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## **Legal Regulation of Financial Services under the Conditions of Accession of Russia to the World Trade Organization**

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**Abstract:**

*Nowadays the problem of bilateral trade's regulation of certain types of services in the context of Russia's accession to the World Trade Organization (WTO) is a problem of current importance. This is due to the fact that recently joined organizations because of their have little experience of interaction with the rules of the world trading system and do not have enough time to adapt to the commitments they have made.*

*One of such sectors is financial services. In order to minimize such incidents, the Russian Federation needs to systematize its obligations and to identify those bilateral relations that are contrary to WTO rules.*

*The aim of this article is to determine the optimal legal position of the Russian Federation in the sphere of trade in financial services in the con-text of WTO membership. Two models financial markets' liberalization were analyzed in the context of the functioning of the WTO.*

*Incurrence covenants of financial services of Russia as a member of this organization were investigated, as well as problems of financial sector's legal regulation of Russia under the conditions of the sanction regime*

**Keywords:** *Financial services, WTO, OECD, Financial market, GATS, GATT, Financial crisis, Exemptions, Restrictions, Sanctions.*

**JEL code:** *G18; G01; F13; F36; F38; F51; F53 .*

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## **1. Introduction**

Financial services have a special place in the sphere of international trade in services. This is confirmed by the constant increase in their volume, observed before the global financial and economic crisis and the resumption of growth after 2013.

Paragraph 5 of the GATS Financial Services Annex contains a legal definition of the term "financial service". Thus, in accordance with this definition, financial services are any services that are of a financial nature offered by a financial service supplier of any state that is a member of the World Trade Organization. But in connection with the tautological character of this definition, there is no possibility of an exact delineation of the range of services included in the number of financial. In this regard, the classification contained in the GATS Service Classifier and duplicated in paragraphs 6, 7 of the abovementioned Appendix has a special significance.

The financial services sector includes two subsectors. The first subsector is insurance services and insurance-related services. The second subsector is banking and other financial services (excluding insurance). All other services are part of the second subsector (lending of all types, acceptance of deposits from the public, financing of commercial transactions, financial leasing, factoring, money transfers and payments, etc.).

The international legal regulation of the financial services sector in the WTO is carried out through an extensive system of acts of international law. In the scientific legal literature, the above-mentioned international acts have been fully investigated, therefore, within the framework of this article we will consider the peculiarities of the financial services sector regulation, which lies in the fact of the various models implementation of financial services market liberalization. A standard approach of market liberalization is contained in the GATS and in the Annexes on Financial Services. The way for so-called swift liberalization opens the Understanding on commitments in financial services and the Agreement of 13.12.1997 (the 5th Protocol).

The aim of this study is to find the optimal legal position of the Russian Federation in the international financial services market in the context of WTO membership.

## **2. Methodology of the Research**

### **2.1 Methods of the study**

In the course of study, the general scientific methods of cognition have been used: methods of induction and deduction, analysis and synthesis, classification and grouping, abstracting and observation. This study includes the following stages:

- 1) analysis of research works on the regulation of financial technologies in the conditions of the World Trade Organization;
- 2) analysis of specific obligations of the Russian Federation in the sphere of trade in financial services within the WTO;
- 3) development of the optimal legal model for Russia's regulation of trade in financial services. This study allowed for the first time to undertake a study of two models of financial markets liberalization in the context of the WTO and to estimate efficiency of Russia's position with regard to the regulation of this area.

The subject of the study are normative legal acts of the WTO, OECD and the Russian Federation in the sphere of trade's regulation in financial services.

### **3. Results and discussion**

Within the framework of the GATS, WTO member countries undertake a number of obligations, both general and specific. The general obligations are all service sectors, including financial services. These include obligations related to ensuring transparency and the provision of the most-favoured-nation treatment. On the basis of content of Art. II GATS, we emphasize that the most-favoured-nation treatment for trade in services implies one common duty of WTO members, consisting in providing services and service providers to other members of the World Trade Organization no less favorable treatment than for the same services and suppliers of any other state.

Thus, the countries participating in the World Trade Organization are provided with equal access to the national markets of other countries participating in the World Trade Organization (Kim, 2002). We should note that this treatment, in addition to services, extends to the suppliers themselves. The provision on granting the most favorable mode has an unconditional character and does not entail requirements for the similar provision of the treatment (Valckx, 2002).

But the GATS provides the possibility of withdrawals from the most-favored-nation treatment, in accordance with Art. II Annexes on Exemptions. Taking into account the fact that not every country joining the World Trade Organization can provide most favored services to service providers in some service sectors, it is permissible to establish exemptions fixed in the list of specific obligations (Mattoo, 1998).

