HOW THE TRANS-PACIFIC PARTNERSHIP AGREEMENT COULD HEIGHTEN FINANCIAL INSTABILITY AND FORECLOSE GOVERNMENTS' REGULATORY SPACE[#]

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Abstract

The post-2007 global financial crisis exposed the chronic instability of a highly liberalised, deregulated and globally integrated financial system. The crisis has sparked a timely rethink on a financial services regime promoted through multilateral and bilateral agreements on trade in financial services and investment, with associated requirements for full capital account liberalisation. The negotiations for a Trans-Pacific Partnership Agreement (TPPA), depicted as an agreement for the 21st Century, provide an opportunity to revisit this approach. To date that has not occurred. Instead, negotiations appear to have proceeded on the basis of the existing bilateral trade agreements between the United States and four other TPPA parties. As a result, the financial services and investment chapters of the proposed TPPA risk binding the nine parties, including New Zealand, to obligations that could heighten financial instability and prevent governments from taking appropriate pre-emptive or remedial action in relation to future crises, including the application of capital controls and restructuring of sovereign debt. The parties are urged to adopt a moratorium on financial services and investment negotiations and enforcement of existing agreements, pending a multi-dimensional review of the financial services regime called for by the United Nations-appointed (UN) Stiglitz Commission of advisers in 2009.

I. Introduction

The post-2007 global financial crisis exposed the chronic instability of a highly liberalised, deregulated and globally integrated financial system. The debate on the nature of the systemic risks and the appropriate remedies is still

[#] This article expands on two previous papers. The first was prepared jointly with Sanya Reid Smith from Third World Network and presented as part of the stakeholder programme at the fifth round of negotiations on the Trans-Pacific Partnership Agreement held in Santiago, Chile in February 2011. Kevin Gallagher, Associate Professor of International Relations at Boston University, United States, Matthew Porterfield, Senior Fellow, Harrison Institute for Public Law, Georgetown University Law Centre, Washington DC, United States, Sarah Anderson, Global Economy Project Director, Institute for Policy Studies, Washington DC, United States and Todd Tucker, Public Citizen, Washington DC, United States also contributed to that paper. The second paper 'Embedding a Failed Model of Financial Services Regulation Through the Trans-Pacific Partnership Agreement' was presented at the New Zealand Centre for International Economic Law Conference in Wellington in 2009.

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embryonic. Despite its magnitude, however, this latest crisis is far from an isolated event.[1] No one knows precisely how and where the next crisis will unfold or what actions national governments and international institutions will need to take. In this fluid situation it is essential that governments retain the policy and regulatory space that will enable them to respond as they see appropriate to their situation.

In particular, the global financial crisis has sparked calls for a rethink on the promotion of financial liberalisation and deregulation through multilateral and bilateral agreement on trade in financial services[2] and associated requirements for full capital account liberalisation.[3] The UN-appointed group of experts on the financial system, known as the Stiglitz Commission, observed in May 2009 that:

> trade-related financial services liberalization has been advanced under the rubric of the WTO's General Agreement on Trade in Services (GATS) Financial Services Agreement with inappropriate regard for its consequences on orderly financial flows, exchange rate management, macroeconomic stability, dollarization, and the prudential regulation of domestic financial systems.[4]

1 In the 2008 Lowy Lecture former Australian Reserve Bank Governor Ian Macfarlane contextualised the current crisis as one of eight that has occurred in just over a decade. Four of those were banking crises. Macfarlane concluded that, even though some other crises had much more severe impacts on Australia, from an international perspective the depth and contagion of the GFC has clearly invalidated the model of a deregulated financial system that has operated in recent decades. Ian Macfarlane "Australia and the International Financial Crisis" (2008 Lowy Lecture, Sydney, 3 December 2008).

2 United Nations *Interim Draft Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System*, 21 May 2009 [Stiglitz Interim Report]; United Nations *Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System,* 21 September 2009 [Stiglitz Final Report]; Andrew Cornford *The World Trade Organization Negotiations on Financial Services: Current Issues and Future Directions,* Discussion Paper No. 172, UNCTAD/OSG/DP/2004/6 (UNCTAD, Geneva, 2004); Chakravarthi Raghavan *Financial Services, the World Trade Organization and Initiatives for Global Financial Reform, Report to the Intergovernmental Group of 24*, October 2009, <www.iatp.org/tradeobservatory/library.cfm>; Kevin P Gallagher *Policy Space to Prevent and Mitigate Financial Crises in Trade and Investment Agreements,* G-24 Discussion Paper No 58 (2010).

3 Most significantly, the International Monetary Fund, previously a stalwart champion for light-handed financial sector regulation and full capital account liberalisation, has published a number of documents that identify flaws in the model. See Jonathan Ostry, et al *Capital Inflows: The Role of Controls,* SPN/10/04 (International Monetary Fund Research Department, Washington DC, 2010); Ourada Merrouche and Erland Nier, "What Caused the Global Financial Crisis? – Evidence on the Drivers of Financial Imbalances 1999-2007", International Monetary Fund Working Paper WP/10/265 (International Monetary Fund: Washington DC, 2010); International Monetary Fund, Financial Stability Board and Bank for International Settlements, "Macroprudential policy tools and frameworks. Update to the G20 Finance Ministers and Central Bank Governors", 14 February 2011.

4 Stiglitz Interim Report, above n 2, at 87, [72].

The challenge to trade in financial services agreements coincides with a major reappraisal of international investment agreements, which face their own crisis of legitimacy. [5] Increasingly, states' obligations to foreign investors and the power of investors to enforce these obligations directly against host governments are seen to have an unacceptable chilling effect on regulations designed to benefit the rest of society and the environment. Recent responses to global financial instability, including renewed support for various forms of capital controls or financial transactions taxes, have generated vigorous debate over the need to revamp current templates and renegotiate existing obligations.[6]

Some investment chapters in free trade agreements have sought to rebalance the competing objectives of investment protection and promotion and the safeguarding of governments' regulatory space by introducing new terminology and interpretive notes,[7] and a broadening of the relevant considerations;[8] yet, as discussed below, the scale and legal impact of these innovations is limited and depends on unpredictable interpretations by ad hoc arbitral tribunals. Moreover, many old-style bilateral investment treaties (BITs) are still in force and have gained added potency through most-favoured-nation (MFN) clauses in the BITs and the Free Trade Agreements (FTAs).[9]

The TPPA negotiations provide the perfect opportunity to revisit the current approach to financial services, investments and currency movements. Its proponents aspire to a trade agreement that is fit for the 21st century.[10] That goal cannot be achieved if the TPPA perpetuates the flawed framework and onerous policy and regulatory constraints in existing multilateral and bilateral trade agreements; instead, it needs to wind them back.

To date, the TPPA negotiators have failed to grasp that opportunity. The Bush administration announced in early 2008 that the US would join New Zealand, Chile, Singapore and Brunei in negotiations on financial services and investment that were left over when the Trans-Pacific Strategic

5 M Sornarajah "The Retreat of Neo-liberalism in Investment Treaty Arbitration" in Catherine Rogers and Roger Alford (eds) *Developments in Investment Arbitration* (Oxford University Press, New York, 2009). Suzanne Spears "The Quest for Policy Space in a New Generation of International Investment Agreements" (2010) 13(4) J Intl Econ L 1037-1075.

6 For example, Letter to Secretary of State Hillary Rodham Clinton, Secretary to the Treasury Tim Geithner and United States Trade Representative Ron Kirk from Ricardo Hausmann, Dani Rodrik, Joseph Stiglitz, Arvind Subramaniam and 246 others, 31 January 2011; and in response, Letter to Secretary of State Hillary Rodham Clinton and others from John Endean, President, American Business Conference and 17 others, 7 February 2011, <www.ase.tufts.edu/gdae/policy_research/CapCtrlsLetter.pdf>.

7 In particular, the interpretive annexes on expropriation that are discussed below.

8 For example the inclusion of provisions that commit governments not to lower labour or environmental standards in pursuit of foreign investment.

9 Emily Sweeney Samuelson and Solomon Ebere *Working Paper on GATS Negotiations on Domestic Regulation: Could a Foreign Investor Use GATS Disciplines in a BIT Claim?* (Harrison Institute for Public law, Georgetown Law, Washington DC, Discussion Draft 19 May 2010).

10 See for example, Tim Groser "Joint Readout of Trans-Pacific Partnership Ministers' Meeting Ahead of Second Round of Negotiations" (press release, 5 June 2010).

Economic Partnership or "P-4" was signed in 2005. The three rounds of US-P4 negotiations coincided with the unfolding of the global financial crisis, yet the draft texts on investment and financial services uncritically followed the standard United States FTA template. Those drafts have been transposed into the nine-party TPPA process, which includes Australia, Malaysia, Peru and Vietnam.

Bracketed composite texts on financial services and investment, compiled during the negotiations, remain secret. However, briefings indicate that there has been no systematic reconsideration in light of the global financial crisis,[11] although some states have raised specific concerns regarding constraints on currency controls and the absence of any balance of payments emergency provision in the US FTA template.[12]

The secrecy surrounding the TPPA negotiations, including the refusal to release draft texts,[13] increases the risk that governments will adopt obligations that carry unacceptable financial, economic and social consequences.[14] It also makes informed commentary much more difficult. Given that information deficit and US dominance in the negotiations, the most reliable basis for analysis is the existing financial services and investment chapters of bilateral FTAs between the United States and four of the TPPA parties: Australia,[15] Chile,[16] Peru[17] and Singapore.[18] If concluded, the TPPA is expected to deepen these obligations for those countries and have a more far-reaching effect for New Zealand, Malaysia, Brunei and Vietnam who do not have an FTA with the United States.

The author argues that the TPPA risks binding the nine parties, including New Zealand, to obligations that could heighten financial instability and prevent governments from taking appropriate pre-emptive or remedial action in relation to future crises.[19] The first section of this article examines

11 The author receives regular briefings from the New Zealand negotiators on the progress of the negotiations, but little information of substance is made available.

12 Confidential communication to the author.

13 Brian Fallow "End Secrecy on TPP Trade Talks – Petition" *New Zealand Herald* (New Zealand, 13 April 2011) quoting New Zealand Minister of Trade Hon Tim Groser.

14 To provide a reference point for the paper presented in the stakeholder presentation in Santiago a 'mock' text was compiled from the United States Free Trade Agreements with Singapore, Chile, Peru and Australia. See <http://web.me.com/jane_kelsey/Jane/TPPA.html>.

15 Australia-United States Free Trade Agreement (signed 18 May 2004, entered into force 1 January 2005).

16 Chile-United States Free Trade Agreement (signed 6 June 2003, entered into force 1 January 2004).

17 United States-Peru Trade Promotion Agreement (signed 12 April 2006, entered into force 31 December 2009).

18 United States-Singapore Free Trade Agreement (signed 6 May 2003, entered into force 1 January 2004).

19 Other ways that a Trans-Pacific Partnership Agreement could restrict governments' ability to use common recovery measures, such as industry bailouts, to mitigate recession, job losses and social distress are not addressed here. Nor are the everyday socio-regulatory issues, such as community access to affordable credit, which financial services agreements raise.

both the link between the post-2007 financial crisis and the World Trade Organization's (WTO) Financial Services Agreement and the ways in which a TPPA that builds on the four FTAs would intensify the risks. The second section considers the additional obligations imposed through an investment chapter, including the prospect of investor-state disputes. The third section explains how a TPPA could foreclose the ability of states to apply capital controls and undertake sovereign debt restructuring. The last substantive section of this article critically assesses the claim that the prudential exception provides adequate regulatory space for governments to avert and respond to financial crises. In conclusion, the parties are urged to adopt a moratorium on the inclusion of financial services, investment and capital transfers in their FTAs, and on the enforcement of their bilateral obligations to each other, pending a multi-dimensional review of the trade in financial services regime called for by the Stiglitz Commission.[20]

II. Trade in Financial Services Agreements and Financial Instability

To understand how a TPPA might exacerbate existing problems it is necessary first to discuss the history and rules of the WTO's Financial Services Agreement, which underpins the four FTAs, and how these rules heighten the risk of financial instability.

A. The WTO Financial Services Agreement

The US had two main sectors in mind when it insisted that services were included in the Uruguay round of GATT negotiations: finance and telecommunications.[21] The powerful US finance industry had already established a model framework through the financial services chapter 17 of the Canada US FTA and chapter 14 of the North American Free Trade Agreement (NAFTA), signed in 1988 and 1993 respectively. The industry's Financial Leaders Group was the driving force behind the extension of the financial services negotiations beyond the end of the Uruguay round in 1994.[22]

The resulting rules and commitments on financial services are spread across four main documents, referred to here as the Financial Services Agreement.

