

A REVIEW OF THE RULING ON THE INTERPRETATION OF THE ‘PRUDENTIAL EXCEPTION’ IN ARGENTINA – MEASURES RELATING TO TRADE IN GOODS AND SERVICES (WT/DS453/AB/R)

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Last year, the WTO Dispute Resolution Body for the first time ruled on a case submitted to it in light of the ‘prudential exception’ of paragraph 2(a) of the Annex on Financial Services. Because of its broad and vague formulation Members have experienced difficulty in applying the exception and a ruling by the Panel and Appellate Body had therefore been eagerly awaited. Due to the extensive potential implications on the regulation of the financial sector within Members this provision potentially has, the exception, until the recent Argentina-Financial Services case, had not been tested in the WTO Dispute Settlement system. A key issue here is balancing the right of Members to regulate their financial services and determine what ‘prudential exceptions’ for it are and the right to free trade in financial services. This paper examines whether the Panel and Appellate Body enlightened Members on the scope and applicability of this exception and clarifies concerns from Members as well as financial sectors on the issue. It does this by examining the language of the provision, the ruling of the WTO Dispute Settlement Body in the case Argentina-Financial Services, the implications of this case and the use of such a ‘prudential exception’ in other multilateral and bilateral agreements. It concludes that the Panel and Appellate Body here followed the intentions of the drafters of the provision and although providing some clarifications on the scope of the provision, it still leaves many considerations open for future debate.

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The ‘Prudential Exception’ has been subject to intense debate following its entry into the Uruguay Round negotiations for further development of WTO law in 1990.¹ Where, during the negotiations, countries were eventually able to agree to a literal echo of their visions regarding the need for an exception clause in the General Agreement on Trade in Services (hereafter GATS); paragraph 2(a) of the Annex on Financial

Services.² This however was far from straightforward.³ The flexibility and arguably subjective nature of the provision⁴ has resulted in calls for interpretative guidance from governments⁵ as well as industries but at the same time, until recently, has not resulted in World Trade Organization (hereafter WTO) Dispute Settlement submissions, which is most likely because of great uncertainty regarding the

¹ MTN.GNS/FIN/1, Note on the Meeting of 11–13 June 1990, Working Group on Financial Services Including Insurance, 2, (July 5, 1990).

² Art. 2(a) Annex on Financial Services reads: *‘Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they*

shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.’

³ MTN.GNS/FIN/1, Note on the Meeting of 11–13 June 1990, Working Group on Financial Services Including Insurance, (July 5, 1990).

⁴ Mads Tønnesson Andenæs and Kern Alexander, *The World Trade Organization and Trade in Services* (Leiden, Brill, 2008), 604.

⁵ Committee on Trade in Financial Services, Note by the Secretariat: Communication from Ecuador, Proposal for furthering work on Regulatory Measures in Financial Services, for inclusion in the Ministerial Declaration, 4, S/FIN/W/80, (October 7, 2011).

outcome, fear of backlash and the general, pre-crisis trend towards deregulation.⁶ The Argentina-Financial Services case therefore, is a first impression case, meaning that it is the first case to deal with the issue and therefore has potentially huge implications, especially considering the presence of (near) identical provisions in numerous Free-Trade Agreements (hereafter FTA) such as the Korea-US FTA⁷ and the Transatlantic Trade and Investment Partnership (hereafter TTIP).⁸ In this case, Panama challenged eight financial measures that Argentina imposed on "countries not cooperating for tax transparency purposes"⁹ of which measure five and six were justified by this 'prudential exception' according to Argentina.¹⁰ This paper will examine whether the case succeeded in clarifying the meaning and scope of paragraph 2(a) of the Annex on Financial Services and what the implications of the Panel and Appellate Body ruling were on the issue.

Concerns Regarding the 'Prudential Exception'

