

# Penn State Journal of Law & International Affairs

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Volume 4

Issue 2 *Violence Against Women Symposium and  
Collected Works*

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September 2016

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ISSN: 2168-7951

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### Recommended Citation

John Anwesen, *The Prudential Carve-Out Clause: is Risk the New Corrupt Moral?*, 4 PENN. ST. J.L. & INT'L AFF. 749 (2016).  
Available at: <http://elibrary.law.psu.edu/jlia/vol4/iss2/15>

*The Penn State Journal of Law & International Affairs* is a joint publication of Penn State's School of Law and School of International Affairs.

# Penn State Journal of Law & International Affairs

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2016

VOLUME 4 No. 2

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## THE PRUDENTIAL CARVE-OUT CLAUSE: IS RISK THE NEW CORRUPT MORAL?

*John Anwesen\**

*This Article presents the first analysis of the WTO panel report in Argentina – Measures Relating to Trade in Goods and Services, the first decision interpreting one of the most controversial clauses in the General Agreement on Trade in Services – the prudential carve-out clause. Prudential carve-out clause has been a matter of controversy ever since the Uruguay Round of Negotiations, when the text was adopted, and remains a matter of debate decades after. The panel report in Argentina – Measures Relating to Trade in Goods and Services, issued in September of 2015, clarified that national measures violating free trade commitments need not be “prudential” and only the reasons for those measures must. However, the panel’s interpretation of the word “prudential” as “preventative” or “precautionary” raises questions. Panel’s interpretation left this word essentially powerless.*

*This Article takes on the task of interpreting the prudential carve-out clause following relatively more of a mechanical framework utilized by the Appellate Body in United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services. The Appellate Body in that case used Vienna Convention’s rules of treaty interpretation. Following Vienna Convention tools of treaty interpretation, this Article proposes that “prudential,” while remaining vague, conveys some sort of a reasonableness standard. After the recent international financial crisis, as countries increasingly engage in regulations of the financial services sector, challenges to such regulations are becoming more likely. Therefore, a close examination of the prudential-carve out clause may help the regulators, potential challengers, and WTO dispute settlement bodies better understand what may or may not be a permissible regulation affecting the international supply of financial services.*

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\* Graduate of the University of Maryland Francis King Carey School of Law. Many thanks to Michael P. Van Alstine. This Article could not have been completed without his continuous support and guidance. Also, special thanks to H. Deen Kaplan for helpful thoughts and comments on the research process of this Article.

## I. INTRODUCTION

Horace (65-8 B.C.), the Roman lyric poet, in *Odes* says: “The sea brought contact with strangers who could disrupt domestic life by exposing citizens to the bad manners and corrupt morals of barbarians.”<sup>1</sup>

The Great Financial Crisis, which officially started in December of 2007, affected virtually all countries around the globe.<sup>2</sup> The collapse in international trade due to the Financial Crisis was “exceptional by historical standards.”<sup>3</sup> There are many arguments about what caused or contributed to the Financial Crisis. Certainly it is difficult to point to one or several causes in a complex world of voluminous interconnected economic transactions. If the task is to avoid a financial crisis, one will inevitably be required to consider the past causes. However, if one accepts that financial crises are inevitable because of many causes, then the task becomes how to contain a potential future crisis—instead of trying to avoid it. If one of the aspirations and objectives for promoting liberalized international trade is world peace—countries depending on each other through trade are less likely to be involved in direct conflicts—such dependency has its downside when one economic sector of one country collapses and pulls various world economies into a downward-spiral. It is no secret that a closed, isolated economy would be immune to international economic crises, but that economy will forgo all of the benefits of liberalized trade during times of prosperity.

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<sup>1</sup> DOUGLAS A. IRWIN, *AGAINST THE TIDE* 12 (1996).

<sup>2</sup> BUSINESS CYCLE DATING COMMITTEE, NATIONAL BUREAU OF ECONOMIC RESEARCH, *DETERMINATION OF DECEMBER 2007 PEAK IN ECONOMIC ACTIVITY 2* (2008).

<sup>3</sup> Andrei A. Levchenko, Logan T. Lewis & Linda L. Tesar, Nat'l Bureau of Econ. Research, *The Collapse of International Trade During the 2008-2009 Crisis* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 16006, 2010) (“Relative to economic activity, the drop in trade is an order of magnitude larger than what was observed in the previous postwar recessions, with the exception of 2001. The collapse appears to be broad-based across trading partners: trade with virtually all parts of the world fell by double digits.”).

Although the days of Horace are long gone and trade may no longer expose citizens to “bad manners and corrupt morals,” trade in financial services may expose them to financial risks. The question then becomes how a country would reap the benefits of liberalized international trade and protect its citizens from the risk of potential financial crises. While countries may attempt reducing toxic risk exposure in the area of financial services, such attempts may violate various World Trade Organization (“WTO”) commitments. However, the General Agreement on Trade in Services (“GATS”) provides an avenue for countries to claim an exception under the prudential carve-out clause. This exception has been long subject to controversy ever since the negotiations on the text began, because negotiators attempted to strike the right balance between free trade and the national right to regulate—an issue that remains unresolved.

Part II of this Article will introduce the historical development of the GATS to show the complexity of the negotiations.

Part III will introduce the GATS structure and summarize some of its parts to give relevant general background information. Part II will point out some of the other GATS exceptions because the reasoning for those exceptions will be useful for limiting the scope of the prudential carve-out clause, as discussed in Part V.

Part IV will introduce the prudential carve-out clause and summarize a recent WTO panel report that interpreted parts of the clause for the first time, adopting a three-prong legal standard. One of the prongs of the legal standard is a requirement that measures must be “prudential,” meaning “preventative” or “precautionary,” as interpreted by the panel.

Part V will analyze the panel report and argue that panel’s interpretation of “prudential” is overly broad in some sense and could lead to absurd regulations. To do so, Part V will follow previous WTO Appellate Body decisions which utilized treaty interpretation rules of the *Vienna Convention*. This Part will propose that “prudential” should have some determination of reasonableness which the panel report did not require. Further, Part V will argue that

the broad scope of the prudential carve-out clause is narrowed by the existence of other exceptions in the GATS.

Part VI will conclude.

## II. GATS HISTORICAL DEVELOPMENT

The original General Agreement on Tariffs and Trade (“GATT”) was drafted in the Second World War’s aftermath by delegates of many countries during 1946-47 and signed on 30 October 1947.<sup>4</sup> For almost a half-century since GATT entered into force in 1948, it did not get much attention from international diplomats and lawyers, except for international trade enthusiasts, because the main focus of the times was the Cold War.<sup>5</sup> However, GATT eventually led to the birth of the World Trade Organization (“WTO”) in 1995.<sup>6</sup> The Agreement Establishing the World Trade Organization (“WTO Agreement”) contains four Annexes, the first item in the Annexes (Annex 1A) is “GATT 1947”—now known as “GATT 1994.”<sup>7</sup> GATT essentially governs trade in goods,<sup>8</sup> while the General Agreement on Trade in Services, Annex 1B to the WTO Agreement, deals with services.<sup>9</sup> While GATT existed for over a half-century, GATS is relatively a new agreement. Services were not always conceived as being internationally tradeable. This conceptual shift about services occurred in the early 1970s and mid-1980s—from services as non-tradeable to services as tradeable.<sup>10</sup> Business pressure was one variable which caused the conceptual change among countries towards the idea that services could be traded internationally by private enterprises.<sup>11</sup> For example, the American

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<sup>4</sup> RAJ BHALA, *INTERNATIONAL TRADE LAW* 5-7 (3d ed. 2007).