The first is the basic GATS text. Its scope is very broad: the agreement applies to all measures (including laws, regulations and administrative decisions) *affecting* the supply of financial services.[23]

20 Stiglitz Final Report, above n 2, at 104, [95].

21 Jane Kelsey *Serving Whose Interests? The Political Economy of Trade in Services Agreements* (Routledge, London, 2008) at 76-82.

22 Ibid.

23 The Appellate Body has stated that "the use of the term 'affecting' reflects the intent of the drafters to give a broad reach to the GATS" and is equivalent to "have an effect on": *European Communities – Regime for the Importation, Sale and Distribution of Bananas* WTO DOC WT/DS27/AB/R (1997) (*EC-Bananas*) at [220] (Report of the Appellate Body).

Members make market access (art XVI) and national treatment (art XVII) commitments on financial services in country-specific schedules using a positive list. Market access commitments mean, amongst other complaints, that a government cannot impose numerical caps, including bans,[24] on the number or size of financial institutions or other financial services suppliers and products. Even Glass-Steagall-type firewalls that prevented commercial deposit-taking banks from also operating as investment banks arguably breach these obligations.[25] National treatment commitments require non-discriminatory treatment of 'like' services and suppliers. Areas of sensitivity include differential regulation of branches of foreign banks and cross-border e-finance, and the nationality or residence of management and directors.[26]

Many of the other GATS provisions also apply only to sectors committed in a member's schedule. These obligations include requirements for reasonable, objective and impartial administration of general measures affecting trade in services and authorisations,[27] and interim constraints on domestic regulation of licensing, professional qualifications and requirements, and technical standards.[28] The obligation not to restrict current payments and capital transfers is also tied to the schedules (art XI) and is bolstered by an obligation in footnote 8 to art XVI (on market access) to allow inflows and outflows of capital that are *essential* to cross-border financial services, and inflows of capital that are *related* to foreign investment. Provision for review

24 The World Trade Organization Appellate Body in *US-Gambling* confirmed the interpretation of the Panel that a ban was effectively a zero quota and as such a quantitative market access restriction. *US–Measures Affecting the Cross-Border Supply of Gambling and Betting Services,* WTO DOC WT/DS285/AB/R (2005) at [238] (Report of the Appellate Body).

25 The United States Financial Services Schedule includes the following commitment: "the Administration has expressed its support for Glass-Steagall reform on a national treatment basis and will work with Congress to achieve an appropriate framework to accomplish this objective" WTO DOC S/FIN/W/12/Add.36.

26 While debates around services often centre on foreign investors, the recent crisis and especially the experience with Iceland highlight the massive risks of unrestricted transactions involving cross-border and offshore financial services suppliers, especially where the supplier is inadequately regulated.

27 General Agreement on Trade in Services, arts VI:1 and VI:3.

28 Under the General Agreement on Trade in Services art VI:5 licensing and professional requirements and technical standards applied to financial services and suppliers must not nullify or impair specific commitments undertaken by a member by being based on criteria that are not objective and transparent, such as competence and ability to supply the service, must not be more burdensome than necessary to achieve quality, and must not use licensing procedures to restrict the supply of the service, unless the measures could reasonably have been expected at the time the sectoral commitment was made (in the case of financial services 1997). These obligations apply until the entry into force of disciplines on domestic regulation negotiated under art VI:4. These negotiations are ongoing and have been tied de facto into the Doha round. For discussion of the implications for financial services of the most recent negotiating text (Working Party on Domestic Regulation, Room Document, Draft: Disciplines on Domestic Regulation Pursuant to the General Agreement on Trade in Services art VI:4, Second Revision, Informal Note by the Chairman, 20 March 2009) see Ellen Gould "The Draft GATS Domestic Regulation Disciplines – Potential Conflicts with Developing Country Regulations" (South Centre, Geneva, 2009).

of administrative decisions[29] and the obligation to avoid anti-competitive practices by monopolies[30] apply across the board. The MFN obligation applies unless exceptions were scheduled at the time the financial services commitments were made.[31]

The second document is the Fifth Protocol to the GATS. The protocol contains the final schedules of commitments on financial services that were agreed in December 1997 in the wake of the Asian financial crisis and came into effect in March 1999. The Protocol embodies the result of the extended negotiations, and sets out any adjustments made by the members to their initial schedules of commitments and MFN exemptions.

The third, the Annex on Financial Services, diverges from the GATS text in two directions. The first group of measures reflects the reluctance of treasury officials, especially in the US, to submit financial services to a GATT regime that was run by the trade bureaucracy and enforced through panels of trade experts.[32] They take the form of an exception for prudential measures, a tailored exclusion for services supplied in the exercise of governmental authority,[33] and a requirement that any panel judging a dispute that involves financial services has the requisite expertise.[34]

On the other hand, the industry lobby secured an expansive definition of financial services as "any service of a financial nature offered by a financial service supplier", who is in turn described as any natural or juridical person *wishing* to supply a financial service.[35] Uniquely for the GATS, the Annex defines a long, detailed and non-exclusive list of sub-sectors that comprise 'financial services', which is incorporated into the text.[36]

29 General Agreement on Trade in Services, art VI:2.

30 General Agreement on Trade in Services, art VIII:2.

31 The General Agreement on Trade in Services Second Annex on Financial Services allowed members to revise their initial most-favoured-nation exceptions at the conclusion of the extended negotiations on financial services.

32 Organisation for Economic Co-operation and Development Memorandum "OECD Presence at GNS Financial Meetings", 18 April 1990, on file with author.

33 Under paragraph 1(b) activities of a central bank, monetary authority or other public entity in pursuit of monetary of exchange rate policies are totally excluded. However, activities that form part of a statutory system of social security or retirement plans and other activities conducted by a public entity for the account, with the guarantee or using the financial resources of the government are not excluded if they are either conducted in competition with a public entity or financial service supplier.

34 General Agreement on Trade in Services, Annex on Financial Services, at [4].

35 General Agreement on Trade and Services, art XXVIII defines 'service supplier' as any person that supplies a service.

36 The full definition in paragraph 5 reads: "For the purpose of this Annex, … [f]inancial services include the following activities:

Insurance and insurance-related services

(i) Direct insurance (including co-insurance):

(A) life

(B) non-life

(ii) Reinsurance and retrocession;

(iii) Insurance intermediation, such as brokerage and agency;

Complementing the core elements of the Financial Services Agreement is the Understanding on Commitments in Financial Services,[37] which was designed by and for the Financial Leaders Group[38] and promoted by OECD members as a model template. The Understanding does not have legal status unless adopted by a WTO member in its schedule.[39] Adopting the Understanding means all its provisions apply, subject to conditions or limitations that are scheduled; those conditions or limitations must

(iv) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Banking and other financial services (excluding insurance)

(v) Acceptance of deposits and other repayable funds from the public;

(vi) Lending of all types, including consumer credit, mortgage, credit, factoring and financing of commercial transaction;

(vii) Financial leasing;

(viii) All payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts;

(ix) Guarantees and commitments;

(x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:

(A) money market instruments (including cheques, bills, certificates of deposits);

(B) foreign exchange;

(C) derivative products including, but not limited to, futures and options;

(D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;

(E) transferable securities;

(F) other negotiable instruments and financial assets, including bullion.

(xi) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;

(xii) Money broking;

(xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;

(xiv) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;

(xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services;

(xvi) Advisory, intermediation and other auxiliary financial services on all the activities listed in sub-paragraphs (v) to (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy."

37 World Trade Organization "Understanding on Commitments in Financial Services" WTO DOC LT/UR/U/1 (15 April 1994).

38 Erik Wesselius "Driving the GATS Juggernaut" *Red Pepper* (United Kingdom, January 2003).

39 The precise legal status of the Understanding is disputed. Bogdandy and Windsor say it has an official World Trade Organization document symbol and is explicitly made part of the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, LT/UR/A/1, 15 April 1994: Armin von Bogdandy and Joseph Windsor "Annex on Financial Services" in R Wolfrum, P-T Stoll and C Feinäugle (eds) *WTO – Trade in Services* (Martinus Nijhoff, Leiden, 2008) at 650. Chakravarthi Raghavan, who closely covered the Uruguay round as a financial journalist, mounts a vigorous argument that the Understanding has no legal status under the Marrakesh Agreement, Vienna Convention or even the official publication of the texts. The way it is treated may mislead people to believe it has more status; Raghavan, above n 2, at 23-24.

be no more restrictive than existing non-conforming measures.[40] The Understanding introduces both the potential to schedule using a negative list and a standstill obligation into the GATS regime, exclusively for financial services.

A government that adopts the Understanding in its unconditional form agrees not to restrict cross-border supply (mode 1) and consumption abroad (mode 2) of a wide range of insurance, banking and other financial services.[41] Foreign financial services suppliers have the right to establish and expand in the host territory (mode 3) using their chosen legal form, including a branch, representative office, franchise or agency.[42] Key personnel are guaranteed 'temporary' entry.[43] Once established, firms must be allowed to offer any 'new' financial services, defined as products or technologies that are supplied in any other member but not yet in the host country.[44] Members must list monopolies in their schedules and endeavour to eliminate or reduce their scope.[45] Other 'endeavours' in relation to non-discriminatory measures include allowing the supplier to offer all financial services across the entire territory and not requiring a foreign firm whose predominant activity is to supply securities-related services to comply with the same measures in relation to banking.[46]

A member adopting the Understanding cannot prevent the transfer or processing of information that is necessary for a financial service supplier to conduct its business.[47] The national treatment provisions guarantee foreign investors access to payment and clearing systems and to official funding and refinancing facilities that are made available in the ordinary course of business, although not as lender of last resort.[48] Governments must also ensure that foreign firms have equal membership of, participation in or access to self-regulatory bodies, exchanges, clearing systems, markets or associations that are required to supply the service.[49]

Only 30 WTO members have adopted the Understanding,[50] and many of them scheduled significant conditions and limitations. They are mainly from the OECD and include TPPA participants Australia, Chile, New Zealand, Singapore and the US, but not Brunei, Malaysia, Peru or Vietnam.

40 General Agreement on Trade in Services Understanding on Financial Services, at [A].
41 Ibid at [B3].
42 Ibid at [B5] and [D2].
43 Ibid at [B9].
44 Ibid at [B7].
45 Ibid at [B1].
46 Ibid at [B10].
47 Ibid at [B8].
48 Ibid at [C1].
49 Ibid at [C2].
50 The non-OECD countries that have adopted the Understanding are Nigeria, Sri Lanka and Turkey. It is also reflected de facto in the schedules of most recently acceded countries.

Once the extensive raft of financial services obligations was complete it was estimated to cover 95 per cent of international trade in banking, securities, insurance and information services, as measured in revenue.[51] However, the structure of the negotiations and the architecture of the GATS, the scope of its regulatory disciplines and the scale of members' commitments to financial liberalisation fell short of the industry's demands. They expected these objectives would be further advanced during the in-built GATS negotiations on market access that began in 2000[52] but that foundered along with the Doha round.[53] As a result, the Wall St finance industry became increasingly eager to advance its interests through the financial services chapter in the US template for bilateral and regional trade and investment agreements.

B. Linkages Between the FSA and the GFC

Before assessing whether a GATS-plus TPPA might intensify the risks to individual parties and to the financial system it necessary to explore whether that can be said of the Financial Services Agreement itself.[54]

The period since the 1970s has been marked by the re-organisation of the scope, scale and geographical spread of the financial services industry. Despite talk of a global market, the industry is highly concentrated with mega-institutions that are deemed "too big to fail". A core of financial services institutions took advantage of foreign direct investment liberalisation, privatisations, dismantling of monopolies and weak competition policies that fostered mergers and acquisitions. One-stop-shops emerged after governments, most notably in the US, removed the segmentation that had prevented financial institutions from engaging in insurance, banking, and securities and opened the door to banks trading on their own account. Transnational banking operations through subsidiaries, branches, agencies and representative offices further centralised control of the international system and fostered host country reliance on the soundness of the home country's fiduciary and prudential rules and surveillance.

51 Pierre Sauvé and James Gillespie "Financial Services and the GATS 2000 Round" in Robert Litan and Anthony Santomero (eds.) *Brookings-Wharton Papers on Financial Services* (Brookings Institution Press, Washington DC, 2000) at 430.

52 Ibid.

53 Council for Trade in Services, Special Session "Negotiations on Trade in Services" WTO DOC TN/S/36 (2011) at [30]-[32] (Report by the Chairman, Ambassador Fernando de Mateo, to the Trade Negotiations Committee).