As widely seen in other WTO law instruments, the Annex on Financial Services also contains an exception clause in paragraph 2(a). This provision essentially entails that 'notwithstanding any other provision of the Agreement',¹¹ WTO Members can take prudential measures to protect investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier or otherwise to ensure the integrity and stability of the financial system.¹² Because of the

language in this provision, and more specifically, the use of 'prudential', this paragraph is also known as the 'Prudential Exception'. The definition of 'prudential' according to the Oxford English Dictionary relates to 'care or forethought, especially in business',¹³ in this context however the rationale remains ambiguous. Concerns regarding the 'Prudential Exception' have revolved around clarification and guidelines for application and stem from an attempt by negotiators to balance the national right to regulate and promoting free trade.¹⁴ The subjectivity of such underlying motivations of course results in discord between governments and among industries who greatly diverge in interests and intentions. Although this is illustrated in the non-exhaustive list of 'prudential reasons' in paragraph 2(a) Annex on Financial Services,¹⁵ allowing countries to rank their own potentially 'prudential reasons', this does not go far enough nor does it provide countries with guidance as to what will be considered as admissible by the Dispute Settlement Body (hereafter DSB). The financial sector has previously dubbed the exception inutile as it fails to cover systemic risks; risks that relate to an entire system instead of one individual entity, which it outlines are the most fundamental due to the huge implications they may have,¹⁶ and Global Trade Watch has referred to the language and structure of the provision as 'self-cancelling'.¹⁷ Indeed, the second sentence of the provision raises questions as to whether it should be assessed if the measure

⁶ Public Citizen's Global Trade Watch, 'Special G20 Report: 'No Meaningful Safeguards for Prudential Measures in World Trade Organization's Financial Service Deregulation Agreements', (Special Pittsburgh G20 Report, 2009), 10.

⁷ Art. 13.10 KORUS FTA, 2012.

⁸ Art. 5-31 TTIP, 2016.

⁹ Decree No. 589 of the Federal Public Revenue Administration of 27 May 2013 (Decree No. 589/2013), (Exhibits PAN-3 / ARG-35).

¹⁰ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, Addendum, para. 58.

¹¹ Paragraph 2(a) Annex on Financial Services, General Agreement on Trade in Services, 1995.

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https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c2s1p1_e.htm

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<https://en.oxforddictionaries.com/definition/prudential>
¹⁴ Mads Tønnesson Andenæs and Kern Alexander, *The World Trade Organization and Trade in Services* (Leiden, Brill, 2008), 606.

¹⁵ Paragraph 2(a) Annex on Financial Services, General Agreement on Trade in Services, 1995.

¹⁶ Inu BarBee and Simon Lester, 'Financial Services in the TTIP: Making the Prudential Exception Work,' *Georgetown Journal of International Law* 45 (2014) 954.

¹⁷ Lori Wallach and Todd Tucker, Memo: Answering Critical Questions About Conflicts Between Financial Reregulation and WTO Rules Hitherto Unaddressed by the WTO Secretariat and Other Official Sources, Public Citizen (May 21, 2010).

at issue, as it is effectively applied, genuinely seeks a prudential objective or whether it is used as a means to escape the respondent's obligations and commitments and what the range of potential prudential reasons actually entails. Alternatively however, it is also intriguing to find that a considerable number of countries find that the provision functions well.¹⁸ Although this is perhaps not a surprise considering the participation in negotiating the clause by such countries, numerous states acted reluctantly when Ecuador requested the Committee on Trade in Financial Services to review the language of the Annex at the 8th WTO Ministerial Conference.¹⁹ Regardless however, the Argentina- Financial Services case was welcomed by WTO members who recognized its potential.

Paragraph 2a of the Annex on Financial Services

The language of paragraph 2(a) of the Annex on Financial Services provides great insight into the intentions of the drafters but also has an inclination to baffle its analysts. The initial part of the first sentence appears to be a common way of setting out exception clauses in WTO law, 'Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures'²⁰ infers that a measure is accepted even when this offends another provision. These exceptions are then listed in broad terms and not limited to certain financial services sectors or issues, granting Members almost complete independence in finding measures it finds should be exempted. The fact however that these measures must be 'for' prudential reasons does not require that it must be necessary or reasonable.

The lack of a necessity test distinguishes the provision from other, like, exception clauses such as article XX of the General Agreement on Tariffs and Trade 1994 (hereafter GATT).²¹ As this has been repeatedly subject to dispute and has been a notorious issue in the interpretation of WTO law, this is seemingly drafted to avoid such controversy and testing.²² Although references have been made to the chapeau of GATT (the introductory paragraph) and WTO exception clauses in contending that the provision in question does require such testing,²³ one can accept with confidence that had the drafters of paragraph 2(a) of the Annex on Financial Services intended to attach such a condition to measures taken for prudential reasons, they would have related to article XX GATT 1994 for example and explicitly phrased it as such. On the other hand, 'for' denotes that a causal relationship must exist between such measure and the prudential reasons and that the burden of proof lies with the party invoking the exception.²⁴ As the clause does not include a standard to be applied, perhaps here the general chapeau of GATT and GATS should be appreciated here and this relationship should be tested on a case by case basis. With regard to the second part of the provision, 'shall not be used as a means of avoiding commitments or obligations' shows striking similarities to article XX GATT 1994's 'not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination',²⁵ suggesting that non-protectionist purposes must be real and perhaps introduces an added obligation not to violate GATS rules. Paragraph 2(a) of the Annex on Financial Services however is evidently troublesome in the way in which it is drafted, it is vague and consequently