<sup>5</sup> *Id.* at 7.

<sup>6</sup> *Id.* at 8.

<sup>7</sup> Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, 1867 U.N.T.S. 154 [hereinafter Marrakesh Agreement].

<sup>8</sup> General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT].

<sup>9</sup> General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 [hereinafter GATS].

<sup>10</sup> BHALA, *supra* note 4, at 1541-42.

<sup>11</sup> *Id.* at 1542.

financial service sector (e.g., American Insurance Group (AIG), American Express, Bank of America, Citibank, Goldman Sachs, J.P. Morgan, and Merrill Lynch) saw expansion opportunities to countries with emerging middle classes and began lobbying for removal of trade barriers with respect to services.<sup>12</sup>

GATS was a product of complex 1986-93 Uruguay Round of negotiations and was not finalized until 1994.<sup>13</sup> GATS negotiations were described as “sector-by-sector—tortuous, inch-by-inch, as it were.”<sup>14</sup> One factor contributing to the difficulties encountered during negotiations was that because of the way services are traded, GATS trade liberalization provisions had to extend further into post-border measures when compared to GATT provisions.<sup>15</sup> Another contributing factor to the complexity was how commitments under GATS were made.<sup>16</sup> GATS commitments are generally classified into general and specific, where specific commitments apply only to specific service sectors and sub-sectors to which a WTO member (“Member”) has committed to; moreover, the specific sectors and sub-sectors are further narrowed by one or more of four modes of supplies through which that service may be supplied.<sup>17</sup> Even after the Uruguay Round was completed and the basic GATS text was finalized, significant trade liberalization commitments were made through Members’ schedules of specific commitments.<sup>18</sup>

Negotiations for market access commitments in the area of financial services were extended to June 30, 1995 and later extended

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<sup>12</sup> *Id.* at 1542-43 (“No GATT contracting party wanted services trade liberalization on the agenda of any new round of multilateral trade negotiation more than the U.S.”).

<sup>13</sup> *Id.* at 1539.

<sup>14</sup> BHALA, *supra* note 4, at 1549.

<sup>15</sup> *Id.* at 1541 (“In general, trade in services involves much more behind-the-border regulation than does trade in goods.”).

<sup>16</sup> *Id.* at 1539.

<sup>17</sup> *See id.* at 1578-91.

<sup>18</sup> *See id.* at 1540 (citing WTO, *Second Protocol to the General Agreement on Trade in Services*, S/L/11 (July 24, 1995); WTO, *Third Protocol to the General Agreement on Trade in Services*, S/L/12 (July 24, 1995); WTO, *Fourth Protocol to the General Agreement on Trade in Services*, S/L/20 (Apr. 30, 1996); WTO, *Fifth Protocol to the General Agreement on Trade in Services*, S/L/45 (Dec. 3, 1997)).

by another month.<sup>19</sup> Negotiations took place in the middle of the Asian economic crisis which could have been used by countries such as Indonesia, Korea, Malaysia, Philippines, and Thailand as an excuse not to liberalize the trade in financial services.<sup>20</sup> However, instead the Asian leaders agreed that Newly Industrialized Countries and Least Developed Countries would benefit from liberalization perhaps because it would permit cheaper financial capital flow into the markets of those countries.<sup>21</sup> Then on December 12, 1997 an agreement on financial services commitments was made which covers a substantial portion of trade in banking, securities, insurance and financial information.<sup>22</sup>

### III. GATS SUMMARY

GATS is composed of the Preamble, six separate parts to the Agreement, and followed by Annexes. One of these Annexes is the Annex on Financial Services. Part I of the GATS deals with the scope by, *inter alia*, defining trade in services through modes of supply.<sup>23</sup> Part II relates to general commitments.<sup>24</sup> Part III relates to specific commitments.<sup>25</sup> Part IV covers negotiations, schedules of specific commitments, and modifications of those schedules.<sup>26</sup> Part V contains institutional provisions such as the dispute settlement and enforcement.<sup>27</sup> Part VI mainly contains definitions and states that the Annexes are an integral part of the agreement.<sup>28</sup> Without going into all of the GATS details, few segments of it are important for purposes of this Article: the Preamble, four modes of supply, general commitments, specific commitments, exceptions from commitments, and dispute settlement.

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<sup>19</sup> BHALA, *supra* note 4, at 1581.

<sup>20</sup> *Id.* at 1581-82.

<sup>21</sup> *Id.* at 1582.

<sup>22</sup> *Id.* at 1581.

<sup>23</sup> GATS, *supra* note 9, art. I.2.

<sup>24</sup> *See generally id.* art. II-XV.

<sup>25</sup> *See generally id.* art. XVI-XVIII.

<sup>26</sup> *See generally id.* art. XIX-XXI.

<sup>27</sup> *See generally id.* art. XXII-XVI.

<sup>28</sup> *See generally id.* art. XXVII-XXVII.

### A. GATS Preamble

The Preamble to GATS recognizes seven important objectives and considerations: (1) importance of trade in services for the growth and development of world economy, (2) economic growth through expansion of trade under the conditions of transparency and progressive liberalization, (3) liberalization through successive rounds of multilateral negotiations aimed at promoting the interests of all participants while giving due respect to national policy objectives, (4) recognizing the general right of Members to regulate, and more specifically, introduce regulation on the supply of services within their territories in order to meet national policy objectives, (5) development of developing countries, (6) facilitate increasing participation of developing countries in trade in services, (7) special economic situation and economic development of least-developed countries.<sup>29</sup>

### B. Four Modes of Supply

Trade in services is defined in an unusual way. Instead of saying what trade in services is, GATS defines the trade in services through how the supply of service is performed. There are four ways in which a service can be supplied—the four modes of supply: (1) “from the territory of one Member, into the territory of any other Member,” i.e. cross-border supply, for example providing customer services from one country to the customers of a company in another country; (2) “in the territory of one Member to the service consumer of any other Member,” i.e. consumption abroad, for example a tourist consuming the services of a guide abroad, (3) “by a service supplier of one Member, through commercial presence in the territory of any other Member,” i.e. commercial presence, for example a branch operating abroad that provides banking services to consumers abroad, (4) “by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other

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<sup>29</sup> See GATS, *supra* note 9, Preamble; *cf.* BHALA, *supra* note 4, at 1569 (In an attempt to avoid overlapping statements, objectives are stated and organized in a different manner in this Article.).