54 This commentary draws on a broad consensus regarding the key elements of the crisis. See Stiglitz Interim Report, above n 2, at 55; Bank for International Settlements *Annual Report 2009* (BIS, Basel, 2009) at 116-37; Ourada Merrouche and Erland Nier, above n 3. For more journalistic accounts see Larry McDonald *A Colossal Failure of Common Sense. The incredible inside story of the collapse of Lehman Brothers* (Ebury Press, Reading, 2009); Gillian Tett *Fool's Gold. How unrestrained greed, corrupted a dream, shattered global markets and unleashed a catastrophe*, (Little Brown, London, 2009); Vince Cable *The Storm. The World Economic Crisis and What it Means* (Atlantic Book, London, 2009); George Soros *The Crash of 2008 and What it Means,* (Public Affairs, New York, 2009).

Commercial presence of foreign firms was complemented by the burgeoning cross-border supply of banking and securities and derivatives trading. Customers increasingly used offshore accounts and Internet transactions that operated with minimal or no licensing, authorisation or effective consumer protection. The growth of cross-border e-finance intensified the risks of international contagion. The massive expansion of this international financial 'trade' relied on unrestricted inflows and outflows of current payments and capital related to financial services transactions, as well as rights to use national payments and clearing systems and official financing facilities, and unimpeded international data flows.

A liberalised and deregulated environment with minimal capital controls, coupled with the creative potential of information technology, fuelled a self-perpetuating dynamic of 'innovation' - the codeword for novel techniques and products designed to arbitrage and evade regulation. Large and small financial services suppliers competed for profits, status, share value and bonuses built on massive leveraging. The result was a raft of highly complex and opaque financial products that were disconnected from real production and assets of real worth. Collateralised debt obligations (CDOs) that were sliced into junior, meza and senior risk tranches and on-sold as 'synthetic CDOs', CDOs of CDOs, sub-prime mortgages, asset backed securities (ABS) based on those sub-prime mortgages, CDOs of ABS, credit default swaps and other securitised financial products were all traded over the counter to minimise transparency. Fragmentation, distance from the underlying assets and subjective pricing outside a market made nonsense of any valuation and risk assessment. Senior and meza level CDOs received AAA credit ratings, while the highest risk CDOs were justified by high returns.

Private risk assessment was gradually elevated to a central tenet of institutional, national and global financial stability. By the mid-2000s most national authorities, at least in the OECD, and the Bank for International Settlements (BIS) through Basel II[55] had subordinated hands-on regulation to "principle based" industry self-regulation. Ironically, Basel II was the BIS's response to the industry's large-scale evasion of a hands-on approach to minimal capital requirements in Basel I. Allowing banks to develop their own methodologies to assess their risk as the basis for establishing capital adequacy requirements created new incentives to minimise their on-balance sheet liabilities.

The risk held by major financial firms was rendered invisible, largely because these transactions were conducted off balance sheet. Trades were often directed through Special Purpose Vehicles, which were shell companies designed to minimise liability by shifting the risk off the institution's books, and were usually located in tax havens to avoid tax. Tranches of the CDOs

55 "Basel II: International Convergence of Capital Measures and Capital Standards: A Revised Framework" (2004, revised July 2005 and July 2006) Bank for International Settlements <www.bis.org/publ/bcbsca.htm>.

were placed in these shell companies as a way of insuring the creator of the products against default, in return for fees. This relieved the issuer of CDO risk and reduced pressure on its own internal credit limits. The SPVs only needed a low level of capitalisation to cover risk.

SPVs morphed into Special Investment Vehicles (SIVs), which were quasi-shell companies that held ABS of CDOs and were effectively unregulated. They raised part of their funding independently through short-term AAA-rated commercial paper. As the value of CDOs fell and ratings were slashed, the market for short-term commercial paper dried up. They and other financial institutions that had lent long term, especially in the property market, on the assumption they could rollover short term funding could not refinance.

Financialisation also spawned a myriad of high-risk, highly leveraged hedge funds, pension funds and private equity funds that invested heavily in credit derivatives. Their profitability relied on quick turnaround and fed demand for toxic financial 'innovations'. The burgeoning business in credit rating, intermediation and investment advice and analysis was barely regulated, if at all. The professions, especially auditors, accountants and law firms, also cashed in on the frenzy.

There are divergent assessments of the degree to which the Financial Services Agreement in the GATS can be linked to past and prospective crises. There has been no substantial discussion in the Committee on Trade in Financial Services about the link, despite several attempts by developing country governments to raise it.[56] A communication tabled by Barbados in February 2011 sought to change that. It argued that: the crisis has served to highlight flaws in the global regulatory and compliance environment which hamper the implementation of corrective measures and in some cases make them open to challenge. Unless it is assumed that such problems will never again recur, they point to a need to review some aspects of the global rules including WTO GATS rules within which countries operate, so as to permit remedial measures to be implemented without running the risk of having them viewed as contraventions of commitments.[57]

This argument implicitly contested the conclusions of a paper published by the WTO Secretariat in March 2010, which largely exonerated the GATS from any causal responsibility and claimed the prudential exception gave governments the regulatory freedom they needed to respond. Their analysis of the crisis suggests that "none of the root causes of the financial crisis can be attributed to services trade liberalization as provided for in the GATS, namely granting market access and national treatment."[58]

56 See, for example, the Committee on Trade in Financial Services WTO DOC S/FIN/M/58 (2009) (Minutes of the Meeting).

57 *Unintended Consequences of Remedial Measures taken to correct the Global Financial Crisis: Possible Implications for WTO Compliance* WTO DOC JOB/SERV/38 (2011) (Communication from Barbados).

58 World Trade Organization *Financial Services. Background Note by the Secretariat* WTO DOC S/C/W/312 and S/FIN/W/7 (2010) at [25].

The Barbados argument failed to dislodge the narrow sectoral mindset of trade in financial services agreements that ignores the associated risks. The Stiglitz Commission attributed that mindset to industry capture:

> Unfortunately, while the GATS Financial Services Agreement provides the only significant regulatory framework for international financial services, it was not conceived and negotiated with these broader considerations in mind but rather was driven by sectoral interests. These special interests often do not realize (or care about) the vulnerabilities that these commitments impose on other aspects of their economy or the international economy.[59]

This author agrees with the WTO Secretariat that the GATS cannot be held directly responsible for the crisis, but joins with Barbados and the Stiglitz Commission in arguing that the relationship is more systemic. Virtually every player and commercial activity in this narrative is covered by the definition of 'financial services' in the GATS Annex. Appendix 1 correlates these developments and 'innovations' to provisions in the WTO's Financial Services Agreement. It is clear that its rules, disciplines and commitments fostered and locked governments into the regime of liberalisation and deregulation that has patently failed.

C. Financial Services Chapter in a TPPA

Not all the elements of the Financial Services Agreement are transposed into the US template for its FTAs, most notably the detailed 'best endeavours' commitments on market access in the Understanding. Overall, however, the architecture, scheduling of commitments and substantive rules take the FTAs far beyond the obligations in the Financial Services Agreement and the consequent risks outlined above.

The four US FTAs have a different architecture from the GATS. The four modes of supplying services are split between chapters on cross-border services, movement of business persons,[60] and investment,[61] which goes beyond the GATS and WTO by including non-services investment.[62] However, financial services are covered in a separate chapter, which applies to financial institutions of the other party; investors of that party, and their investments, in financial institutions in the host territory; and cross-border trade in financial services. A 'financial institution' is defined as any financial intermediary or other enterprise/institution that is authorised to do business and regulated or supervised as a financial institution under the law of the host

59 Stiglitz Final Report, above n 2, at 103, [89].

60 Only in the Singapore-United States Free Trade Agreement and the Chile-United States Free Trade Agreement.

61 The treatment of temporary movement of persons (mode 4) is not relevant for the purposes of this discussion.

62 Investment was one of the 'Singapore issues' whose inclusion had been proposed since the first World Trade Organization ministerial meeting in Singapore in 1996. A European Union-led proposal for its inclusion in the Doha round was rejected at the Cancun ministerial conference in 2003.

Party. 'Financial services' have the same expansive and open-ended definition as in the GATS. As discussed in the next section, financial investments that are not covered by the financial services chapter fall under the investment chapter.

The architecture and rules of the financial services chapter differ from the Financial Services Agreement in several fundamental ways. First, the market access and national treatment commitments are subject to a negative list,[63] whereas the GATS Annex uses a positive list. The risks of error,[64] new technologies[65] and policy and regulatory failure,[66] are higher with a negative list. Foresight is a further problem, as negotiators may have no reason to anticipate problems that subsequently arise with a particular financial market, product, service or supplier.

Second, GATS-plus restrictions are introduced. For example, financial regulators cannot limit the ability of residents, or nationals wherever they are located, to purchase financial services from cross-border financial service suppliers of the other Party; nor can they increase the effective legal responsibility and accountability of financial firms by requiring at least some of the senior executives to be nationals and that a majority of directors are nationals or residents of the host country.

The FTAs also include the pre-commitment to allow supply of "new financial services" that is contained in the Understanding. However, they go further. The Understanding applies only to services supplied by financial institutions established in the host country; the FTAs extend to cross-border supply of new financial services. Moreover, the parties' negative list schedules cannot reserve the right to regulate new financial services, removing the ability to use precautionary or restrictive regulation for potentially toxic services and products.

63 Article 9 provides for two schedules of non-conforming measures: one imposes a standstill on existing measures; the second permits new measures in specified sectors, subsectors or activities. However, these reservations do not apply to 'new financial services' under art 6. Martin Roy, Juan Marchetti and Aik Hoe Lim *Services Liberalisation in the New Generation of Preferential Trade Agreements (PTAs): How Much Further than the GATS?* (WTO Economic Research and Statistics Division, Geneva, 2006) at 54 (World Trade Organization Staff Working Paper).

64 That risk already exists with the positive list approach. An analysis by the World Trade Organization secretariat in 1999 concluded that 1,420 of 7,040 market access commitments in GATS schedules appeared to be mis-scheduled. World Trade Organization "Structure of Commitments for Modes 1, 2, and 3" WTO DOC S/C/W/99 (1999) at 4. The risk is especially high where complex, untransparent financial services, investors and products are concerned.

65 The principle of 'technological neutrality' assumes even greater significance with a negative list where a government fails to anticipate new technologies that may raise policy or regulatory concerns.

66 As occurred in New Zealand with the failure of private banks to service poor and rural customers adequately, which led to the creation of Kiwibank, and the collapse of poorly regulated finance companies.

A TPPA that was based on those existing FTAs would significantly expand the WTO obligations of TPPA parties that have no bilateral agreement with the US. The Wall St lobby has called for a 'best of breed' agreement that goes considerably further.[67]

III. High-Risk Financial Investment Rules

The standard investment chapter of the four FTAs is significant for three reasons. First, a number of its provisions, including those on expropriation and investor-state dispute settlement, are imported into the chapter on financial services, significantly broadening its scope. Second, it confers protections and rights on investors and financial investments that fall outside the coverage of the financial services chapter. Third, the MFN provision creates a web of state obligations and investor rights that cross-fertilises the FTAs with BITs with third parties.

Again, some context is required before considering the rules. As noted in the introduction, the objectives, rules and arbitral interpretations of international investment agreements have become highly contentious. Debate centres on the need for a new balance between governments' competing economic, social, environmental and development objectives and responsibilities.[68] This debate is especially important in the TPPA context, because the US template has been designed to serve the dominant and highly litigious Wall St complex.

The US currently uses the 2004 version of the US Model BIT as the basis for its international investment agreements. That version is a moderated form of the pure investor rights approach found in the 1994 US Model BIT, but it retains some highly controversial elements. Prior to the 2008 presidential election Senator Obama gave a commitment to make significant changes in the investment rules of trade agreements.[69] Post-election, the Obama administration formed an advisory body of investment experts, drawn from business, academia, labour, environmental NGOs and the legal profession, to review the 2004 Model BIT.[70]

67 Nan Seuffert and Jane Kelsey "Trans Pacific Partnership and Financial Services" in Jane Kelsey (ed) *No Ordinary Deal – Unmasking the Trans-Pacific Partnership Free Trade Agreement* (Bridget Williams Books, Wellington, 2010) 231-245 at 232-234.

68 For a discussion of various actual and proposed changes to traditional bilateral investment treaties see Suzanne Spears "The Quest for Policy Space in a New Generation of International Investment Agreements" (2010) 13(4) J Intl Econ L 1037-1075.