¹⁸ Committee on Trade in Financial Services, Report of the Meeting Held on 13 July 2000, Note by the Secretariat, 32, 35, S/FIN/M/27 (August 23, 2000).

¹⁹ Committee on Trade in Financial Services, Note by the Secretariat: Communication from Ecuador, Proposal for furthering work on Regulatory Measures in Financial Services, for inclusion in the Ministerial Declaration, 4, S/FIN/W/80, (October 7, 2011).

²⁰ Paragraph 2(a) Annex on Financial Services, General Agreement on Trade in Services, 1995.

²¹ Article XX, General Agreement on Tariffs and Trade, 1994.

²² Mads Tønnesson Andenæs and Kern Alexander, *The World Trade Organization and Trade in Services* (Leiden, Brill, 2008), 610.

²³ S/WPDR/M/12, supra note 50, Annex, Informal Summary of Discussions on the Checklist of Issues for WPDR, 16.

²⁴ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, Addendum, para. 7.891.

²⁵ Article XX, General Agreement on Tariffs and Trade, 1994.

difficult to apply as seen in the case Argentina-Financial Services.

The Argentina- Measures Relating to Trade in Goods and Services Case

The dispute between Argentina and Panama here concerned eight financial, taxation, foreign exchange and registration measures imposed by Argentina on services and service suppliers from what Argentina deemed ‘countries not cooperating for tax transparency purposes’, otherwise regarded ‘non-cooperative countries’.²⁶ According to Argentinean law, these are countries that have not signed an agreement on the exchange of tax information.²⁷ On the basis of this decree, Argentina imposed such measures on Panama which Panama in turn considered inconsistent with WTO law. As seen in the Panel and Appellate Body Reports, the DSB was urged to rule on whether Argentina could invoke the ‘Prudential Exception’ of paragraph 2(a) of the Annex on Financial Services. Here, a ruling had been anxiously anticipated and its potential as a first impression case has not been underestimated by the Appellate Body, who acknowledged the United States’ view that it warrants a cautious approach because of the broad scope of the provision and the reliance on it in other plurilateral and bilateral trade agreements.²⁸ Perhaps however the Panel and Appellate Body have been too cautious in this respect as failure to consider the most controversial aspect of the exception leaves many questions unanswered. Interestingly, the Appellate Body refers to previous cases where emphasis was placed on interpretation based on the actual text of

a document when read in its context.²⁹ This explicitly implies that literal implications should be considered as opposed to the general chapeau of other agreements, which is indeed appropriate considering the nature of such documents. The chapeau of GATT 1994 is for example conceivably guided by the principle of good faith whereas the ‘Prudential Exception’ as in the Annex on Financial Services focuses on anti-abuse.³⁰ This is supported by the fact that here, the Panel took a literal approach to the question of whether the provision actually constitutes an exception³¹ and whether the clause requires a measure to be ‘domestic regulation’.³² Considering this submission, the Panel rejected Panama’s proposals and ruled that the exception would not apply exclusively to domestic regulation nor would it only apply to measures taken to counteract imminent risks, thereby explicitly emphasizing the evolutionary nature of the provision.³³ Nevertheless, in an attempt to clarify concerns surrounding the ‘Prudential Exception’ and considering the Party’s submissions, the Panel outlined three requirements that are to be fulfilled for a measure to be justified under the exception. First of all, a party, in this case Argentina, must prove that the measures were measures “affecting the supply of financial services”, secondly, that the measures were taken “for prudential reasons” and finally, that the measures had not been used “as a means of avoiding commitments or obligations” under the GATS.³⁴ Considering the first condition, the Panel determined that the clause covers any measure that has ‘an effect on’ the supply of financial services,³⁵ the Appellate Body furthered

²⁶ Panel report factual aspects

²⁷ Article 1 Decree No. 589/2013

²⁸ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, Addendum, Annex C-3. Para. 20.

²⁹ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Appellate Body, para 6.227.