Member,” i.e. temporary movement of natural persons, for example a visiting professor teaching abroad.<sup>30</sup>

### C. General Commitments

Commitments under GATS are categorized into general and specific.<sup>31</sup> General commitments are the minimum obligations that apply across the board to all sectors and sub-sectors of supplied services.<sup>32</sup> General commitments in GATS Part II are: the Most Favored Nation treatment (“MFN”) under Article II, and Transparency under Article III of GATS.<sup>33</sup> MFN treatment requires any treatment which a Member accords to like services and service suppliers of any other country to be immediately and unconditionally accorded to the other Members’ service suppliers.<sup>34</sup> In other words, when two countries liberalize trade among each other and one of them is a Member, any favorable treatment related to service supply granted by the Member is automatically multilateralized for all Members.<sup>35</sup> Finally, Article III contains transparency commitments related to “all relevant measures of general application which pertain to or affect the operation of [GATS].”<sup>36</sup>

### D. Specific Commitments

Specific commitments in GATS Part III cover mainly two topics: National Treatment and Market Access.<sup>37</sup> According to GATS Part III, a Member may make market access and/or national treatment commitments in specific sectors (sub-sectors or sub-sub-sectors) of supplied services; moreover, a Member can also specify

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<sup>30</sup> GATS, *supra* note 9, art. I; *see also* BHALA, *supra* note 4, at 1546-48.

<sup>31</sup> *See* GATS, *supra* note 9, Table of Contents.

<sup>32</sup> *See* GATS, *supra* note 9, art. II.1, III.1; *see also* BHALA, *supra* note 4, at 1578.

<sup>33</sup> GATS, *supra* note 9, art. II, III.

<sup>34</sup> *See* GATS, *supra* note 9, art. II; *see also* BHALA, *supra* note 4, at 1579-82.

<sup>35</sup> *See* GATS, *supra* note 9, art. II; *see also* BHALA, *supra* note 4, at 1562-63.

<sup>36</sup> GATS, *supra* note 9, art. III.

<sup>37</sup> *See id.* art. XVI, XVII.

the mode(s) of supply to which such commitment(s) are applicable to.<sup>38</sup>

Once a Member makes specific market-access commitment(s), unless the specific commitment(s) provide otherwise, Member may not impose: (1) “limitations on the number of service suppliers,” (2) “limitations on the total value of service transactions or assets,” (3) “limitations on total number of service operations or on the total quantity of service output,” (4) “limitations on the total number of natural persons that may be employed,” (5) measures that restrict or require a particular form of legal entity organization, (f) limitations on foreign shareholding percentage or total value of foreign investment.<sup>39</sup>

Once a Member makes specific national treatment commitment(s), unless the specific commitment(s) provide otherwise, the Member must “accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favorable than that it accords to its own like services and service suppliers.”<sup>40</sup>

#### E. Exceptions

GATS provides many exceptions from general and specific commitments. The applicability of the prudential carve-out clause may depend on the reasoning of those exceptions, as discussed in Part V(A)(2), and at this point it is sufficient to be generally aware of the existence of those exceptions. Some of those exceptions include: economic integration agreements, labor market integration agreements, balance of payment safeguards, MFN exemptions, government procurement, providing advantages to adjacent countries, emergency safeguard measures, essential security interest, disclosure of information contrary to public interest, movement of

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<sup>38</sup> *Id.* art. XVI.1, XVII.1; *see also* BHALA, *supra* note 4, at 1585.

<sup>39</sup> GATS, *supra* note 9, art. XVI.2.

<sup>40</sup> *Id.* art. XVII.1.

natural persons, administration of domestic regulations, and general exceptions.<sup>41</sup>

For example GATS Article XIV, General Exceptions provides five types of measures which a Member may implement that are exempted from the Member's general or specific commitments.<sup>42</sup> Of the five categories of measures, three of the categories require measures to be "necessary."<sup>43</sup> For example, subparagraph (c) in part permits implementation of measures "necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement . . . relating to . . . the prevention of deceptive and fraudulent practices. . . ."<sup>44</sup> In other words, if a Member is implementing a law or a regulation related to prevention of deceptive and fraudulent practices, and that law or regulation is not inconsistent with Member's commitments under the Agreement, any measures that are *necessary* to the implementation of such law or regulation are also exempted from the Agreement—even if those necessary measures are inconsistent with the Agreement.<sup>45</sup> Additionally, such measure(s) will not be exempted if arbitrary or discriminatory without legitimate justification(s).<sup>46</sup>

While the scope of each of these exceptions may be a topic for a separate article, it may be consequential on the ultimate determination of whether the prudential carve-out clause applies.

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<sup>41</sup> See generally *id.* art. II.2, II.3, V, VI, X, XII-XIV bis, Annex on Article II Exemptions.

<sup>42</sup> *Id.* art. XIV.

<sup>43</sup> *Id.* art. XIV.(a)-(c).

<sup>44</sup> *Id.* art. XIV.(c).

<sup>45</sup> See *id.*; see generally Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, ¶300-27, WT/DS285/AB/R (Apr. 7, 2005) [hereinafter *U.S. – Gambling and Betting Services*].

<sup>46</sup> See GATS, *supra.* note 9, art. XIV; see also *U.S. – Gambling and Betting Services*, *supra.* note 45, ¶ 339-51.

IV. ANNEX ON FINANCIAL SERVICES: PRUDENTIAL CARVE-OUT  
CLAUSE

Trade in the financial service sector is also governed by the Annex on Financial Services (the “Annex”).<sup>47</sup> The tension between trade liberalization commitments and nations’ sovereignty presents itself in the prudential carve-out clause contained in the Annex. Prudential carve-out clause provides an exception from general and specific GATS commitments:

Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement.<sup>48</sup>

This text in the GATS has attracted much attention. Many have claimed that the prudential exception was not clear and clarification was necessary, sometimes attempting to provide clarification.<sup>49</sup> Also, there has been some confusion about whether

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<sup>47</sup> GATS, *supra* note 9, Annex on Financial Services.