69 Lori Wallach and Todd Tucker "US Politics and the TPPA" in Jane Kelsey (ed) *No Ordinary Deal – Unmasking the Trans-Pacific Partnership Free Trade Agreement* (Bridget Williams Books, Wellington, 2010) at 54.

70 The formal name of this body was the Subcommittee on Investment of the Advisory Committee on International Economic Policy of the United States Department of State Regarding the Model Bilateral Investment Treaty (ACIEP).

As their final report of September 2009 showed, the advisory group was highly polarised.[71] Corporate representatives opposed virtually any changes to the existing model. Groups representing public interest organisations submitted a joint annex laying out recommendations for a significant overhaul, including the need for a stronger "prudential measures exception" to protect a government's actions to secure the stability of its financial system, as well as safeguards for the use of capital controls to prevent or mitigate financial crisis.[72]

The original aim was to complete the new model BIT by the end of 2009. As of mid-2011 the Obama administration was still trying to build consensus in Congress. The outcome was originally expected to shift the US position in the TPPA negotiations in either direction. Despite the incomplete review, the investment chapter for the TPPA is reportedly in a relatively advanced state and is based on the 2004 template. The most significant provisions are the investor rights provisions, MFN rules, and the investor-state disputes mechanism.

A. Investor Rights

Financial investment is defined broadly through a combination of the financial services and investment chapters in the four FTAs. As noted above, the financial services rules apply to measures 'relating to' financial institutions of one Party, investors of another Party in financial institutions in the other Party's territory, and the investments of those investors in such financial institutions. The rules in the investment chapter apply to other kinds of financial investments, such as bonds, debentures and other debt instruments, futures, options and other derivatives. The investment rules cover all assets that an investor owns directly or indirectly; one characteristic explicitly mentioned is the expectation of gain or profit,[73] extending obligations regarding the treatment of an investment to the impact on gain or profit, as well as its value.

The investment chapter confers rights on financial investors and investments that are not found in the WTO but are common in BITs and other FTAs. The most significant of these guarantee "covered investments" a "minimum standard of treatment" (MST), including "fair and equitable treatment" and "full protection and security", as well as protection against direct and indirect expropriation. Only the expropriation provision is imported into the financial services chapter, meaning MST applies only to financial investments other

71 "Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty" (2009) United States Department of State <www.state.gov/e/eeb/rls/othr/2009/131098.htm>.

72 "Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty: Annexes" (2009) United States Department of State <www.state.gov/e/eeb/rls/othr/2009/131118.htm#b>.

73 In the Australia-United States Free Trade Agreement, the Singapore-United States Free Trade Agreement and the Chile-United States Free Trade Agreement.

than "financial institutions and investors, and their investments, in financial institutions". Both provisions potentially open governments to challenges and compensation claims when they take actions to pre-empt or counteract a financial crisis, irrespective of whether the measures are also seen as market access or national treatment violations.

Examples of measures that might trigger such complaints, if their impact was significant enough, are tighter restrictions on swaps and other derivative products; reductions in the proportion of bank portfolios that can be allocated to sectors, such as real estate, which are prone to speculative activity; loan-to-value limits on mortgage lending; financial transaction taxes on banks to recoup the cost of bailouts or provide a future fund for such bailouts;[74] regulations to help consumers, such as restrictions on abusive lending;[75] a ban on speculation through naked short-selling;[76] restrictive regulation of "new financial services" and products; or restoration of a Glass-Steagall-style firewall.[77] Governments would have to rely on the unpredictable prudential defence, which only applies in relation to financial services, and the special provisions for taxation measures, discussed below.

B. Expropriation

Key indicators of expropriation are the permanence of the interference with the property, the substantial degree of such interference, the existence of investment-backed expectations and, as discussed below, the proportionality between the public policy objective and the impact on the property rights of the investor.[78]

74 In the United States, the banking industry has already threatened to bring a legal challenge (under United States law) against such a tax, see for example Eric Dash "Wall St. Weighs a Challenge to a Proposed Tax" New York Times (United States, 17 January 2010). For a discussion on the various tax options see Kern Alexander "International Regulatory Reform and Financial Taxes" (2010) 13(3) J Intl Econ L 893-901; see also the view of the European Commission staff in European Commission "Innovative financing at a global level" SEC(2010) 409 final, 1 April 2010 (Commission Staff Working Document).

75 For example, the United States' proposed reduction in credit card fees in order to help consumers has already caused lost profits for banks. See Andrew Martin "Banks Seek to Keep Profits as New Oversight Rules Loom" (2010) Dealbook Blog <http://dealbook.blogs.nytimes.com/2010/07/16/banks-seek-to-keep-profits-as-new-oversight-rules-loom/> and David Ellis "Credit card relief is here, but watch out for new traps" (2010) CNN Money <http://money.cnn.com/2010/02/17/news/companies/credit_card_rules/>.

76 At the Council for Trade in Financial Services meeting in December 2010 Barbados specifically questioned the compatibility of a ban on naked short selling of credit default swaps on Eurozone government bonds that the German Financial Regulator (BAFin) introduced in May 2010. Todd Tucker "Public Citizen's Blog on Globalization and Trade: Eyes on Trade" (2011) Eyes on Trade Blog <http://citizen.typepad.com/eyesontrade/2011/03/dodd-frank.html>.

77 The United States Financial Services Schedule (WTO DOC S/FIN/W/12/Add.36) includes the following commitment: "the Administration has expressed its support for Glass-Steagall reform on a national treatment basis and will work with Congress to achieve an appropriate framework to accomplish this objective."

78 United Nations Conference on Trade and Development *Investor-State Dispute Settlement and Impact on Investment Rule Making* (UNCTAD, Geneva, 2007) at 57.

It is the protection against indirect expropriation, often referred to as regulatory takings, that has been heavily criticised in recent years, with major campaigns centred on NAFTA disputes[79] and BIT claims by private water contractors.[80] As a result, some refinements have been introduced to BITS and the investment chapters in FTAs. The most notable is an interpretive annex on expropriation that specifies factors to be considered before an action is deemed an indirect expropriation. All four FTAs have such an Annex.

Many financial re-regulatory measures are likely to be caught if a tribunal interprets expropriation to include serious impairment of the expectation of gain or profit from the financial investment. As the Stiglitz Commission notes: "By definition, regulations reduce profits because they restrict potentially profitable actions."[81] The unique nature of financial services and investments, where the asset from which the investor expects to profit is also the medium of exchange, complicates the application of "indirect expropriation" to the regulation of financial investments, which are often very short term and fluid. Investment-backed expectations are also distinctive because they have been generated through intensive regulatory arbitrage by the finance industry and endorsed as "orthodoxy" by international economic institutions.

The Annex does not appear to mitigate this risk. It comes into play where the regulatory action in question is interpreted as interfering with a tangible or intangible property right or interest in an investment. In relation to indirect expropriation, a panel has to determine whether the action constitutes indirect expropriation using a case-by-case, fact-based inquiry. The first factor to be considered is the economic impact (on the investor) of the action, although adverse effect on the economic value of the investment is not determinative of itself. Other relevant factors include the extent to which the action interferes with distinct, reasonable investment-backed expectations and the character of the government action. This is not a closed list but there is no indication what other factors might be considered.

The Annex in the four FTAs differs from the interpretative annexes in other agreements involving some of the TPPA parties. In both the ASEAN Comprehensive Investment Agreement and the Australia New Zealand ASEAN FTA (AANZFTA), which involves six of the nine TPPA parties, the criteria for indirect expropriation provide governments with somewhat more regulatory space. A panel inquiring into a complaint must consider whether the action breaches the government's prior binding written commitment to the investor. It must also consider the government's objective and apply a proportionality test in relation to the public purpose. Given that Australia has accepted the US language in the AUSFTA it seems unlikely that this wording would survive into a TPPA.

79 See Public Citizen "Table of NAFTA 'Chapter 11' Foreign Investor-State Cases and Claims, November 2010" (Public Citizen, Washington DC, 2010).

80 David Hall, Emanuele Lobina and Violeta Corral *Replacing Failed Private Water Contracts* (Public Services International Research Unit, Geneva, 2010).

81 Stiglitz Final Report, above n 2, at 63, [93].

The Annex in the four FTAs also creates a strong presumption that "except in rare circumstances" non-discriminatory regulatory actions that are directed to "legitimate public welfare objectives" will not be deemed indirect expropriations.[82] While the list of public welfare objectives is only indicative,[83] the list does not include financial or economic stability. The ASEAN-ANZ text has a blanket exclusion for such actions. It is open to an investor under either agreement to argue that the prudential defence provides an equivalent and more appropriate protection for financial regulation; the inadequacies of that provision are discussed below.

C. Minimum Standard of Treatment

States must also accord financial investments the minimum standard of treatment required under customary international law. This provision explicitly requires "fair and equitable treatment" and "full protection and security" for investments. According to The United Nations Conference on Trade and Development (UNCTAD) in 2007,

> the overall result of the arbitral decisions to date is that the fair and equitable treatment standard no longer prohibits solely egregious abuses of government power, or disguised uses of government powers for untoward purposes, but any open and deliberate use of government powers that fails to meet the requirements of good governance, such as transparency, protection of the investor's legitimate expectations, freedom from coercion and harassment, due process and procedural propriety, and good faith.[84]

The guarantee of "fair and equitable treatment" has been repeatedly interpreted as conferring a right to a stable and predictable legal and business environment that does not frustrate an investor's legitimate expectations regarding the profitability or value of the investment at the time the investment was made.[85] The UNCTAD suggested the provision in its basic NAFTA form "could be broad enough to apply to virtually any adverse circumstance involving an investment".[86] The four FTAs have modified the NAFTA provision by clarifying that customary international law results from "a general and consistent practice of States that they follow from a sense of legal obligation" and that the MST standard refers to "all

82 Australia-United States Free Trade Agreement, Investment Annex 1: Expropriation [4(b)].

83 A footnote in the Peru-United States Free Trade Agreement notes this explicitly.

84 UNCTAD, above n 78, at 46.

85 See relevant extracts from *Tecnicas Medioambientales Tecmed SA v United Mexican States* ICSID Case No ARB(AF)/00/2, 29 May 2003 (Final Award); *Enron and Ponderosa Assets v Argentine Republic*, ICSID Case No ARB/01/3, 14 January 2004 (Decision on Jurisdiction); *CMS Gas Transmission Company v Argentine Republic*, ICSID Case No ARB/01/8, 17 July 2003 (Decision on Jurisdiction); and 12 May 2005 (Award); *Occidental Exploration and Production Company v Ecuador,* London Court of International Arbitration, Case No UN 346, 1 July 2004 (Award) in Matthew Porterfield "State Practice and the (Purported) Obligation under Customary Law to Provide Compensation for Regulatory Expropriations" (2011) ExpressO <works.bepress.com/matthew_porterfield/1>.

86 UNCTAD, above n 78, at 75.

customary principles that protect the economic rights and interests of aliens". However, the "clarification" provides no guarantee of how an ad hoc arbitral panel will interpret the provision.[87]

Perhaps because MST has attracted less critical attention than expropriation and thus remains less explicitly circumscribed, it has become the legal grounds of choice for many foreign investors seeking to enforce international investment agreements.[88] It is therefore significant that the obligation has not been incorporated into the financial services chapter,[89] and applies only to the residual category of financial investments covered by the investment chapter. However, "the extent to which the government action interfered with distinct, reasonable investment-backed expectations" is one element of the case-by-case assessment of indirect expropriation required in the Annex on Expropriation, and could indirectly import elements of "fair and equitable treatment" into the financial services chapter.

D. Investor-state Disputes

The right of foreign investors to enforce international investment agreements through supra-national arbitration is especially fraught. According to the UNCTAD in 2007, more than two thirds (70 per cent) of the 259 known claims under international investment agreements had been filed within the past four years, and virtually none of them was initiated by a government.[90]

Governments that try to re-regulate foreign establishments, investments and capital movements face a serious risk of investor-state enforcement of the MST and expropriation guarantees. Investors have already used these powers to sue governments for the financial regulations they imposed to deal with financial crises. All but one of 27 pending BIT cases against Argentina at the International Centre for Settlement of Investment Disputes (ICSID) relate to the country's financial crisis in the early 2000s. The claims argue that either the measures to delink the peso from the US dollar or to staunch capital flight constituted indirect expropriation, violated investors' expectations from the pre-crisis era, or were a prohibited restriction on free transfers.[91]

87 For a comprehensive critique of the minimum standards obligation as part of customary international law see Porterfield, above n 85.

