO regarding transparency in government regulation of services. Its purpose is to provide more specific recommendations for how governments should pursue GATS transparency issues in forthcoming negotiations.

Improving General Transparency Disciplines

A transparent and fair regulatory system is important for every service sector. Pursuant to GATS Articles XVIII and XIX, general commitments should be sought in three areas: (A) Standard-setting, (B) the Regulatory Application Process, and (C) Judicial, Arbitral, or Administrative Tribunals.

A. Standard-setting

Negotiators should seek agreement on the following general principles:

1. All new (or revised) regulations should be available for public comment prior to adoption with adequate time for comments by service suppliers operating in (or seeking to operate in) the national market.
2. To facilitate the notice and comment process, a public hearing should, when necessary and appropriate, be held to receive private sector input regarding proposed regulations.
3. Government agencies should address the comments received from interested parties.
4. New regulations should not be made effective until market participants have a reasonable period of time to become familiar with their contents and to take steps to implement them, except in emergency situations.
5. New regulations should be drafted so that they are clear and understandable.
6. Any hearings by government-sponsored advisory committees should normally be open to the public. When regulators or advisory committees hold private meetings that relate to pending regulatory proposals, a report of the substance of the meeting should be made available promptly to the public.

B. Regulatory Application Process

Negotiators should seek agreement on the following general principles:

1. All current regulations and licensing criteria should be publicly available and accessible in writing and through electronic media so that all market participants have easy access to such material. Licence applicants should be provided with a written statement setting out fully and precisely the documents and information the applicant must supply for the purpose of obtaining authorisation.
2. Regulators should establish a mechanism to respond to inquiries on rules and regulations from service suppliers. Enquiry points for the public should be provided.
3. Regulatory interpretations and the grants of regulatory exemptions should be made available to the public on a prompt basis (subject to business confidential rules).
4. When an examination is required for the licensing of an individual, regulators should schedule such examinations at reasonably frequent intervals. Examinations should be open to all eligible applicants, including foreign applicants.
5. Actions on any application for a licence should be taken within a reasonable period of time. Licences should enter into force immediately upon being granted.

6. No service supplier should be denied a license, and no new service should be prohibited, on the basis of any factor not identified in the published written regulations or interpretations.
7. When an application for a license or other regulatory status is denied, regulators should provide a detailed explanation for that action, including the particular requirements that were not satisfied. Applicants should be given the opportunity to resubmit applications or to file additional or supplementary material.
8. Administrative fees charged in connection with licences should be fair and reasonable, should not act to unreasonably limit licensing requests or the introduction of new products and service, and should seek to recover no more than the costs of the competent authority in processing the licence application and thereafter supervising the regulated entity.
9. Confidential information provided by an applicant should not generally be disclosed. Disclosure of such information should occur only in accordance with established rules permitting public disclosure.

C. Judicial, Arbitral, or Administrative Tribunals

Negotiators should seek agreement on the following general principles:

1. Service providers should have an opportunity to file a complaint about inconsistent enforcement between foreign and domestic providers.
2. Service providers should have an opportunity to file a complaint about arbitrary regulatory action against those who give comments in regulatory hearings.
3. Applicants should have an opportunity to file a complaint in the event that a license application is refused review or a decision is delayed by the relevant authority.
4. Applicants should have an opportunity to file an appeal in the event that a license application is denied. Appeals should be decided within a reasonable period of time. In the event of the appeal being dismissed by the regulatory authority, the regulatory authority's decision should be capable of being reviewed by judicial/administrative courts or by arbitration.
5. In any regulatory enforcement proceeding, the service supplier should be notified in a timely manner about the proceeding and should be given an opportunity to be heard and to submit documentary evidence. Subjects of regulatory proceedings should have the right to legal counsel of their choice. The subjects of regulatory proceedings should be permitted access to evidence.
6. The burden of proof to demonstrate that a licensed market participant has not conducted its business in accordance with the relevant law should lie with the regulatory authorities.
7. Disciplinary actions should not be taken on violations of regulatory standards that were not in effect at the time the relevant activity took place.
8. Sanctions by a regulatory authority should not be imposed in an unfair or discriminatory manner. Regulators should treat similarly situated persons and entities in a similar manner.
9. The subjects of any regulatory enforcement proceeding should have an opportunity to appeal any enforcement finding or sanction imposed.