<sup>48</sup> *Id.*

<sup>49</sup> See generally *Communication From Barbados: Unintended Consequences of Remedial Measures taken to correct the Global Financial Crisis: Possible Implications for WTO Compliance*, COMMITTEE ON TRADE IN FINANCIAL SERVICES, ¶¶ 11, 23, JOB/SERV/38, (Feb. 18, 2011), <https://www.coc.org/files/BarbadosSubmission.pdf> (“It would seem that the wording of paragraph 2 of the GATS Annex on Financial Services may need to be amended.”); Roger Kampf, *Liberalisation of Financial Services in the GATS and Domestic Regulation*, 3 INT. TRADE L. & REG. 155 (1997) (“The scope of this exemption to basic GATS principles is not well defined. It can therefore be expected that measures taken under this provision will be the subject of controversial interpretation in the future, possibly in the context of dispute settlement procedures.”); Juan A. Marchetti & Petros C. Mavroidis, *What Are the Main Challenges for the GATS Framework? Don’t Talk About Revolution*, 3 EUR. BUS. ORG. L.

the measure or the reason for that measure must be prudential in order to qualify as an exception under the clause.<sup>50</sup> Some have stated that further clarification was necessary with respect to the apparent contradiction between the first and the second sentences, sometimes calling the clause a “self-cancelling loophole.”<sup>51</sup> Others expressed concerns that the exception will be used for disguised protectionist measures.<sup>52</sup> Some predicted that the issue will eventually appear in

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REV. 511 (2004) (“Examples of provisions the scope of which is unclear include: the scope of the so-called ‘prudential carve-out.’”); Dominique Servais & Julie Dutry, *GATS 2000: High Stakes for the Financial Services Sector?*, 6 INT. BUS. L. J. 653, (1993) (“[T]he clause is interpreted differently according to the country.”); Mamiko Yokoi-Arai, *GATS’ Prudential Carve Out in Financial Services and Its Relation with Prudential Regulation*, 57 INT. COMP. L. Q. 613 (2008) (“The difficulty of the prudential carve out is that while the uncertainty caused by its text is clear, there has not been any indication or the urgent need to revise it.”); Michael S. Barr & Geoffrey P. Miller, *Global Administrative Law: The View from Basel*, 17 EUR. J. INT. L. 15 (2006) (“[T]he financial services accord requires market liberalization and national treatment, but permits countries to engage in valid ‘prudential measures’ that would otherwise be inconsistent with the agreement; the scope of such prudential measures is likely to be circumscribed by adherence to the Basel standards.”) (citation omitted); Gretchen Morgenson, *Barriers to Change, From Wall St. and Geneva*, N.Y. Times, Mar. 17, 2012, [http://www.nytimes.com/2012/03/18/business/wto-and-barriers-to-financial-change.html?\\_r=0](http://www.nytimes.com/2012/03/18/business/wto-and-barriers-to-financial-change.html?_r=0) (“Last October, Ecuador asked that the W.T.O. review financial rules so that the country could preserve its ability to create regulations that ensure ‘the integrity and stability of the financial system.’”).

<sup>50</sup> E.g., Roger Kampf, *Liberalisation of Financial Services in the GATS and Domestic Regulation*, 3 INT. TRADE L. & REG. 155, 158 (1997); G-20 Pittsburgh Summit, Special Pittsburgh G-20 Report from Public Citizen’s Global Trade Watch, *No Meaningful Safeguards for Prudential Measures in World Trade Organization’s Financial Service Deregulation Agreements*, at 10-17 (Sept. 2009).

<sup>51</sup> G-20 Pittsburgh Summit, Special Pittsburgh G-20 Report from Public Citizen’s Global Trade Watch, *No Meaningful Safeguards for Prudential Measures in World Trade Organization’s Financial Service Deregulation Agreements*, at 3-5 (Sept. 2009); see also Communication from Barbados, *supra* note 49, ¶ 11; Alan Alexandroff et al., *Global Trade Watch on the Prudential Carve Out*, International Economic Law and Policy Blog (Dec. 12, 2015, 11:57 PM), <http://worldtradelaw.typepad.com/ielpblog/2010/05/global-trade-watch-on-the-prudential-carve-out.html>.

<sup>52</sup> E.g., Dominique Servais & Julie Dutry, *GATS 2000: High Stakes for the Financial Services Sector?*, 6 INT. BUS. L. J. 653, 664-65 (1993) (“It is often propounded that there is a real risk of the prudential clause being used by some countries as an mechanism to justify the upholding of certain regulations that aim, under the prudential veil, to protect the local financial industry by either refusing,

front of a WTO panel.<sup>53</sup> While others stated that the “confrontational approach” within the dispute settlement system [was] unlikely.<sup>54</sup> In any event, the importance of this clause has not been overstated. “After a decision is rendered, the losing nation will see how much (or how little) sovereignty has been transferred to the WTO.”<sup>55</sup> Such a decision was rendered on September 30, 2015 by a WTO panel.

A. Argentina – Measures Relating to Trade in Goods and Services:  
Report of the Panel

On September 30, 2015 a WTO panel for the first time addressed the prudential carve-out clause in *Argentina – Measures Relating to Trade in Goods and Services* (the “Panel Report”).<sup>56</sup>

In the Panel Report, *inter alia*, Argentina claimed that the prudential exception in paragraph 2(a) of the Annex applied to measures 5 (requirements for market access related to reinsurance services) and 6 (requirements for access to the Argentina’s capital market) implemented by Argentina.<sup>57</sup> Measure 5 essentially banned

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or limiting, access to their market.”); Roger Kampf, *Liberalisation of Financial Services in the GATS and Domestic Regulation*, 3 INT. TRADE L. & REG. 155, 161 (1997) (“Individual countries could, for example, attempt to cover discriminatory treatment under the prudential carve-out.”).

<sup>53</sup> Duncan Alford, *International Financial System Risks: A Current Assessment*, 1 J. INT. BANKING L. & REG. 40 (2005) (“The operation of this prudential supervision ‘carve out’ and the trade liberalisation [sic] provisions of the Financial Services Agreement will undoubtedly come before the WTO dispute resolution mechanism in the near future.”); Roger Kampf, *Liberalisation of Financial Services in the GATS and Domestic Regulation*, 3 INT. TRADE L. & REG. 155, 158 (1997) (“It can [] be expected that measures taken under this provision will be the subject of controversial interpretation in the future, possibly in the context of dispute settlement procedures.”).

<sup>54</sup> Mamiko Yokoi-Arai, *GATS’ Prudential Carve Out in Financial Services and Its Relation with Prudential Regulation*, 57 INT. COMP. L. Q. 613, 640 (2008) (“The community of international financial regulators is close-knit, and such a confrontational approach [bringing dispute within WTO dispute settlement system] does not seem likely.”)

<sup>55</sup> Duncan Alford, *International Financial System Risks: A Current Assessment*, 1 J. INT. BANKING L. & REG. 40, 41 (2005).

<sup>56</sup> Panel Report, *Argentina – Measures Relating to Trade in Goods and Services*, WT/DS453/R (Sept. 30, 2015).