88 Gus van Harten "A return to the Gay Nineties? The Political Economy of Investment Arbitration" in Gus Van Harten (ed) *Investment Treaty Arbitration and Public Law* (OUP, Oxford, 2008) cites a study of 19 awards against host States. The host State was sanctioned for unfair or inequitable treatment or for a failure to provide full protection and security in 13 cases; failure to provide compensation for expropriation or other deprivation of property in seven cases; discriminatory treatment in five cases; and failure to observe contractual or other obligations in two cases.

89 However, for a financial investment under the financial services chapter to qualify as a permissible expropriation it must comply with MST, as well as being for a public purpose, non-discriminatory, and on payment of prompt, adequate and effective compensation.

90 UNCTAD, above n 78, at 7.

91 Luke Eric Peterson "Argentina by the numbers: where things stand with investment treaty claims arising out of the Argentine financial crisis" (2011) 4(2) Investment Arbitration Reporter 1.

In a case involving one of the TPPA parties, a foreign investor sued the Malaysian government under a BIT for the use of capital controls to deal with the 1998 financial crisis.[92] These capital controls are widely recognised to have spared Malaysia the worst of the financial crisis. The latest economic crisis could give rise to more investor-to-state cases.[93] For example, failure to bail out banks equally has already resulted in host governments being held liable.[94]

Australia is unique among the four FTAs for rejecting US demands for investor-state enforcement, although the US can activate consultations about such powers citing "a change of circumstances".[95] The Australian Government's Trade Policy Review in April 2011 pledged to reject investor-state dispute settlement in future agreements.[96] By contrast, the New Zealand government has been prepared to negotiate on the issue, arguing that similar provisions in other agreements, such as the New Zealand-China FTA, have not created any problems.[97] That argument is far from compelling: US firms dominate the financial sector and are notoriously litigious. Moreover, the agreement with China is relatively new so it is premature to suggest the power would not be used, especially given the backlash against Chinese investment in New Zealand agriculture.[98]

E. MFN Provisions

The most-favoured-nation (MFN) provision in the four FTAs requires the host country to provide a covered investor with the highest standard of treatment available to an investor from any other foreign country. It would apply to obligations under existing agreements as well as agreements negotiated after the TPPA comes into force.

92 *Philippe Gruslin v Government of Malaysia,* ICSID Case No ARB/99/3. The investor lost on a point of jurisdiction.

93 See Luke Eric Peterson "Whither the New Financial Crisis Claims?" (2009) Kluwer Arbitration Blog <http://kluwerarbitrationblog.com/blog/2009/02/05/whither-the-new-financial-crisis-claims/#more-231>.

94 See for example the partial award in the United Nations Commission on International Trade Law arbitration in March 2006: *Saluka Investments BV (The Netherlands) v The Czech Republic* (17 March 2006). Available at <www.pca-cpa.org/upload/files/SAL-CZ%20Partial%20Award%20170306.pdf>.

95 Australia-United States Free Trade Agreement, art 11.16.

96 "Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity" (2011) Australian Government Department of Foreign Affairs and Trade at 14 <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html>.

97 Hon Tim Groser in response to a parliamentary question for oral answer, (23 November 2010) 669 NZPD 15651. New Zealand has faced only one investor-state dispute which was lodged by Mobil Oil in 1987; and settled out of court: *Mobil Oil Corporation v New Zealand (ICSID Case No ARB/87/2)*. The dispute went to the International Centre for the Settlement of Investment Disputes (ICSID) after the High Court determined ICSID had jurisdiction under the Arbitration (International Investment Disputes) Act 1979; *Attorney-General v Mobil Oil New Zealand Ltd* [1989] 2 NZLR 649.

98 For international coverage of this debate see Russell Padmore "Foreigners Eye New Zealand Farms" (2010) BBC News <www.bbc.co.uk/news/business-11470531>.

This would allow the financial investors of one TPPA party to take advantage of stronger investor rights and protections in a BIT, or financial services and investment chapter of an FTA that another TPPA party has with a third country. New Zealand and Australia have few BITs and relatively few investment chapters in FTAs.[99] However, TPPA parties like the US and Vietnam have many BITs, a lot of which follow the old model. The widely varying scope and wording of these provisions creates a legal labyrinth.

Many old-style BITs provide no prudential or other defence and no safeguard mechanisms to allow for financial re-regulation, and contain no interpretive note to restrict the scope of indirect expropriation. For example, Vietnam has a BIT with the United Kingdom that has no interpretive note on expropriation; investors from TPPA countries could be entitled to demand the same treatment from Vietnam through the MFN provision in a TPPA.

Conversely, MFN provisions in such BITs and FTAs may entitle the non-TPPA countries and their financial investors to benefit from more favourable provisions in the TPPA. For example, the Vietnam-UK BIT guarantees that investors will receive treatment no less favourable than any other country's investors;[100] that would entitle UK investors to any greater benefits conferred on investors under a TPPA.

The MFN provisions in a TPPA would therefore create a dynamic ratcheting effect where investor rights and state obligations extend far beyond what is in the financial services and investments chapters of the agreement itself. The scope, scale and effect of this expansion would be impossible to predict. Arbitral outcomes on MFN cases have not been consistent, including on the crucial questions of whether there should be any limitations on what provisions can be imported under MFN and whether that can include investor-state dispute powers.[101]

Investors also have incentives to treaty-shop so as to by-pass recent innovations and concessions negotiated in a TPPA. For example, the UNCTAD notes the case of *MTD Equity Bhd v Chile,* which involved a

99 New Zealand only has two operative Investment Promotion and Protection Agreements which are with China and Hong Kong SAR, China, and has investment chapters in the Free Trade Agreements with Australia and ASEAN China, Malaysia, Singapore and Thailand. The investment protocol with Australia, signed in 2011, does not include any enforcement provision. However, Australia has 22 operative BITs, including with Chile, Peru and Vietnam; some date back to the early 1990s.

100 Bilateral Investment Treaty between the United Kingdom and Vietnam 2002, art 3.1.

101 UNCTAD, above n 78, at 53-54. In *Tecmed v Mexico*, above n 85, the International Centre for the Settlement of Investment Disputes (ICSID) panel limited the application of the most-favoured-nation standard to situations where the additional rights "imported" from a different IIA do not impact on the balance of rights in a significant way. In 2000, the ICSID panel decided in *Emilio Augustín Maffezini v Kingdom of Spain* ICSID Case No ARB/97/7, that the investor could "import" the dispute settlement provisions of the BIT between Chile and Spain and avoid the requirement to submit his dispute to Spanish courts prior to initiating a case under ICSID, subject to conditions about specific wording, subject matter and public policy objectives in adopting the agreement. Similar importing of dispute processes from another BIT was allowed in *Siemens AG v Argentine Republic* ICSID Case No ARB/02/8.

Malaysian construction company that, after being authorised to invest in Chile, did not have its construction project approved because of zoning requirements. The complainant submitted a claim under the Chile–Malaysia BIT (1992), and invoked the MFN clause in that agreement to "import" the provisions on fair and equitable treatment included in the BITs between Chile and Denmark (1993) and Chile and Croatia (1994).[102]

It has also been argued that GATS commitments could become enforceable via an investor-to-state dispute settlement mechanism in a TPPA, where the MFN obligation entitles financial institutions of the parties to any better treatment given to the commercial establishments of non-parties, including under the GATS.[103] At present that would only be directly relevant where TPPA negotiators seek to reserve more regulatory space by clawing back a commitment made in their GATS schedules.[104] However, if new regulatory disciplines are agreed under the GATS that go further than the financial services provisions in a TPPA, they could also be imported through the MFN provision. The March 2010 chair's text from the GATS Working Party on Domestic Regulation[105] includes a requirement that domestic regulations be "pre-established", "objective" and "relevant to the supply of services"; all are vague terms whose interpretation by an ad hoc arbitral panel in a TPPA would be impossible to predict with any certainty. Acceptance of other proposals made during the negotiations, such as New Zealand's proposal for a "necessity test" and restricting regulation to "legitimate" objectives,[106] would certainly fall under an MFN provision that is based on the four FTAs.

In a related development, financial investors of one TPPA party could secure greatly expanded rights if they could combine TPPA provisions with more favourable treatment in an FTA with another Party. For example, Australian banks own 94 percent of New Zealand's banking sector.[107] Under the services protocol to the 1989 Australia and New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), the banks enjoy full MFN and national treatment, and rights to establish a commercial presence in the legal form of their choice. The ANZCERTA investment protocol that was signed in 2011 also confers rights to MST and protections from expropriation. Neither the services nor investment protocols provides for state- or investor-enforcement

102 Ibid at 55.

103 Sweeney Samuelson and Ebere, above n 9.

104 For example, New Zealand did not reserve the right to use discriminatory subsidies in its GATS 1994 schedule but subsidies are routinely excluded from national treatment obligations in the Free Trade Agreements.

105 World Trade Organization Working Party on Domestic Regulation *Disciplines on Domestic Regulation Pursuant to GATS Article VI:4* (Informal Note by the Chairperson) (14 March 2010) which is an annotation of the March 2009 Chair's text (Second Revision, Informal Note by the Chairman) (20 March 2009).

106 Working Party on Domestic Regulation, "The Necessity Test in the Disciplines on Domestic Regulation", Room Document, 9 February 2011, RD/SERV/39.

107 "Report of the Parliamentary Inquiry into Banking" (2009) New Zealand Government <www.issues.co.nz/library_images/bankinquiry/report_of_the_parliamentary_banking_inquiry.pdf>.

and the MFN provisions explicitly exclude enforcement mechanisms.[108] A TPPA would vastly increase the leverage of Australian banks over New Zealand regulators unless ANZCERTA was carved out altogether or at least from the enforcement provisions.[109]

IV. Constraints on Capital Controls & Sovereign Debt Restructuring

The four FTAs import into the financial services chapter the Transfers and Payments provision in the Cross-border Services Chapter and the Transfers provision in the Investment Chapter. Unlike GATS art XI, these obligations apply irrespective of whether sectors are subject to market access commitments. Governments must permit all transfers relating to a covered investment to be made "freely and without delay into and out of its territory"; the equivalent applies to transfers and payments for cross-border financial services. In effect, these rules require comprehensive capital account liberalisation between the parties.[110]

The prohibition on capital controls exemplifies the way in which rigid and enforceable "trade" rules can prevent governments from responding to major shifts in economic thinking. In a significant reversal of its position, the International Monetary Fund (IMF) has published successive papers that treat capital controls as a legitimate policy tool for preventing and mitigating crises.[111] The Asian Development Bank,[112] United Nations bodies,[113] and the Stiglitz Commission have echoed that view. In January 2011, 250 international economists, including a Nobel Prize winner, former IMF economists and other prominent experts, prompted a vigorous exchange of views when they wrote to the US government expressing concern over the extent to which US trade and investment treaties restricted

108 The New Zealand government reserved most-favoured-nation treatment in the Annex to the Protocol on Investment to the New Zealand-Australia Closer Economic Relations Trade Agreement (signed on 16 February 2011), but waived its application in a side letter. However, art 6 of the Investment Protocol explicitly excludes application to dispute settlement.

109 A side letter in the Australia-New Zealand-ASEAN Free Trade Agreement (signed 27 February 2009, entered into force 1 January 2010) states that the dispute chapter does not create rights and obligations as between Australia and New Zealand. It is uncertain whether the other parties would allow a similar side-letter in the Trans-Pacific Partnership Agreement.

110 Sarah Anderson *Policy Handcuffs in the Financial Crisis* (Institute for Policy Studies, Washington DC, 2009) and Sarah Anderson *Comments on the U.S. Model Bilateral Investment Treaty before the U.S. State Department and USTR* (Institute for Policy Studies, Washington DC, 2009).

111 Ostry et al, above n 3; Ourada Merrouche and Erland Nier, above n 3; International Monetary Fund et al, above n 3.

112 ADB *Asia Capital Markets Monitor* May 2010 at 3.

113 United Nations Economic Commission for Asia and the Pacific "Theme Topic for the Sixty-Sixth Session: Addressing Challenges in the Achievement of the Millennium Development Goals; Promoting a Stable and Supportive Financial System; and Green Growth or Environmentally Sustainable Economic Growth, Including Through Technology and Financing" UN Doc E/ESCAP/66/26 (14 April 2010).

the use of capital controls and calling for governments to be permitted to deploy them without being subject to investor claims.[114] Secretary to the US Treasury Timothy Geithner replied to the economists that US investors should have "the right to make investments through capital transfers and to repatriate capital and investment returns"; countries should not have the right to restrict transfers under FTAs.[115]

A range of measures to control speculative capital flows has been applied since the crisis. These include quotas on the proportion of derivatives contracts held relative to capital, and restrictions on investments in financial products based on the duration or nature of the instrument, raising market access and national treatment issues.[116]

Financial transaction taxes are increasingly considered a viable means to stem hot money flows, curb speculation and generate revenue for emergency bailouts, economic recovery programmes and other urgent needs. However, one ground cited by European Commission staff for rejecting a financial transaction tax was the potential liability for violating investors' rights to transfer investments "freely and without delay" under the GATS.[117]

Under the four FTAs, taxation measures fall under the expropriation obligations, but enforcement is subject to prior consultation between the tax authorities of both parties; a claim can only proceed where the authorities agree the measure constitutes expropriation or when they cannot agree. There are no similar restrictions on complaints that taxation measures breach the transfer provisions.