WTO member-countries also assume obligations related to ensuring the transparency of domestic regulations (GATS Article III). The need for transparency is determined by the dominance of domestic regulations in the regulation of trade in services in the territories of states that have joined the WTO (Crosby, 2008). In order to export its services, the service provider should be aware of the specifics of the domestic legal regulation of a service sector on the territory of a member country of the World Trade Organization, which he can learn only monitoring open sources (Cottier *et al.*, 2012).

Specific obligations include access to the market for service providers, members of the WTO and the provision of national treatment for them in respect of any sector and subsector of services, including the financial services sector (Claybrook, 2008). A WTO member, at his own discretion, determines the level of liberalization of the financial services market, and also establishes a number of conditions and restrictions for gaining access to this market, which are fixed in the list of specific obligations (Parlin, 2002). However, such restrictions and conditions should not be discriminatory for some countries that have joined the WTO.

The obligation of the national treatment provision requires for service providers of the member-countries of the World Trade Organization the same treatment as for national service providers (Assefa, 2014). It should be noted that the requirement of the national treatment, contained in Art. XVII GATS and formulated in such a way that contributes to the legalization of inequality of the national treatment (Carro & Juillard, 2002). Usually, the national treatment acts as an exception: only in the sectors mentioned in the list of specific obligations, as well as on the requirements and conditions that it specifies.

Therefore, in the list of specific obligations of each WTO member state, it is necessary to fix all the restrictions of the national treatment for all existing treatments of service supplies, they are:

- cross-border supply;
- consumption abroad;
- commercial presence;
- movement of individuals.

The specifics of the legal regulation of trade in financial services are reflected in the Annex on Financial Services, which is part of the GATS (Barbee and Lester, 2014). Thus, this Annex provides the possibility of WTO member-country adopting prudential measures or precautions, which include measures to protect policyholders, investors, and trustees of financial service providers, as well as measures to ensure the stability and integrity of the financial system in whole. The adoption of precautionary measures implies the introduction of certain restrictions in the sphere of trade in financial services (Kern, 2007). In this regard, the Annex refers to the inadmissibility of using such measures to evade WTO members from their obligations under financial services (for protection purposes).

Thus, the standard approach the financial services market liberalization assumes that the country entering the WTO accepts obligations in the financial services sector, including restrictions on the national treatment or access to the market, as well as the possibility of taking precautionary measures or prudential measures (Kern, 2003). But this approach no longer met the needs of developed countries, which occupy leading positions in the sphere of trade in services. The member-countries of the Organization for Economic Cooperation and Development (OECD) have moved much further in

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the liberalization of financial markets. The optional agreement was adopted in addition to the GATS. It is an agreement on obligations for financial services, within which a model of rapid liberalization of the financial services market was implemented. The Arrangement Standards deviate significantly from the method of concrete obligations, which is incorporated in Part III of the GATS, towards greater detail of their binding content (Carro and Juillard, 2002).

At the same time, the model of rapid liberalization of the financial market proved to be unacceptable for the most of developing economies. Liberalization of the financial market implies its deregulation, which entails the risks of financial crises. The financial markets of emerging economies are affected to a greater extent. According to experts, the growth in the outflow and inflow of foreign capital that may arise in connection with the liberalization of financial services requires careful monitoring and management by financial authorities, especially in small countries where rapid flows can have quite tangible consequences (Moore, 2000).

Russia by accepting obligations in the financial sector in accordance with the Financial Services and GATS Annex, has chosen a standard approach to the financial market liberalization. The degree of liberalization is evidenced by the volume of commitments undertaken. So, in particular, Russia assumed obligations on 4 subsectors of insurance services and 12 sub-sectors of banking and other services, that is, in the entire financial sector as a whole.

It is necessary to recognize that Russia had to make significant liberalization of financial markets due to pressure from the WTO member-countries. This practice is common for countries that are entering the WTO. Thus, the United Nations Conference on Trade and Development (UNCTAD) stated that the commitments of the new member countries demonstrate a higher level of liberalization. It seems that the structure of obligations of new WTO member countries on supplies treatment, as in the case of sectoral coverage, does not fully correlate with the development level of their economies, as well as with similar indicators of commitments of the countries participating in the Uruguay Round. Apparently, this is due to the holding of negotiations in a multi-lateral, but in a bilateral format.

WTO member-countries, leaders in the international trade in financial services, especially the United States, during the negotiations on Russia's accession to the WTO, insisted on the opening of financial markets for branches of foreign legal entities that are providers of financial services. In particular, the American Council of Life Insurers openly stated that would oppose Russia's accession, if Russia does not guarantee access to the market of foreign life insurance companies. But in the list of specific obligations of Russia, as one of the measures applied to all sectors of financial services, it is provided that legal entities providing financial services should be established in organizational and legal form in accordance with the current Russian legislation.