<sup>57</sup> *Id.* ¶¶ 7.781, 7.808, WT/DS453/R (Sept. 30, 2015).

the supply of reinsurance services from countries not cooperating for purposes of tax transparency and the global fight against money laundering and terrorist financing according to the criteria defined by the Financial Action Task Force.<sup>58</sup> Measure 6 banned stock market intermediaries from transacting (e.g. public offering of negotiable securities, forward contracts, futures or options of any nature or other financial instruments or products) with persons from non-cooperative countries.<sup>59</sup> A country was to be considered “cooperative” if it: (i) “[had] signed with Argentina a tax information exchange agreement or an international double taxation convention with a broad information exchange clause, provided that the information [was] effectively exchanged; or (ii) [had] initiated with Argentina the negotiations necessary for concluding such an agreement and/ or convention.”<sup>60</sup> Under measures 5 and 6 Argentina imposed different requirements on service suppliers depending on whether they were established and registered in cooperative or non-cooperative countries.<sup>61</sup>

Panama argued against the applicability of the prudential carve-out clause.<sup>62</sup> Although the panel ultimately found for Panama on this issue, Panama appealed the report to the Appellate Body arguing that the panel erred, *inter alia*, in not limiting the scope of the prudential carve-out clause to “domestic” regulations.<sup>63</sup> Argentina also appealed the Panel Report arguing, contrary to the panel’s finding, that the services provided from cooperative and non-cooperative countries were not “like” services.<sup>64</sup> While the Panel Report is pending an appeal, the Dispute Settlement Body (“DSB”) will not be able to adopt the Panel Report.<sup>65</sup> The Appellate Body report, once issued, will be automatically adopted, receiving legal

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<sup>58</sup> See *id.* ¶¶ 2.23–2.34.

<sup>59</sup> See *id.* ¶¶ 2.35–2.36.

<sup>60</sup> *Id.* ¶¶ 7.907 [footnote omitted].

<sup>61</sup> *Id.* ¶ 7.907.

<sup>62</sup> *Id.* ¶¶ 7.793–7.807.

<sup>63</sup> See Notification of an Appeal by Panama, *Argentina – Measures Relating to Trade in Goods and Services*, WT/DS453/7 (Oct. 30, 2015).

<sup>64</sup> See Notification of Another Appeal by Argentina, *Argentina – Measures Relating to Trade in Goods and Services*, WT/DS453/8 (Nov. 30, 2015).

<sup>65</sup> Understanding on Rules and Procedures Governing the Settlement of Disputes art. 16, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401 [hereinafter DSU].

force, unless the DSB decides by unanimous consensus not to adopt the report.<sup>66</sup> Customarily when DSB adopts a panel report, it is adopted “as modified by the Appellate Body”;<sup>67</sup> thus, ultimately DSB may adopt the Appellate Body’s findings of law which were directly appealed. Appellate Body may even modify rulings on issues that were not directly appealed if the modification was necessary for ruling on the issues appealed.

The Panel Report provided important guidance and if adopted by the DSB will serve as persuasive authority for the development of the international trade law as the meaning of the clause and its practical application became especially important in the context of post-recession regulations. The Panel Report adopted a three-prong legal standard under which the measure qualifying for the prudential exception must: (1) affect the supply of financial services, (2) be taken *for prudential reasons*, (3) and not be used as means of avoiding the Country-Member’s commitments or obligations.<sup>68</sup> Consequently the Panel Report applied the adopted standard to the measures implemented by Argentina, as discussed in subsection (4).

1. *The Scope of the Annex: Measures Affecting the Supply of Financial Services.* - The Panel Report found that the provision represents an exception; therefore, the burden of proof lies with the responding party to demonstrate that its measures are covered under the provision.<sup>69</sup> As a preliminary matter, the panel report considered paragraph 1(a) as context for the interpretation of paragraph 2(a) of the Annex—the prudential carve-out clause; thus, it found that the party claiming the exception must demonstrate that the measure in question is a measure “affecting the supply of financial services.”<sup>70</sup>

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<sup>66</sup> *Id.* art. 17.

<sup>67</sup> Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, ¶ 257, WT/DS27/AB/R (Sept. 9, 1997) [hereinafter *EC – Bananas III*].

<sup>68</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶¶ 7.851, 7.796 (Although the parties did not appeal any of the three prongs of the adopted legal standard, Panama appealed arguing that there is a fourth prong requirement in the Annex that the measure must be “domestic.”)

<sup>69</sup> *Id.* ¶ 7.816.

<sup>70</sup> *Id.* ¶ 7.822 (citation omitted).



Having previously found that the measures in question were “affecting trade in services” and were in violation of the GATS, the Panel Report stated that if a measure *affects trade* in services under Article I:1, it must be considered to be a measure *affecting the supply* of services.<sup>71</sup> In other words, the panel report equated the words *trade* and *supply*, perhaps because Article I:2 of the GATS states that “[f]or purposes of this Agreement, trade in services is defined as the supply of a service. . . .”<sup>72</sup>

To sum it up, if a measure affects trade in services and violates the GATS, then the prudential exception may apply if the services *affected* by that measure are *financial*. According to the panel report *affecting* has a broader meaning than “regulating” or “governing.”<sup>73</sup> As to what services are considered *financial*, the Panel Report stated that “paragraph 5 of the Annex on Financial Services defines the concept of a ‘financial service’ as ‘any service of a financial nature offered by a financial service supplier of a Member’ . . . [and] all the services subsequently listed in paragraph 5 of the Annex are services of ‘a financial nature.’”<sup>74</sup>

2. *Measures Taken “for Prudential Reasons.”* - The Panel Report took on the task of determining which measures are “for prudential reasons” by: (a) distinguishing that the *reason* for the measure must be prudential—not the measure itself, (b) analyzing the term “prudential reasons,” and (c) analyzing the word “for” separately.<sup>75</sup>

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<sup>71</sup> *Id.* ¶ 7.851.

<sup>72</sup> GATS, *supra* note 9, art. I.2.

<sup>73</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.854 (quoting *EC – Bananas III*, *supra* note 67, ¶ 220) (“The ordinary meaning of the word ‘affecting’ implies a measure that has ‘an effect on,’ which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term ‘affecting’ in the context of Article III of the GATT 1947 is wider in scope than such terms as ‘regulating’ or ‘governing.’”)

<sup>74</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.857.

<sup>75</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶¶ 7.859-63.

a. *Reasons must be prudential.* - Panel Report found that the *reasons* for the measure must be prudential.<sup>76</sup> Although Panama observed that other paragraphs in the Annex (paragraphs 3 and 4) refer to “prudential measures” and “prudential issues” and argued that the key term is the word “prudential”—not the “reasons,”<sup>77</sup> the Panel Report emphasized that the text speaks of the *reasons* being prudential and not the *measures*.<sup>78</sup> Moreover, the Panel Report stated that a contrary interpretation “would not give any meaning to the term ‘reasons’ used in that provision.”<sup>79</sup> Finding that there is no other reason why to use the terms (prudential reasons and prudential measures) interchangeably, the panel held that the textual term—prudential reasons—should be used instead.<sup>80</sup>

b. *Prudential means “preventative” or “precautionary.”* - Next the Panel Report consulted dictionary definitions of “*motivos coutelares*” (prudential reasons) and held that the ordinary meaning of “prudential” is “preventative” or “precautionary.”<sup>81</sup> The Panel Report looked into the Spanish Royal Academy’s dictionary and found that “*motivo*” (motive) means “that which moves or has efficacy or power to move; moving cause or reason for something” and “*coutelar*” (prudential)—“preventative, precautionary; said of a measure or rule intended to prevent a particular outcome or guard against that which might impede it.”<sup>82</sup> Also, the Panel Report considered English and French dictionary definitions of equally authentic versions of the provision.<sup>83</sup> The Panel Report looked into the *Shorter Oxford Dictionary* and found that the word “prudential” is defined as “[o]f, involving or characterized by prudence; exercising prudence, esp. in business affairs.”<sup>84</sup> The Panel Report looked into the Le Petit Robert dictionary, but did not find a definition for “prudential,” instead the

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<sup>76</sup> *Id.* ¶ 7.863.