Government attempts to stabilise capital flows are vulnerable to investor-initiated disputes. Special dispute resolution annexes in the FTAs with Singapore, Peru and Chile[118] require an extended "cooling off" period before investors may file claims relating to "transfer" provisions. The amount of damages related to certain types of capital controls is also limited to the reduction in the value of the transfers under the Chile and Peru agreements. However, investors can still threaten to initiate a claim for compensation where a government authority proposes to use capital controls. Moreover, the restrictions do not apply where claims relate to obligations other than transfers, such as national treatment.

114 Letter to Secretary of State Hillary Rodham Clinton, n 6; Kevin Gallagher and Sarah Anderson "Corporate Lobby Groups Issue Weak Attack on Economists Who Support Capital Control Flexibility" (paper presented to the Institute of Policy Studies/Global Development and Environmental Institution at Tufts University, Medford, 10 February 2011).

115 Letter from US Treasury Timothy Geithner to Dr Ricoardo Hausmann and others, 12 April 2011 <www.ase.tufts.edu/gdae/policy_research/CapCtrlsLetter.html>.

116 Gallagher "Policy Space", above n 2; International Monetary Fund et al, above n 3 esp 53-95.

117 European Commission staff noted this conflict in European Commission Working Document, above n 4.

118 The Australia-United States Free Trade Agreement does not provide for investor-state dispute settlement. It may also be significant to the TPPA negotiations that the United States Free Trade Agreement with the Republic of Korea, signed in 2007, does not include the cooling off period.

These constraints are compounded in the US FTAs by the absence of any right to use capital controls on inflows and outflows to prevent or mitigate crises, even in balance of payments emergencies. That contrasts with the trade and investment agreements of virtually every other major capital exporter,[119] and has been strongly criticised by senior legal counsel for the IMF,[120] among others.

A parallel concern affects sovereign debt restructuring (SDR), which is especially pertinent to the fallout from the Global Financial Crisis. Like capital controls, SDR is increasingly viewed as a valid alternative, or complement, to IMF- or taxpayer-financed bailouts at times of debt crises. Yet governments that restructure debt as a post-crisis recovery strategy risk investor-initiated claims for damages. The four FTAs define sovereign debt as an "investment". Restructuring, by definition, reduces the value of a sovereign bond and could be seen as a violation of not only the transfers provisions, but also of "fair and equitable treatment"[121] and constitute an "expropriation." By filing investor-state claims, bondholders could thereby circumvent official restructuring processes.[122]

Debt-related claims by investors during a negotiated restructuring are not permitted in the Peru-US FTA.[123] The Chile-US FTA has a more comprehensive exclusion.[124] However, both versions are inadequate, as they do not apply where the measures violate national treatment or MFN provisions. A nation in crisis may well be justified in giving domestic bondholders priority under a sovereign debt restructuring to protect the banking system or ensure fulfillment of wage and pension commitments.

V. The "Prudential Measures" Defence

All four FTAs import and adapt the exception for prudential measures from paragraph 2 of the GATS Financial Services Annex along the following lines:

119 Gallagher "Policy Space", above n 2.

120 Deborah Siegel "Using Free Trade Agreements to Control Capital Account Restrictions: Summary of Remarks on the Relationship to the Mandate of the IMF" (2004) 10 *ILSA* J Intl & Comp L 297-304.

121 This applies only to 'investments' not covered by the financial services chapter.

122 For example, Italian bondholders sued Argentina to recoup the full value of their original bonds. Michael Waibel "Opening Pandora's Box: Sovereign Bonds in International Arbitration" (2007) 101(4) AJIL 711-759.

123 Peru-United States Free Trade Agreement, annex 10-F. "Negotiated restructuring" is defined in art 10.28 as "the restructuring or rescheduling of a debt instrument that has been effected through (i) a modification or amendment of such debt instrument, as provided for under its terms, or (ii) a comprehensive debt exchange or other similar process in which the holders of no less than 75 percent of the aggregate principal amount of the outstanding debt under such debt instrument have consented to such debt exchange or other process". The agreement excludes claims based on national treatment and most-favoured-nation from this special process.

124 Chile-United States Free Trade Agreement, annex 10B excludes debt restructuring from coverage under the Investment chapter, except for the national treatment and most-favoured-nation obligations.

> Notwithstanding any other provision of this Chapter or Chapters [on Investment, Cross-border services, Telecommunications, Electronic Commerce, and Competition][125] a Party shall not be prevented from adopting or maintaining measures for prudential reasons,[Fn] including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system.
>
> [Fn] It is understood that the term "prudential reasons" includes the maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions or cross-border financial service suppliers.[126]

The so-called "second sentence" reads:

> Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions.[Fn]
>
> [Fn] The Parties understand that a Party may take measures for prudential reasons through regulatory or administrative authorities, in addition to those who have regulatory responsibilities with respect to financial institutions, such as ministries or departments of labor.[127]

This provision is pivotal in determining what measures a state is permitted to take under the GATS, the four FTAs and potentially under the TPPA, either to pre-empt or respond to a financial crisis. Since 2007 there has been a vigorous debate about its meaning, scope and application. World Trade Organization Director-General Pascal Lamy sought to reassure members in one of several reports on the financial crisis that he made to the Trade Policy Review Body, saying:

> it is worth recalling that the GATS contains a specific exception for measures taken for prudential reasons (paragraph 2 of the Annex on Financial Services). The most important aspect of this exception is that it does not restrict in principle the freedom of regulatory authorities with respect to the types of measures that can be adopted for prudential reasons. The carve-out does not prescribe what types of prudential measures are allowed. Rather, it states the objectives that such measures should pursue. Therefore, the carve-out is designed to cover any type of regulatory action that a country might see fit as long as it is for the achievement of a prudential objective.[128]

Many commentators and reports for inter-governmental bodies have rejected such a broad reading, for reasons discussed below.[129]

125 Cross-references to other chapters vary across the four agreements.

126 Chile-United States Free Trade Agreement, art 12.10.1 and Peru-United States Free Trade Agreement, art 12.10.1.

127 Chile-United States Free Trade Agreement, art 12.10.1.

128 Trade Policy Review Body "Report to the TPRB from the Director General on the Financial and Economic Crisis and Trade-Related Developments" WT/TPR/OV/W/2 (2009) at [27].

129 For example, Cornford, above n 2, at 14-17; Raghavan, above n 2; Lori Wallach *No Meaningful Safeguards for Prudential Measures in World Trade Organization's Financial Service Deregulation Agreements* (Public Citizen, Washington, 2009); Todd Tucker "PMD: "Strictly Business" interpretations of a WTO rule", *Eyes on Trade* 29 April 2011 <citizen.typepad.com/eyesontrade/2011/04/index.html>.

The GATS-plus elements of the four FTAs, including complex cross-references to a variety of chapters, compound the legal uncertainty. Three issues of significance to the TPPA are addressed here: what is defined as prudential; the meaning and effect of the second sentence; and the scope of application, especially to capital controls.

A. Definition of a "Prudential Measure"

The term "measures for prudential reasons" is not defined. The text specifically mentions measures aimed at protecting individual financial institutions, their investors and depositors, and the "integrity and stability of the financial system" as indicative of "prudential" reasons. The use of inclusive language suggests that other objectives may also be considered as prudential.

There is no indication of how measures that arguably have mixed prudential and non-prudential objectives should be treated. The exception certainly appears to exclude financial services regulations such as directed lending requirements and other regulations of financial products that are adopted for non-prudential reasons, such as restrictions on food-based derivatives to limit food price volatility.[130]

"Prudential" is not a term of art; it shifts with time and context. Joel Trachtman refers to "a post-financial crisis evolutionary interpretation".[131] Yet this shifting foundation creates uncertainty for governments seeking to predict how a panel might interpret their measures in a dispute. Increasing references to macro-prudential measures is an example,[132] where the boundary between them and monetary policy objectives is unclear. The report from international financial institutions to the G-20 in February 2011 observed that capital controls could be macro-prudential "in some circumstances".[133]

The WTO Secretariat's writings illustrate the significance of the shifts that have occurred over time. The Secretariat's note on financial services prepared in 1998 in advance of the GATS 2000 negotiations referred to an earlier WTO paper that identified four distinct kinds of government intervention that could impact on the financial services sector: (i) macroeconomic policy management, (ii) prudential regulations, (iii) non-prudential regulation

130 World Trade Organization *Opening Markets in Financial Services and the Role of the GATS Special Studies No 1* (1997) at 3, discussing non-prudential regulation of financial services. See also Olivier de Schutter "Food Commodities Speculation and Food Price Crises–Regulation to reduce the risks of price volatility" (2010) Briefing Note by the Special Rapporteur <www.srfood.org/index.php/en/component/content/article/894-food-commodities-speculation-and-food-price-crises>.

131 Joel Trachtman "Applicability of the NAFTA 'Prudential Carveout' to Capital Controls" (2011) International Economic Law and Policy Blog <http://worldtradelaw.typepad.com/ielpblog/2011/01/applicability-of-the-nafta-prudential-carveout-to-capital-controls.html>.

132 For example, Alan Bollard "Where are we going with macro- and micro-prudential policies in New Zealand" (speech to the Basel III Conference, Sydney, 25 March 2011). The English language explanation from the Ministry of Strategy and Finance, Republic of Korea of a package of measures introduced in June 2010 was entitled: 'New Macro-economic Prudential Measures to Mitigate Volatility of Capital Flows' <http://english.mosf.go.kr/>.

133 International Monetary Fund et al, above n 3, at 13.

to pursue various public policy objectives (other than (iv)), and (iv) trade restrictions concerning market access or national treatment. It stated that item (ii) was dealt with by the prudential provision in the Annex and item (iv) by the market access and national treatment provisions of the GATS.[134]

The note declined to discuss the appropriate content of prudential regulation, but provided numerous examples that confirm its opaqueness. Measures that would clearly be prudential included capital adequacy ratios, risk management system requirements and limits on risk concentration, liquidity requirements, prohibitions on insider trading and transactions giving rise to conflicts of interest, rules on classification of and provisioning for non-performing assets, "fit and proper" tests for directors and managers, as well as transparency and disclosure requirements. Non-prudential regulatory measures included lending requirements to certain sectors or regions, restrictions on interest rates or fees and commissions, and requirements to provide certain services.

The Secretariat also identified a grey zone. Segregation of banking, securities and insurance businesses, while having prudential objectives, could be perceived as having non-prudential elements.[135] A restriction on new licenses that aims to prevent "over-banking" or excessive competition, and thereby reduce systemic risk, would constitute a market access barrier and might not qualify as prudential because its primary objective is to restrict competition, not to protect investors or depositors or address instability; similarly with measures that limit the share of banking assets that foreign banks can hold.[136] The Secretariat also cast doubt on whether Glass-Steagall type firewalls would be treated as prudential, given that the US viewed them as such, but European countries perceived them as having non-prudential elements.[137]

Consistent with Trachtman's evolutionary interpretation, the Secretariat suggested that state practice could alter the prudential status of a measure in either direction. For example, portfolio allocation rules for the investments of financial institutions might no longer be considered prudential, given the shift to provide greater flexibility in investment decisions.[138] Conversely, licensing requirements that were liberalised and made purely prudential might no longer need scheduling as limitations on market access or national treatment. However, the Secretariat then implied that licensing requirements might still fall foul of the GATS Domestic Regulation provision on licensing requirements by constituting an unnecessary barrier to trade in financial services, even if they otherwise met the criteria of the prudential provision.[139]

134 World Trade Organization Secretariat "Financial Services" S/C/W/72 (1998) (Background Note by the Secretariat).
135 Ibid at 10, footnote 44.
136 Ibid at 12, [44].
137 Ibid at 10, footnote 44.
138 Ibid.
139 Ibid at 12, [41].