Russia agreed to make some concessions in the insurance services sector and assumed the obligation to admit insurance services to branches of foreign insurers (reinsurers), but only 9 years after its accession to the WTO. The report of the working group on Russia's accession to the WTO states that domestic insurance companies should use this postponement to increase competitiveness and to bring to the market effective insurance products, both in the sphere of property and personal insurance.

After the 9-year term expires, the branches of foreign insurers will receive the right to provide life insurance services, compulsory insurance (except third party liability insurance) and provision of services for other types of insurance (in particular, property insurance), with the exception of public procurement insurance. Branches of foreign reinsurers will be able to provide services in the field of reinsurance, except for reinsurance of risks associated with public procurement insurance and compulsory insurance, in addition to third party liability insurance. At the same time, branches of foreign legal entities must meet the requirements for licensing, guarantee deposit and ensuring financial stability.

Concerning the subsector of banking services, Russia has taken a more tough stance. In the list of specific obligations of Russia, commercial representation is permissible only in the form of a Russian legal entity or a representative office of a foreign bank. It should be taken into account that there is a restriction on market access established in the horizontal obligations of the Russian Federation: representative offices are prohibited from carrying out any commercial activity, including supply of services. Thus, branches of foreign banks are denied access to the Russian market, although, as follows from Art. 18 of the Federal Law No. 3954 of 02.12.1990 "On Banks and Banking Activities", until 2006, foreign banks were allowed to establish branches and conduct business in Russia. We emphasize that none of the branches of a foreign bank was registered, and the text of the Law excluded references to branches of foreign banks.

The Russian Federation cautiously approached the liberalization of the banking services market and did not allow branches of foreign banks to enter it. It is widely believed that the main danger from liberalization in this sphere is the loss of sovereignty over own finances, which is one of the key strategic outposts of the sovereignty of any state. Experts state that Russia was able to defend restrictions for foreign banks in such way.

However, many underestimate the fact that this decision will not contribute to the inflow of foreign investment into the Russian financial sector. One can say with confidence that in the domestic banking system there has been no significant increase in the share of foreign capital. At the time when Russia joined the WTO (January 1, 2012), the share of non-residents in the total authorized capital of the banking system was at the level of 27.7 percent, and by early 2015 it had decreased to 21.68 percent. It should be noted that this decrease was caused by several objective reasons, in particular, the introduction of sectoral economic sanctions, recession, as well as a

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significant reduction in the credit rating of the Russian Federation. But this can hardly be explained solely by the unfavorable political and economic environment. For comparison: in Ukraine, which is currently on the verge of default, the share of foreign capital at the beginning of January 2015 was at the level of 32.5 percent.

The banking lobby has led to an increase of the threat of foreign capital to the domestic banking system. According to this, the Russian Federation's accession to the WTO did not help to attract foreign investments as most banking analysts had hoped. As analysts noted earlier, an increase of the permissible limit of foreign participation in the capital of Russian banks to a level significantly higher than the current 20-24 percent, is able to attract even more investors to the sector.

Accordingly, Russia has a huge potential for the banking services market liberalization. As noted in the above-mentioned Report of the Working Group, Russia plans to return to consideration of granting access to the market to direct branches of foreign companies and banks acting as professional participants in the securities market. The consideration of granting access is planned in the framework of the forthcoming negotiations on Russia's accession to the OECD or within one of the upcoming rounds of multilateral trade negotiations of the WTO, proceeding from what will happen earlier.

Despite economic sanctions, the Russian Federation intends to continue to move towards liberalization of the financial market, including the banking services market. But the effect of sanctions leads to a significant increase in the well-known risks of the financial market liberalization. In particular, the commercial presence of foreign banks leads to an increase of the financial market instability, which results in the outflow of capital abroad. In the conditions of sanctions, this risk multiplies many times, which is confirmed by cases of the withdrawal of well-known foreign banks from the Russian market. Thus, maintaining the quota of foreign capital in the banking sector is not only topical, but also justified.

#### **4. Conclusions**

The domestic experience of the sanctions regime shows that the domination of financial services of foreign suppliers is a particular danger. In cases where certain financial services are provided only by one foreign supplier, the likelihood of negative consequences in connection with its refusal to provide a particular service, is increased.

Due to the accession of the Russian Federation to the Understanding on Obligations for Financial services is inappropriate. Participation in the Arrangement is able to open a lot of opportunities for the monopoly of foreign financial service providers in the delivery of new services, which under the conditions of sanctions can have a negative effect, expressed as losses from the termination of the supply of financial services by such suppliers.

Thus, the choice of the future strategy for the development of financial markets must be carried out taking into account all the potential risks to the economic security of the state in the conditions of existing sanctions.

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