<sup>77</sup> *Id.* ¶ 7.860 (footnote omitted).

<sup>78</sup> *Id.* ¶ 7.861.

<sup>79</sup> *Id.* ¶ 7.862.

<sup>80</sup> *See id.* ¶¶ 7.859-63.

<sup>81</sup> *See id.* ¶ 7.865.

<sup>82</sup> *Id.* (quoting DICCIONARIO DE LA LENGUA ESPAÑOLA (23rd ed. 2014)).

<sup>83</sup> *See Argentina – Measures Relating to Trade in Goods and Services, supra* note 56, ¶ 7.866.

<sup>84</sup> *Id.* (quoting SHORTER OXFORD ENGLISH DICTIONARY (6th ed. 2007)).

report looked into the word “prudence” which was defined as “[a]ttitude of a person who, reflecting on the significance and consequences of his acts, takes steps to avoid mistakes and possible mishaps, and refrains from anything that might be a source of harm.”<sup>85</sup> Panama, Argentina, and third parties such as United States and Brazil agreed with the definition of “preventative” or “precautionary,” except Panama applied it to the word “measures” and further defined “precautionary” differently.<sup>86</sup>

The Panel Report found support in the context of the clause which provides a non-exhaustive list of prudential reasons: “the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier” or “to ensure the integrity and stability of the financial system.”<sup>87</sup> According to the panel, these are examples of precautionary reasons.<sup>88</sup> Then, the panel basically recognized that “preventative” or “precautionary” are also vague words and stated that the meaning and importance attached to prudential reasons may vary over time; however, such vagueness—according to the panel—is appropriate, because “WTO Members should have sufficient freedom to define the prudential reasons that underpin their measures, in accordance with their own scales of values.”<sup>89</sup> The panel found support in policy objectives identified in previous panel reports and stated that Country-Members, “in applying concepts equally important for society, such as those covered by Article XX for the GATT 1994 [general

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<sup>85</sup> *Id.* (quoting *DICTIONNAIRE DE LA LANGUE FRANÇAISE* (2000)).

<sup>86</sup> *See Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶¶ 7.797, 7.867 (citing Third Party Written Submission of the United States, *Argentina – Measures Relating to Trade in Goods and Services*, at 7 n.13, WT/DS/453, (June 4, 2014), *available at* <https://ustr.gov/sites/default/files/US%203rd%20Pty%20Sub%20Fin.pdf>) (citation omitted).

<sup>87</sup> *See Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.866; *see also* GATS, *supra* note 9, Annex on Financial Services, § 2(a).

<sup>88</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56 ¶ 7.868

<sup>89</sup> *Id.* ¶ 7.871.

exceptions], are entitled to determine the level of protection they consider appropriate.”<sup>90</sup>

The panel also found that the broad interpretation of the word “prudential” “corresponds to the object and purpose of the GATS, as set out in its own preamble, which recognizes ‘the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives.’”<sup>91</sup> The Panel Report concluded its analysis of the word “prudential” by stating that a broad interpretation is “consistent with the concerns of the international community regarding the nature and impact of the financial risks and the consequent need to preserve sufficient flexibility when determining the prudential reasons to which the regulation should respond.”<sup>92</sup>

c. *Measures taken “for” prudential reasons require a “rational relationship” between the measure and its prudential objective.* - Before interpreting what “for” means, the Panel Report compared the prudential exception provision to the general exceptions of Articles XIV of the GATS and XX of the GATT 1994 and found that the prudential exception provision does not require the measures to be “necessary.”<sup>93</sup> Therefore, the prudential exception provision does not require measures to be the least trade-restrictive means for achieving the stated objective.<sup>94</sup>

The panel began the interpretation of the word “for” by looking at its ordinary meaning.<sup>95</sup> It looked into dictionaries in Spanish, English and French and found that the meaning similarly

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<sup>90</sup> *Id.* ¶ 7.870 (citing Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, ¶ 176, WT/DS161/AB/R, WT/DS169/AB/R, (Dec. 11, 2000); Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, ¶ 168, WT/DS135/AB/R, (Mar. 12, 2011)) (citation omitted).

<sup>91</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.872 (quoting GATS, *supra* note 9, Preamble).

<sup>92</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.875.

<sup>93</sup> *Id.* ¶ 7.884.

<sup>94</sup> *Id.* (footnote omitted) (Note that in the Panel Report used the words “objective” and “reason” interchangeably.).

<sup>95</sup> *Id.* ¶ 7.886.

denotes a causation.<sup>96</sup> Therefore, “[a] measure taken ‘for’ prudential reasons would [] be a measure with prudential cause.”<sup>97</sup> Then essentially the panel held that for a measure to be taken “for” prudential reasons, there must “be a rational relationship of cause and effect between the measure and the reason for it” in fact.<sup>98</sup> “[A] central aspect of the rational relationship of cause and effect is the adequacy of the measure to the prudential reason, that is to say, whether the measure, through its design, structure and architecture, contributes to achieving the desired effect.”<sup>99</sup>

3. *The Meaning of the Second Sentence of the Prudential Carve-out Clause Remains Uninterpreted.* - The panel refused to interpret the meaning of the “[measures] shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement,” because it had already found that the prudential exception did not cover the measures in question under the second prong of the legal test.<sup>100</sup>

4. *Panel Report’s Application of the Three-prong Legal Standard to Argentina’s Measures.* - The Panel Report applied this three-prong standard to Argentina’s measures 5 and 6 and found that the measures were not taken for prudential reasons.<sup>101</sup> Argentina’s measure 5 placed certain requirements on “non-cooperative” country service suppliers before they could gain access to the Argentine reinsurance service market.<sup>102</sup> Measure 6 prohibited certain stock market transactions with entities from “non-cooperative” countries.<sup>103</sup>

The Panel Report agreed that the reasons identified by Argentina with respect to measure 5 were prudential, namely “to protect the insured, to ensure the solvency of insurers and reinsurers, and to avoid the possible systemic risk of the insolvency and failure

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<sup>96</sup> *Id.* ¶ 7.887 (citations omitted).

<sup>97</sup> *Id.* ¶ 7.888.

<sup>98</sup> *Id.* ¶ 7.889.

<sup>99</sup> *Id.* ¶ 7.911.