Since the 2007 crisis, the WTO Secretariat has taken a more liberal approach to the exception, and in doing so has reinforced the uncertainty. The Secretariat issued a highly defensive background note on financial services in March 2010, presenting an analysis that "suggests that none of the root causes of the financial crisis can be attributed to services trade liberalization as provided for in the GATS, namely granting market access and national treatment."[140]

The paper relies heavily on academic writings of von Bogdandy and Windsor,[141] Leroux[142] and Jarreau[143] to support its interpretation,[144] but ignores a number of expert reports prepared for other international bodies, including UNCTAD and the G-24 that take a contrary position.[145]

Indeed, a legal interpretation that relies on academic writing may compound the confusion. For example, Mamiko Yokoi-Arai classifies financial regulation into prudential and systemic regulation: "Systemic regulation is concerned with the safety and soundness of the overall financial system. Prudential regulation is to safeguard the safety and soundness of individual financial institutions for the purpose of protecting consumers."[146] She says the division is not clear-cut, but the objectives usually fall into either or both categories. Yet the prudential provision refers to both consumer protection and the stability of the financial system.

Legal interpretation would gain little guidance on the object and purpose of the provision from the formal positions adopted by WTO members. Communications to the Committee on Trade in Financial Services during the GATS 2000 negotiations reveal divergent understandings of the object of the provision and the appropriate scope of "prudential". Switzerland suggested that prudential measures should be defined in terms of international standards.[147] That proposal builds on paragraph 3 of the GATS Annex that provides a mechanism for mutual recognition of prudential measures of any other country, which can be unilaterally, through harmonisation or by agreement, and on art VI:5(b) that requires reference to international standards when assessing compliance with domestic regulation disciplines on financial services. However, Switzerland's proposed approach would have

140 Ibid at 25.

141 Armin von Bogdandy and Joseph Windsor "Annex on Financial Services" in R Wolfrum, P-T Stoll and C Feinäugle (eds) *WTO – Trade in Services* (Martinus Nijhoff, Leiden, 2008).

142 Eric H Leroux "Trade in Financial Services under the World Trade Organization" (2002) 36(3) JWT 413.

143 Steven Jarreau "Interpreting the General Agreement on Trade in Services and the WTO Instruments Relevant to the International Trade of Financial Services: The Lawyers' Perspective" (1999) North Car J Int'l L & Comm 1.

144 World Trade Organization (2010), above n 58 at 8, para 30.

145 Stiglitz Final Report, above n 2; Cornford, above n 2; Raghavan, above n 2; Gallagher, above n 2.

146 Mamiko Yokoi-Arai "GATS Prudential Carve-out in Financial Services and its Relation with Prudential Regulation" (2008) 57 ICLQ 613 at 631.

147 Council for Trade in Services "GATS 2000 Financial Services" S/CSS/W/71 (2001) at [18]-[21] (Communication from Switzerland).

prevented countries from adopting measures for precautionary reasons that were inconsistent with the then prevailing, and subsequently discredited, international standards under Basel I or Basel II.

Colombia, by contrast, argued for states' right to adopt "rigorous and efficient regulatory measures and supervisory mechanisms", reasoning that "prudential regulations and adequate supervision are required to prevent management errors from resulting in losses to depositors and consequently destabilising the financial system itself. In other words, a more liberal financial system should not be confused with a financial system with slacker operational rules".[148] Cuba went further and argued that financial system regulation needs to be suited to individual countries "so that its operation and liberalisation do not overexpose countries to foreign capital, which can trigger off instability and crisis."[149]

This uncertainty makes the test applied when assessing whether a measure is "prudential" absolutely crucial. The prudential status of a measure is not self-judging. Matthew Porterfield argues that even if a measure was intended to achieve a prudential objective, a panel would require some evidence of risk and a requisite degree of nexus, with the burden of proof falling on the regulating state. However, unlike other exceptions, the prudential provision gives no guidance on the standard to be applied.[150] Article XX of GATT, for example, specifies that some types of measure are merely required to be "related to" their objectives, whereas others are required to meet the more stringent standard that they are "necessary" to achieve their objectives.[151] The prudential measures language is silent on the standard of proof and degree of nexus required.

That silence raises particular problems where governments wish to introduce more restrictive precautionary regulations on "new financial services" that are, by definition, both novel and already permitted by domestic law, often because they have been designed to evade existing regulation. More restrictive regulation would breach the party's obligations under the four FTAs. A government seeking to justify its actions under the prudential provision would have difficulty providing concrete evidence of risk. How, for example, would a government wanting to regulate over-the-counter CDOs traded across the border during the mid-2000s have demonstrated both a risk and a nexus with the proposed regulation when the toxicity of CDOs only

148 Council for Trade in Services "Financial Services" (2001) S/CSS/W/96 at [2] (Communication from Colombia).

149 Council for Trade in Services "Negotiating proposal for financial services" (2002) S/CSS/W143 at [6] (Communication from Cuba).

150 Matthew Porterfield contributed to this argument in the paper on TPPA and Financial Crisis presented at the TPP Stakeholders Programme, in Santiago, Chile.

151 See for example: General Agreement on Tariffs and Trade, art. XX(b) (measures "necessary to protect human, animal or plant life or health") and art. XX(g) (measures "related to the conservation of exhaustible natural resources . . . ."). The equivalent provision in the European Union's template for financial services contains an explicit 'necessity' test; see the European Union-Korea Free Trade Agreement, arts 7.38 and 8.4.

became widely accepted after the financial crisis was in train? Indeed, the pre-commitment not to regulate new financial services is intended precisely to prevent a government from taking such actions.

B. The Second Sentence

Even if it is clear that a measure is "prudential" there is no agreement among experts on the meaning and application of the second sentence, whereby prudential measures that do not conform with the provisions of the agreement "shall not be used as a means of avoiding the Party's commitments or obligations under such provisions." The article does not specify any criteria or standard for determining when a party will be found to be improperly using the measure to avoid its obligations under the agreement.

This provision could be interpreted in various ways. Von Bogdandy and Windsor suggest it is enough for a government to show that it was acting in good faith for prudential reasons,[152] a view that the WTO Secretariat cites with approval.[153] It is unclear how they would treat a measure has both a prudential and potentially protectionist dimension.

However, the equivalent NAFTA provision has been interpreted as permitting tribunals to review financial measures to determine whether they are "reasonable" or "arbitrary".[154]

Other commentators look to different parts of the text for guidance. In a robust blog debate on the question Simon Lester suggests there are direct parallels with the chapeau in the general exception provisions in art XX of GATT and art XIV of GATS (which are largely imported into the four FTAs),[155] because the provisions have a common aim of trying to root out disguised restrictions.[156] Lester's interpretation would mean "that any measures taken for the stated policy reasons not be disguised trade restrictions (or here, measures taken to avoid commitments of obligations)", provided the non-protectionist purposes offered to justify the measure were "authentic". However, Lester concedes that the language "is a bit vague and hard to pin down, and could be constructed otherwise".

Assuming that the provision was treated as analogous to the general exceptions, a dispute panel would focus on two questions: is the financial service regulation "provisionally justified" as falling within the scope of

152 Von Bogdandy and Windsor, above n 141.

153 World Trade Organization (2010), above n 58.

154 *Fireman's Fund Insurance v United Mexican States* ICSID Case No. ARB(AF)/02/01, 17 July 2006, at [166]-[168] (Award).

155 These articles state that measures that are otherwise within the scope of an exception may not be used "as a means of arbitrary or unjustifiable discrimination ... or a disguised restriction on international trade."

156 Simon Lester "Global Trade Watch on the Prudential Carve-out" (2010) International Law and Economic Policy Blog <http://worldtradelaw.typepad.com/ielpblog/2010/05/global-trade-watch-on-the-prudential-carve-out.html>.

the prudential measures defence; and, if so, is it applied in a manner that does not inappropriately circumvent the Party's obligations under the TPPA?[157]

The flaw in Lester's analogy arises from the structure of the prudential provision and its circular wording: "Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provision." The general exceptions defence comes into play where a domestic measure has been found to breach an obligation; the regulating state makes a prima facie case for an exception on one of the stated grounds; and the complainant has to establish that the exception has been abused. The approach in the prudential provision is totally different. Whereas the general exceptions state in positive language the right of the party to take such action, provided it does not constitute a disguised barrier, the use of prudential measures is conditional on meeting the requirements of the second sentence. Tucker points to the drafters' deliberate decision not to adopt the same wording as the general exceptions, noting that a genuine exception would "clearly allow countries reprieve from their obligations under the agreement if the exception's requirements are met".[158]

Even if the measure is adopted for prudential reasons it is automatically in conflict with the second sentence, because the provision only applies where it has been determined that "measures do not conform to the provisions of this Agreement". The party would then have to make a prima facie case that the measure was "prudential" *and* that it was not used as a means to avoid the commitment. Given that it has already been determined that the measure is inconsistent, the regulating party needs to show a lack of intention.

Wallach argues for a strong interpretation of "used as a means of avoiding" obligations that would disqualify measures that a government knows are inconsistent with its other financial services obligations, even when their purpose is prudential.[159] Tucker supports that approach based on a detailed analysis of the negotiating history of the prudential exception. He argues that the "constructive ambiguity" in the GATS provision was informed by a growing consensus among developed countries that the purpose of the exception was "to provide a minimum requirement that prudential measures not violate the market access and national treatment disciplines, even if they violated other softer disciplines in the GATS".[160]

157 See for example *United States–Import Prohibition of Certain Shrimp and Shrimp Products* WTO DOC WT/DS58/AB/R (1998) (Appellate Body Report) describing sequence of analysis under the General Agreement on Tariffs and Trade, art XX.

158 Todd Tucker "Don't Abuse me: the prudential quandary" (2011) Eyes on Trade Blog <http://citizen.typepad.com/eyesontrade/2011/02/dont-abuse-me-the-prudential-quandary.html>.

159 Wallach, above n 129.

160 Tucker, above n 129.

That would effectively render the exception self-cancelling, which is problematic given that the treaty provision must be interpreted in a manner than does not render it redundant.[161] Yet "used" does imply intention. An alternative reading that would retain some role for the defence would apply it to situations where a government believed, erroneously but in good faith, that the measure was not inconsistent with its substantive obligations, even though that belief was legally incorrect. That would be rare.

C. Coverage

The scope of the prudential exception is further complicated in the four FTAs through the cross-references to other chapters on investment, cross-border services, telecommunications, electronic commerce and competition. The status of capital controls is particularly relevant to financial crises.[162]

The first question is whether capital controls are a "prudential measure" or an instrument of monetary or exchange rate policy; in the latter case the exception would not apply to the transfers provision. A separate paragraph of the article that contains the prudential defence provides a discrete exception for "non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies".[163] That exclusion explicitly does not affect a party's obligations under the transfers provisions relating to financial investment, and transfers and payments for cross-border services.[164]

If capital controls are treated as monetary and exchange rate tools, they therefore appear to fall outside both exceptions. Reflecting on the equivalent NAFTA provision, Trachtman suggests the monetary policy exception might cover capital controls to the extent that they fall within the Financial Services chapter, as transfers are incorporated into that chapter and the chapter itself is not excluded from the monetary policy exception.[165] Having set out that argument, he nevertheless concludes that "although it is not free from doubt, it is possible, and perhaps plausible", that an arbitral panel would determine that neither exception applies to capital controls.

161 It was established in *United States – Standards for Reformulated and Conventional Gasoline*, WTO DOC WT/DS2/AB (1996) at 23 (Decision of the Appellate Body) that "interpretation must give meaning and effect to all the terms of a treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."

162 For a discussion of the implications of the limitations of the scope of the prudential defence for capital controls see *International Economic Law and Policy Blog* <http://worldtradelaw.typepad.com/ielpblog/2011/01/applicability-of-the-nafta-prudential-carveout-to-capital-controls.html>.

163 Peru-United States Free Trade Agreement, art 12.10.2.

164 Application to cross-border services is only in the Australia-United States Free Trade Agreement and the Peru-United States Free Trade Agreement.