³⁰ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, Addendum, Annex C-3. Para. 24.

³¹ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, paras. 7.811-816.

³² WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, paras. 7.826-829.

³³ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, para. 7.878.1.

³⁴ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, para. 7.851.

³⁵ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, paras. 7.853-858.

this by asserting that the types of measures triable should not be restricted, thus confirming its broad scope.³⁶ With regard to the second requirement, the Panel confirmed that ‘for’ requires parties to find “a rational relationship of cause and effect” between the measure that the Member seeks to justify under paragraph 2(a) and the prudential reason provided for taking it.³⁷ To the disappointment of many legal scholars, the Panel declined to rule on the third, arguably most contentious requirement.³⁸ Although, some insightful thoughts have been provided by third parties who were wooed by the Panel in providing their opinions on this. The Panel agreed with the US for example that, together with the first sentence of the exception, ‘shall not be used as a means of avoiding’ GATS commitments, only requires that a measure is ‘taken for prudential reasons’ by a Member and not in order to avoid its GATS obligations.³⁹ Thus, it appears that the Panel in this case confirms the broad scope of the ‘Prudential Exception’ and mirrors the drafter’s hesitation in appropriating the anomaly.

Implications

The effect of the Panel and Appellate Body ruling in the Argentina- Financial Services case appears to grant national governments broad discretion in conceiving their own prudential reasons, leaving regulators appeased. However, this does not defer from the fact that unwillingness to rule on the third requirement leaves this issue open for debate in future jurisprudence. Although the case confidently identified three conditions for a measure to be justified under the exception,⁴⁰ and a

broad interpretation of ‘domestic regulation’, we remain uncertain whether this ‘Prudential Exception’ applies in areas where trade guidelines potentially do not accurately reflect the international discussions on trade. Whereas pre-crisis, deregulation was the preferred path, in the aftermath of the 2008 global financial crisis one sees a push for guidance on the applicability of GATS constraints on financial regulation.⁴¹ The case in this respect does not provide direction, as macro-prudential measures for example, even when realized for prudential reasons, may experience difficulties in satisfying the anti-avoidance aspect of the clause⁴² and similarly, regulators still cannot rely solely on this provision when considering systematic risks. Simultaneously however, the Panel’s reference to systemic risk is interesting. Where the Panel agreed with Argentina that avoidance of potential systemic risk can constitute a prudential objective in a protection measure, systemic risk is not a prudential measure,⁴³ thereby sharply distinguishing prudential measures from prudential reasons. Consequently, it appears that though insightful, the case leaves much interpretation of the exception open for further discussion, letting members regulate supply of services to meet national policy objectives.⁴⁴ However, bearing this in mind, it is credible to assert that the Appellate Body’s continuation of principles composed by the Panel suggests that future cases will also be approached in this way, implying that although the principles established in Argentina-Financial Services positively contribute to WTO law interpretation and hold great potential, future cases may also see

³⁶ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Appellate Body, para. 6.253.

³⁷ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Appellate Body, para. 6.245.

³⁸ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, paras. 7.945.

³⁹ Integrated Executive Summary of the Arguments of the United States, WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, Addendum, Annex C-3 para. 23.

⁴⁰ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, paras. 7.869-871, Report of Appellate Body, para. 7.851.

⁴¹ Andrew Cornford, ‘Coverage of Prudential Measures in the GATS: some conclusions of a WTO Appellate Body’ (Multi-year Expert Meeting on Trade, Services and Development, UNCTAD, Geneva, 18-20 May, 2016).

⁴² *Ibid.*

⁴³ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, paras. 7.869-871, Report of Appellate Body, paras. 7.898-904.

⁴⁴ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, paras. 7.869-871, Report of Appellate Body, para. 6.260.

an abstention of strictly qualifying the second sentence of paragraph 2(a) of the Annex on Financial Services. In addition, as the Panel accepted Argentina's argument that several of its measures were confirmed by the Organization for Economic Co-operation and Development's (hereafter OECD) Global Forum and itself used global consensus in evidencing the prudential tracks to financial regulation.⁴⁵ This perhaps suggests that future WTO DSBs should consult other International Financial Institutions such as the International Monetary Fund when considering the scope of prudential exceptions, as these clearly have more experience in the application effects of financial regulation.