<sup>100</sup> *Id.* ¶ 7.945.

<sup>101</sup> *See id.* ¶¶ 7.906-7.920, 7.939-7.944.

<sup>102</sup> *See* discussion *supra* pp. 12-13.

<sup>103</sup> *See id.*

of direct insurance companies.”<sup>104</sup> The Panel Report found that requesting relevant information from the regulatory authorities of other jurisdictions is part of those identified reasons.<sup>105</sup>

The panel found the main issue in the conditions under which a country was to be considered “cooperative.”<sup>106</sup> More specifically, one way a country could be considered cooperative was if it had “initiated with Argentina the negotiations necessary for concluding [an agreement with tax information exchange or an international double taxation convention with a broad information exchange clause] and/or convention.”<sup>107</sup> The panel stated that this criteria does not provide a “formal mechanism for the effective exchange of information between Argentina and the country with which it [was] negotiating.”<sup>108</sup> In other words, mere negotiations did not provide substantive information exchange.

There was another problem with the criteria under which a country could be designated as “cooperative.” Argentina published the list of cooperative countries only once, at the beginning of every year, so countries that began negotiations after the list was published would have no access to the Argentine service market until the following year.<sup>109</sup> In this instance, Panama was on the January 2014 list, because it had begun negotiations in November of 2013, but other countries that began negotiations in 2014 were not on the list yet, although they were in the same situation as Panama—merely negotiating.<sup>110</sup> Hence, the panel held that the entire measure did not have a “rational relationship of cause and effect with the identified prudential reasons,” because granting “cooperative” status without

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<sup>104</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.904.

<sup>105</sup> *Id.* ¶ 7.910 (“In our view, having adequate and timely information concerning the foreign reinsurance company is fundamental for the purpose of anticipating crises or systemic risks which, as we have seen, could be incubating in an imperceptible manner over time and suddenly erupt.”).

<sup>106</sup> *Id.* ¶ 7.913.

<sup>107</sup> *Id.* ¶ 7.912 (footnote omitted).

<sup>108</sup> *Id.* ¶ 7.916.

<sup>109</sup> *See id.* ¶ 7.918.

<sup>110</sup> *See id.*

actual information exchange did not bear such relationship with the stated prudential reason.<sup>111</sup>

With respect to measure 6, the Panel Report found several reasons identified by Argentina to be prudential: “strengthen[ing] the mechanisms for protecting and preventing abuses against small investors, within the framework of the protective function of consumer law”<sup>112</sup>; “ensur[ing] the full effectiveness of the principles of investor protection, fairness, efficiency, transparency, non-fragmentation and reduction of systemic risk”;<sup>113</sup> and “prevention of money laundering and terrorist financing,” which in turn strengthen the integrity and stability of the financial system.<sup>114</sup> However, the panel found that there was no rational relationship of cause and effect with the identified prudential reasons, because measure 6, similar to measure 5, exempted service suppliers from “cooperative” countries that did not actually exchange any information.<sup>115</sup>

#### V. ANALYZING THE PANEL REPORT

Even if the Appellate Body renders a decision without significant modifications and DSB adopts the Panel Report, the legal standard to be used in future disputes is still be open to arguments.<sup>116</sup> “In the 1996 Japan Alcoholic Beverages case, . . . [t]he Appellate Body concluded adopted panel reports are not binding in a strict sense in a subsequent case, even if the subsequent case involves the same parties and basically the same facts.”<sup>117</sup> Article IX:2 of the WTO Agreement provides the exclusive authority to adopt

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<sup>111</sup> *See id.* ¶¶ 7.919-7.920.

<sup>112</sup> *Id.* ¶ 7.932.

<sup>113</sup> *Id.* ¶ 7.933.

<sup>114</sup> *Id.* ¶¶ 7.934-7.935 (footnotes omitted).

<sup>115</sup> *Id.* ¶¶ 7.939-7.944.

<sup>116</sup> *See* discussion *supra* pp. 13-14.

<sup>117</sup> BHALA, *supra* note 4, at 19; *see also* Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, pp. 12-13, WT/DS8/AB/R, WT/DS10/ AB/R, WT/DS11/AB/R (Oct. 4, 1996) [hereinafter *Japan – Alcoholic Beverages II*] (“Generally, in international law, the essence of subsequent practice in interpreting a treaty has been recognized as a ‘concordant, common and consistent’ sequence of acts or pronouncements which is sufficient to establish a discernable pattern implying the agreement of the parties regarding its interpretation.”).

interpretations of the Multilateral Trade Agreements—in this case GATS—to the Ministerial Conference and the General Council.<sup>118</sup> “The fact that such an ‘exclusive authority’ in interpreting the treaty has been established so specifically in the WTO Agreement is reason enough to conclude that such authority does not exist by implication or by inadvertence elsewhere.”<sup>119</sup> Nonetheless, the Appellate Body stated that “panel reports are important part of the GATT *acquis*” and create “legitimate expectation among WTO Members”; thus, “should be taken into account where they are relevant to any dispute.”<sup>120</sup>

The following sections will: (A) analyze the interpretation of “for prudential reasons,” and (B) briefly discuss the second sentence of the prudential carve-out clause.

#### A. Interpretation of “for Prudential Reasons”

Interpretation of the prudential carve-out clause involves a multi-layered inquiry. The Appellate Body’s framework for interpreting GATS provisions provides a valuable foundation for analyzing the Panel Report.<sup>121</sup> Under Article 3.2 of the DSU, Country-Members recognized that the WTO dispute settlement system may clarify provisions of covered agreements in “accordance with customary rules of interpretation of public international law.”<sup>122</sup> Articles 31 and 32 of the Vienna Convention on the Law of Treaties (the “Vienna Convention”) are well settled in WTO case law to be such customary rules.<sup>123</sup> Interpreting “measures taken for prudential

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<sup>118</sup> Marrakesh Agreement, *supra* note 7, art IX.2.

<sup>119</sup> *Japan – Alcoholic Beverages II*, *supra* note 117, at 13.

<sup>120</sup> *Id.* at 14.

<sup>121</sup> See generally *U.S. – Gambling and Betting Services*, *supra* note 45 (The report provides a step-by-step framework for treaty interpretation according to Articles 31 and 32 of the Vienna Convention on the Law of Treaties.).

<sup>122</sup> DSU, *supra* note 65, art. 3.2.