165 Article 10.2. For an exploration of the legal argument see Trachtman, above n 131.

The implications of this omission extend beyond the risk of a state-state or investor-state dispute. The fact that other nations' treaties do have such an exception may create incentives for discriminatory application of currency controls and potentially encourage traders to divert hot money through US affiliates.[166]

D. Conclusion

Given these limitations and interpretive uncertainties, governments cannot presume the prudential provision will protect measures that they consider are appropriate to maintain or restore financial stability and support financial and economic recovery in the face of a crisis. It is important to recall that the prospect of investor-state disputes make the risks of litigation under a TPPA much higher than the GATS, where only states can enforce the agreement. States may be deterred from bringing a case by broader political considerations and are limited to reversal of the measure or retaliatory measures as the remedy. Investors will sue if they can make money through claims for multi-million dollars in compensation. The less visible and potentially more pernicious impact of these powers is the chilling effect of a threatened dispute, especially during the mandatory prior consultation on proposed regulation under the transparency provisions of the four FTAs.[167]

VI. Conclusion

A TPPA based on the existing US FTA template would unduly restrict a government's authority to regulate the financial sector and financial transactions, use capital controls and restructure sovereign debt to prevent and mitigate financial crises. Recognising such risks, the Stiglitz Commission called on governments to revise their approach:

> Agreements that restrict a country's ability to revise its regulatory regime–including not only domestic prudential, but crucially, capital account regulations–obviously have to be altered, in light of what has been learned about deficiencies in this crisis. … All trade agreements need to be reviewed to ensure that they are consistent with the need for an inclusive and comprehensive international regulatory framework which is conducive to crisis prevention and management, counter-cyclical and prudential safeguards, development, and inclusive finance. [168]

166 Kevin Gallagher, Joel Trachtman et al, above n 131. Another contributor to this blog suggested the balance of payments exception in NAFTA might save some provisions where there is cross-over, but even if that were so there is no exception for balance of payments measures in the four Free Trade Agreements.

167 Transparency provisions in the Financial Services chapter require the parties to give interested persons and the other party a reasonable opportunity to comment on proposed regulations of general application and at the time it adopts the regulations address in writing the substantive comments received from interested persons. See, for example, the Peru-United States Free Trade Agreement, art 12.11.

168 Stiglitz Final Report, above n 2, at 104, [95].

A number of changes would help to make a TPPA text that is genuinely fit for the 21st century. First, the self-judging carve-out of measures adopted by a party for essential security interests[169] should be explicitly said to include measures that a government considers necessary with respect to the maintenance or restoration of its essential financial and related security interests. Second, it should restrict the definition of "financial service" to core traditional banking and insurance services. Third, it should exclude from the definition of "investment" any short-term investment and sovereign debt. Fourth, it should ensure that financial services, financial investment and transfers are not subject to investor-initiated disputes. Any state-to-state dispute settlement procedures should only be available after an extensive consultation process that is open to non-government and non-industry commentators.

Ultimately, however, the only effective way to ensure the regulatory space that governments require in this era of financialisation is to exclude coverage of financial services, financial investment and currency movements from a TPPA in a way that also rescinds any existing obligations between the parties that exceed those undertaken through the GATS 1994, pending the broader review of the financial services regime recommended by the Stiglitz Commission.

169 Based on the General Agreement on Trade and Services, art XIVbis.

Appendix 1: Relationship between the key elements of the financial crisis and the WTO Financial Services Agreement

Factors that contribute to the global financial crisis	Relevant GATS rule or obligation (subject to members' schedules)	GATS reference
The international dominance of a highly concentrated core of financial services institutions through privatizations, dismantling of monopolies, mergers and acquisitions, and other foreign direct investment.	Remove quantitative and qualitative market access restrictions, including economic needs tests and caps on individual or aggregate foreign investment, in mode 3 (commercial presence).	Article XVI (Market Access)
	Guaranteed non-discriminatory treatment of foreign investors.	Article XVII (National Treatment)
	List and endeavour to eliminate monopolies.	Understanding para B:1 (Market Access: Monopoly Rights)
	Allow foreign investors to establish or expand within the host territory, including through acquisition of existing enterprises.	Understanding para B:5 (Market Access: Commercial Presence
	Endeavour to remove or limit significant adverse effects on other members financial service suppliers of non-discriminatory measures that limit the expansion of the activities into the entire territory of the host.	Understanding para B.10(b) (Market Access: Non-discriminatory Measures)
The conduct of transnational banking operations through branches, agencies and representative offices that further centralized control of the international system and reliance on the soundness of the home country's fiduciary and prudential rules and surveillance.	Mode 3 commercial presence is defined to include the creation of a branch or representative office.	Article XXVIII (Definitions)
	Mode 3 commercial presence is defined to include wholly- or partly-owned subsidiaries, joint ventures, partnerships, franchising operations, branches, agencies, representative offices or other organisations.	Understanding para D:2 (Definitions)
	Remove requirements to invest through a specific type of legal entity or joint venture in mode 3.	Article XVI:2(e) (Market Access)
	Guarantee non-discriminatory treatment of foreign investors.	Article XVII (National Treatment)
	Allow foreign suppliers to establish or expand a commercial presence within the host territory, including through acquisition of existing enterprises	Understanding para B:5 (Market Access: Commercial Presence)

Factors that contribute to the global financial crisis	Relevant GATS rule or obligation (subject to members' schedules)	GATS reference
Intensified system-wide exposure to toxic 'innovations' arising from the removal of segmentation that prevented financial institutions from engaging in insurance, banking and securities and allowed trading on own account.	Not restrict or require a specific type of legal entity.	Article XVI: 2(e) (Market Access)
	Remove quantitative restrictions, represented by a ban on a commercial activity.	Article XVI:2(c) (Market Access)
	Endeavour to remove or limit significant adverse effects on other members' financial services suppliers of non-discriminatory measures that:	
	• prevent them supplying all the financial services permitted by the member	Understanding para B.10(a) (Non-discriminatory Measures)
	• require a supplier whose dominant activity is providing securities to comply with the same measures for banking and securities services.	Understanding para B.10(c) (Non-discriminatory Measures)
	Only use licensing requirements that could have reasonably been expected at the time commitments were made (in 1997), and that are not based on objective and transparent criteria, such as competence and ability, are not more burdensome than necessary to ensure quality, or involve licensing procedures that are themselves a restriction on supply of the service.	Article VI:5(a) (Domestic Regulation)
	Financial services include trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise.	Annex Article 5 (Definitions)
Cross-border supply of banking and trading through offshore accounts and Internet by entities with minimal or no local presence, no authorization requirements and no effective consumer protection.	Remove quantitative restrictions on market access (including bans) and economic needs tests in cross-border supply and consumption abroad.	Article XVI (a) to (d) (Market Access)
	Permit non-resident suppliers to supply a range of insurance and reinsurance services and data processing and information transfer services relating to banking.	Understanding para B.3 (Market Access: Cross-border Trade)
	Not restrict residents purchasing most insurance and the entire range of banking and other financial services in the territory of any other member.	Understanding para B:4 (Market Access: Cross-border Trade)
	A non-resident supplier is one that supplies the service into the territory, irrespective of whether it has a commercial presence there.	Understanding para D.1 (Definitions)

Factors that contribute to the global financial crisis	Relevant GATS rule or obligation (subject to members' schedules)	GATS reference
Over-the-counter trading of derivatives, credit default swaps and securities that minimise transparency and are subjectively priced, with no reference price based on market exchange that might form the basis of valuation and risk assessment.	Financial services include trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise derivative products, interest rate instruments including swaps, transferable securities and other negotiable instruments.	Annex para 5(a)(x) (Definitions)
Unrestricted inflows and outflows of current payments and capital related to financial services transactions.	Allow all inflows and outflows of capital that are essential to cross-border supply of financial services and inflows that are related to commercial establishment.	Article XVI fn 8 (Market Access)
	Not restrict international transfers and payments for current transactions related to specific commitments, subject to the right to restrict capital transactions, including exchange controls, in ways that are IMF compliant and are at the request of the IMF or pursuant to the balance of payments emergency provision.	Article XI (Payments and Transfers)
The establishment of special purpose vehicles or special investment vehicles in tax havens or regimes of minimal regulation as repositories for collateralised debt obligations that remained off balance sheet.	The right to establish or expand within the host territory.	Article XVI (Market Access) Understanding para B:5 (Market Access: Commercial Presence)
	Permit residents to purchase most insurance and the entire range of banking and other financial services in the territory of any other member.	Understanding para B:4 (Market Access: Cross-border Trade)
	Allow all inflows and outflows of capital that are essential to cross-border supply of financial services and inflows that are related to commercial establishment.	Article XVI fn 8 (Market Access)
	Not restrict international transfers and payments for current transactions related to specific commitments, subject to the right to restrict capital transactions, including exchange controls, in ways that are IMF compliant and are at the request of the IMF or pursuant to the balance of payments emergency provision.	Article XI (Payments and Transfers)
	A non-resident supplier is one that supplies the service into the territory, irrespective of whether it has a commercial presence.	Understanding para D.1 (Definitions)

Factors that contribute to the global financial crisis	Relevant GATS rule or obligation (subject to members' schedules)	GATS reference
Unregulated and highly leveraged hedge funds, pension funds and private equity funds whose profitability relied on quick turnaround and fed demand for financial innovations.	Financial services include:	
	- trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise derivative products including futures and options, exchange rate and interest rate instruments including swaps and forward rate agreements, and other negotiable instruments;	Annex para 5(a)(x) (Definitions)
	- asset management, collective investment management, pension fund management.	Annex para 5(a)(xiii) (Definitions)
	Permit all inflows and outflows of capital that are essential to the cross-border financial service.	Article XVI fn 8 (Market Access)
	Not restrict international transfers and payments for current transactions related to specific commitments, subject to the right to restrict capital transactions, including exchange controls, in ways that are IMF compliant and are at the request of the IMF or pursuant to the balance of payments emergency provision.	Article XI (Payments and Transfers)
	Rights to join or access a self-regulatory body, securities or futures exchange or market, clearing agency or other organization required to provide a service on an equal basis.	Understanding para C.2 (National Treatment)
Light-handed principle-based regulation, consistent with the Basel II approach of self-assessment of risk as the basis for establishing capital adequacy requirements.	Only use technical standards and licensing requirements that could reasonably have been expected at the time commitments were made and that are objective, transparent and not more burdensome than necessary to achieve quality.	Article VI:5 (a) (Domestic Regulation)
	In determining conformity with those obligations take into account international standards of relevant international organisations.	Article VI:5 (b) (Domestic Regulation)
	Ensure a foreign service suppliers can participate in, join or access any self-regulatory body, securities or futures exchange or market, clearing agency or other organisation required to provide a service on an equal basis.	Understanding para C.2 (National Treatment)

Factors that contribute to the global financial crisis	Relevant GATS rule or obligation (subject to members' schedules)	GATS reference
A burgeoning business in credit rating, intermediation and investment advice that was barely regulated, if at all.	Financial services include advisory, intermediation and other auxiliary services on all the other activities defined as financial services, including credit reference and analysis, and investment and portfolio advice.	Annex para 5(a)(xvi) (Definitions)
	Allow on a non-discriminatory basis the cross-border supply of advisory and auxiliary banking and other financial services, other than intermediation.	Understanding para B.3 (Market Access: Cross-border Trade)
	Residents must be permitted to purchase all such services, including intermediation, offshore.	Understanding para B:4 (Market Access: Cross-border Trade)
	Financial service suppliers must be allowed to establish and expand a commercial presence.	Understanding para B:5 (Market Access: Commercial Presence)
	Ensure a foreign service supplier can participate in, join or access any self-regulatory body, securities or futures exchange or market, clearing agency or other organisation required to provide a service on an equal basis.	Understanding para C.2 (National Treatment)
Trading in 'innovative' financial products (such as collateralised debt obligations (CDOs) and CDOs of CDOs, sub-prime mortgages, asset backed securities (ABS) based on sub-prime mortgages and ABS CDOs, super senior bonds held by financial institutions on or off their balance sheets or externally insured) by diverse financial entities, brokers, agencies and other intermediaries though offshore accounts, Internet trading or locally established firms.	Financial services includes lending of all types including:	
	• insurance	Annex para 5(a)(i)
	• reinsurance and retrocession	Annex para 5(a)(ii)
	• insurance intermediation	Annex para 5(a)(iii)
	• mortgage credit	Annex para 5(a)(vi)
	• financial leasing	Annex para 5(a)(vii)
	• guarantees and commitments	Annex para 5(a)(ix)
	• trading in money market instruments, derivatives, swaps, transferable securities	Annex para 5(a)(x)
	• participation in issues of all kinds of securities including underwriting and placement as agent, whether publicly or privately	Annex para 5(a)(xi)
	• settlement and clearing services for financial assets including securities and derivatives	Annex para 5(a)(xiv)
	• intermediation services on all banking and related financial services activities.	Annex para 5(a)(xvi)
	Permit any foreign financial services supplier with a commercial presence to offer within the territory a new services or product that is already supplied in another member's country not in the host country.	Understanding para B:7 (Market Access: New Financial Services)