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**The GATS
and
Financial Services Regulation**

SESSION # 4



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The GATS and Financial Services Regulation

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Session 4. Financial Services regulation and liberalization

The overarching principle: “The Right to Regulate”

GATS Preamble:

Recognizing the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right

The “right to regulate” in WTO’s jurisprudence

“...as confirmed by the preamble to the GATS, China **retains the right to regulate, and to introduce new regulations** on the supply of services to meet domestic policy objectives... Finally, **paragraph 2(a) of the GATS Annex on Financial Services provides that**, notwithstanding any other provisions of the GATS, a WTO Member may take measures for prudential reasons, including for the protection of e.g. investors and depositors, or to ensure the integrity and stability of the financial system”

(Panel Report, China-Electronic Payment Services, para.7.569.)

The “right to regulate” in WTO’s jurisprudence

“Turning to the object and purpose of the GATS, we note that both the third and fourth recitals of the preamble of the GATS refer to Members' "national policy objectives"... The **fourth recital recognizes "the right of Members to regulate**, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives". **The "national policy objectives" referred to in the preamble could be pursued through various means, including through measures taken pursuant to paragraph 2(a) of the Annex on Financial Services**, provided that the measures "affect[] the supply of financial services", are taken "for prudential reasons", and are not "used as a means of avoiding" the Member's GATS commitments or obligations. An interpretation limiting the types of measures that could potentially fall under paragraph 2(a) would not be in consonance with the balance of rights and obligations that is expressly recognized in the preamble of the GATS.”

(Appellate Body Report, Argentina – Financial Services, para. 6.260.)

The GATS within the broader financial services regulatory framework

Types of government intervention with an impact on financial services:

- Macroeconomic policy management
 - *Outside the scope of GATS (Annex on FS, para.1.b)*
- Prudential regulation
 - *Subject to para 2.a) of Annex on FS*
- (Non-prudential) Domestic regulation
 - *Subject to Article VI*
- Trade liberalization
 - *Articles XVI, XVII and XVIII*

Zooming in on the GATS “prudential exception”

- Domestic Regulation

(a) 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.

Zooming in on the GATS “prudential exception”

- **Step 1: the measure must fall within the scope of the Annex:**
 - “The Panel observed that, **as a preliminary requirement, measures falling within the scope of paragraph 2(a) must be those "affecting the supply of financial services"** pursuant to paragraph 1(a) of the Annex on Financial Services.” (*)
- Only “Domestic Regulation”?
 - “The Panel noted that Panama had proposed a further preliminary requirement, namely, "that the respondent must demonstrate that the measure [at issue] constitutes a 'domestic regulation'." The Panel rejected Panama's argument in this respect...Specifically, the Panel stated that **"paragraph 2(a) of the Annex on Financial Services covers all types of measures affecting the supply of financial services within the meaning of paragraph 1(a) of [this] Annex and not only those measures that could be characterized as 'domestic regulations' within the meaning of Article VI of the GATS."** (*)

(*) Appellate Body Report, Argentina – Financial Services, para. 6.244.

Zooming in on the GATS “prudential exception”

- **Step 2: whether the measures were taken “for prudential reasons”**
 - “Having found that measures 5 and 6 fall within the scope of paragraph 2(a) , the Panel went on to examine whether these measures were taken "for prudential reasons" within the meaning of paragraph 2(a).” (*)
 - “The Panel divided its analysis into two steps. As a first step, the Panel found that the reasons identified by Argentina for adopting the measures were "prudential reasons". As a second step, the Panel focused on the word "for" and found that a Member invoking paragraph 2(a) must demonstrate that there is "**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. The Panel found that measures 5 and 6 do not have such a rational relationship with the prudential reasons identified by Argentina and, accordingly, that these measures were not taken "for" prudential reasons within the meaning of paragraph 2(a).” (*)
- **Step 3: whether the measure was used as a means of avoiding the Members’ commitments**
 - “Upon making these findings, the Panel did not go on to examine, under the second sentence of paragraph 2(a), whether the measures were not being used as a means of avoiding Argentina's commitments or obligations under the GATS.” (*)

(*) Appellate Body Report, Argentina – Financial Services, para 6.245.

Zooming in on the GATS “prudential exception”

- **A broad view of “prudential reasons”**
 - “Being merely illustrative, the list contained in paragraph 2(a) could include other prudential reasons beyond those explicitly cited”
 - “In the Panel’s opinion, the meaning and importance that Members attach to these prudential reasons may vary over time, depending on different factors, including the perception of the risk prevailing at different points in time.”
- **Freedom to define prudential reasons:**
 - “The nature and scope of financial regulation at different times reflect the knowledge, experience and scales of values of governments at the moment in question. We therefore consider that WTO Members should have sufficient freedom to define the prudential reasons that underpin their measures, in accordance with their own scales of values.”

(*) Panel Report, Argentina – Financial Services, paras. 7.869 to 7.871.

Zooming in on the GATS “prudential exception”

- **Evolutionary nature of “prudential reasons”:**
 - “We therefore agree with the third parties concerning the evolutionary nature of the concept of “prudential reasons”
 - “Accordingly, our interpretation appears to be consistent with the concerns of the international community regarding the nature and impact of the financial risks and the consequent need to preserve sufficient flexibility when determining the prudential reasons to which the regulation should respond.”
- **Potential risks do not need to be imminent:**
 - 7.878. In our view, it is important to understand that “systemic” problems may be incubating or gestating over the course of time and erupt rapidly; hence the importance of being prepared for them in advance. For example, in the particular case of the insurance sector, a situation of failure – and, ultimately, the possibility of contagion and financial instability, together with a threat to the protection of the consumers of these services – might be slow to emerge.
 - 7.879. In the light of the foregoing, we conclude that the expression “motivos cautelares” (prudential reasons) refers to those “causes” or “reasons” that motivate financial sector regulators to act to prevent a risk, injury or danger that does not necessarily have to be imminent.

(*) Panel Report, Argentina – Financial Services, paras. 7.872 to 7.879.

The GATS and Financial Regulation: The Case of Financial Inclusion

“The GATS and Financial Inclusion”

- (Secretariat Note S/FIN/W/88, 14 November 2014)
- Section 6: The Role of the GATS

Thank you!