Prudential Exception elsewhere

The 'Prudential Exception' as we know it in paragraph 2(a) of the Annex on Financial Services has been incorporated in an identical or otherwise similar manner in numerous Free Trade Agreements such as the Korea-US FTA⁴⁶ and the North American Free Trade Agreement,⁴⁷ (hereafter NAFTA) allowing private investors and corporations to sue governments in addition to the national governments themselves. Although to this date there have not been considerable cases enlightening this provision, the use of it provides interesting insights. In NAFTA for example, article 1410(1) adds a reasonableness test to its 'prudential measures' creating in essence, a barrier for measures to be exempted, something which negotiators in the Uruguay Round explicitly rejected.⁴⁸ NAFTA also does not contain the 'self-cancelling' second sentence of paragraph 2(a) Annex on Financial Services,⁴⁹ strikingly though, the tribunal in the 'Fireman's Fund' challenge although ruling on whether a tribunal determines

whether a challenged measure qualifies for the prudential exception, it also determined that a more robust exception does not necessarily qualify to protect a government's prudential measure.⁵⁰ In addition, the EU-Singapore Preferential Trade Agreement shows that the EU is more restrictive in drafting a prudential exception, including a necessity test and requiring that measures 'shall not constitute a means of arbitrary or unjustifiable discrimination against financial service suppliers of the other Party'.⁵¹ Perhaps however, the difference between GATS and such agreements should be attributed to the observation that the WTO, though GATS does not attempt to regulate the scope of the domestic regulation but rather seeks to ensure that WTO member's domestic regulation does not pose unnecessary barriers to cross-border trade in services.⁵² Although this reflects a discrepancy in the degree of liberalization and suggests that these cannot be viably compared, these alternative formulations and such comparisons are certainly thoughtworthy when considering alternative language and interpretation for the WTO exception. Likewise however they highlight the limitations of such alternative interpretations as well and illuminate the fact that their intentions perhaps do not wholly correspond to those of the WTO.

Conclusion

Overall, it appears that the subjective nature of paragraph 2(a) of the Annex on Financial Services limits the ability to clearly define it and those that were seeking clear guidance on the provision regarding content and implications from the Argentina- Measures Relating to Trade in Goods and Services case have probably been disappointed. On the other hand, perhaps such

⁴⁵ WT/DS453/R, Argentina- Measures Relating to Trade in Goods and Services, Report of Panel, paras. 7.863-879.

⁴⁶ Article 13.10 US-Korea Free Trade Agreement, 2012.

⁴⁷ Article 410 North American Free Trade Agreement, 1994.

⁴⁸ MTN.GNS/FIN/1, Note on the Meeting of 11-13 June 1990, Working Group on Financial Services Including Insurance, 85, 87, 88, (July 5, 1990).

⁴⁹ Paragraph 2(a) Annex on Financial Services, General Agreement on Trade in Services, 1995.

⁵⁰ ICSID Case No. ARB(AF)/02/01, Fireman's Fund Insurance Company v. The United Mexican States, Before the Arbitral Tribunal constituted under Chapter Eleven of the North American Free Trade Agreement, 59, 73-77, 95, and 103, July 17, 2006.

⁵¹ Article 8.50, EU- Singapore Preferential Trade Agreement, 2015.

⁵² Mads Tønnesson Andenæs and Kern Alexander, *The World Trade Organization and Trade in Services* (Leiden, Brill, 2008), 561.

expectations are irrational as it irrefutable that the Panel simply ruled in line with the drafter's intentions. Although the outcome of the case seems unsatisfying at a first glance, the ruling is also arguably to the benefit of national governments as it leaves room for regulators to interpret the provision and devise their prudential reasons. It is important to consider that a lack of jurisprudence at a WTO as well as on a regional level can potentially be attributed to the presence of more well-established provisions in the text of the Annex such as mutual recognition and cooperation. This has the potential effect of discouraging members from bringing a case based on this exception and is perhaps why it is likely that we will not see many further disputes. On the other hand, the unveiling of the Panama Papers and other offshore tax havens⁵³ may fuel more WTO Dispute Resolution submissions which may require effective guidance on how a measure can be used to avoid commitments or obligations under the Agreement.⁵⁴ It remains however, that although insightful, the long term implications of the ruling on the 'Prudential Exception' in this case are however still to be seen.

⁵³ Sidley Update: 'WTO Ruling Clarifies Flexibility in Member Governments' Regulation of Financial Services' <http://www.sidley.com/news/2014-04-20->

[international-trade-update](#) (last accessed on November 27, 2016).

⁵⁴ Paragraph 2(a) Annex on Financial Services, General Agreement on Trade in Services, 1995.