<sup>123</sup> See *U.S. – Gambling and Betting Services*, *supra* note 45, ¶ 159 (“[T]he task of interpreting any other treaty text[] involves identifying the common intention of Members, and is to be achieved by following the customary rules of interpretation of public international law, codified in Articles 31 and 32 of the Vienna Convention.”); see also Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, ¶¶ 61-62, WT/DS213/AB/R (Nov. 28, 2002); Appellate Body Report, *United States –*



reasons,” as discussed below, requires looking into: (1) ordinary meaning, (2) context, (3) object and purpose, (4) other things taken into account with the context, and (5) supplementary means of interpretation.<sup>124</sup> However, “it should be kept in mind that treaty interpretation is an integrated operation, where interpretive rules or principles must be applied as connected and mutually reinforcing components of a holistic exercise.”<sup>125</sup>

1. *Ordinary Meaning.* - First, analyzing under Article 31 of the Vienna Convention, the ordinary meaning of “prudential” is vague. “Article 31(1) of the Vienna Convention requires a treaty to be interpreted ‘in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.’”<sup>126</sup> Identifying the ordinary meaning of a term may begin with dictionary definitions; however, the Appellate Body in Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, ¶ 300-27, WT/DS285/AB/R (Apr. 7, 2005) [hereinafter *U.S. – Gambling and Betting Services*], made a reservation for using dictionary definitions alone, because such approach is too mechanical.<sup>127</sup> According to the Appellate Body, if in abstract the range of definitions of the word may include the definitions of the contestant parties, then the next proper step is to inquire into which one of the definitions is properly attributable to the party-respondent.<sup>128</sup>

The Panel Report determined the ordinary meaning of “prudential” mainly from Spanish and French dictionaries.<sup>129</sup> Although the Panel Report defined the word “prudential” as “preventative” or “precautionary,” this does not really clarify what reasons may or may not be justified, because virtually any reason for a measure can be stated in terms of being “preventative” or “precautionary.” Consider a measure implemented for the reason of

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*Continued Existence and application of Zeroing Methodology*, ¶ 267, WT/DS350/AB/R (Feb. 4, 2009) [hereinafter *U.S. – Continued Zeroing*].

<sup>124</sup> See *U.S. – Gambling and Betting Services*, *supra* note 45.

<sup>125</sup> *U.S. – Continued Zeroing*, *supra* note 123, ¶ 268.

<sup>126</sup> *U.S. – Gambling and Betting Services*, *supra* note 45, ¶ 164.

<sup>127</sup> *U.S. – Gambling and Betting Services*, *supra* note 45, ¶¶ 164-66.

<sup>128</sup> *U.S. – Gambling and Betting Services*, *supra* note 45, ¶ 167.

<sup>129</sup> See discussion *supra* Part III.A.2.ii.

aiding a quick recovery of financial institutions after an economic recession: Is not that reason preventing a slow or no recovery? Thus, virtually any reason may be “preventative.”

Further, according to the Panel Report, if “prudential” means preventative, and the text states “measures for prudential reasons” are basically exempted, then what will give the panel authority to not exempt *any* absurd preventative reasons a country will claim? Consider a Country-Member claiming that the prudential reason for a measure is to “prevent” all left-handed people from making any financial investments. According to the current interpretation of “prudential” as “preventative” or “precautionary,” such a measure would qualify for the exception. It may seem at first that such a measure would not qualify under the exception, because there would be no rational relationship of cause and effect,<sup>130</sup> but such a relationship will need to exist only between the actual measure and the *stated* reason for it, and the stated reason is preventing left-handed people making certain investments. Under the present definition of “prudential” as “preventative” or “precautionary” coupled with the fact that any measure may be stated in terms of preventing some event, the current interpretation of the word “prudential” means virtually *any* reason, including absurd “preventative” reasons. Because the word “prudential” practically loses its meaning, and “the Appellate Body has stated that ‘interpretation must give meaning and effect to all the terms of a treaty,’”<sup>131</sup> a careful interpretation of the word “prudential” is still required.

Dictionaries do not clarify the word. The Oxford English Dictionary defines “prudential” as “of, belonging to, or of the nature of prudence; involving prudence, characterized or prescribed by forethought and careful deliberations” or as “matters that fall within the scope or province of prudence.”<sup>132</sup> The Oxford English

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<sup>130</sup> See discussion *supra* Part III.A.2.iii.

<sup>131</sup> See *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.840 (quoting Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, p. 23, WT/DS2/AB/R (Apr. 29, 1996) [hereinafter *US – Gasoline*]; see also Appellate Body Report, *United States – Continued Dumping and Subsidy Offset Act of 2000*, ¶ 271, WT/DS217/AB/R, WT/DS234/AB/R (Jan. 16, 2006) [hereinafter *US Offset Act*].

<sup>132</sup> 12 THE OXFORD ENGLISH DICTIONARY 729 (2nd ed. 1991).

Dictionary defines “prudence” as “ability to discern the most suitable, politic, or profitable course of action, esp. as regards conduct; practical wisdom, discretion,” or “wisdom; knowledge of or skill in a matter.”<sup>133</sup> The Shorter Oxford Dictionary defines “prudential” as “of involving, or characterized by prudence; exercising prudence, esp. in business affairs” and defines “prudence” as “the quality of being prudent” or as “wisdom; knowledge of or skill in a matter;” or “foresight; providence.”<sup>134</sup> It also defines “prudent” as “characterized by or proceeding from care in following the most politic and profitable course; having or showing sound judgment in practical affairs; circumspect, sensible” or as “wise, discerning, sapient.”<sup>135</sup> Merriam-Webster’s Collegiate Dictionary defines “prudential” as “of, relating to, or proceeding from prudence” or as “exercising prudence.”<sup>136</sup> Merriam-Webster’s Collegiate Dictionary defines “prudence” as “the ability to govern and discipline oneself by the use of reason,” or as “sagacity or shrewdness in the management of affairs,” or as “skill and good judgment in the use of resources,” or as “caution or circumspection as to danger or risk.”<sup>137</sup>

As you can see from the English dictionary definitions, as opposed to French and Spanish as found by the Panel Report, “prudential” may have meanings different from “preventative” or “precautionary.” According to the dictionaries, a “prudential” reason, among the meaning adopted by the panel, may mean a reason “prescribed by forethought and careful deliberations” or a reason “involving, or characterized by quality of being wise” or a reason “of involving the quality of having or showing sound judgment” or a reason “relating to or proceeding from the ability to govern and discipline oneself by the use of reason or by skill and good judgment in the use of resources.” All these definitions encompass a requirement that whatever must be “prudential” must in some sense be well thought of, be wise, show sound judgment, or be reasonable.

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<sup>133</sup> *Id.* at 728-29.

<sup>134</sup> 2 THE NEW SHORTER OXFORD ENGLISH DICTIONARY 2396 (1st ed. 1993).

<sup>135</sup> *Id.*

<sup>136</sup> MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 1002 (11th ed. 2005).

<sup>137</sup> *Id.*

Thus, a closer look into the context in which the word “prudential” was used is required.

2. *Context.* - After inquiring into the ordinary meaning of the text, if a definitive conclusion cannot be reached, the next step is to inquire into the context in which the relevant terms are situated pursuant to Article 31(2) of the Vienna Convention.<sup>138</sup> Article 31 paragraph 2 of the Vienna Convention also provides for documents in addition to the text of the treaty which may be considered as context.<sup>139</sup> “Documents can be characterized as context only where there is sufficient evidence of their constituting an ‘agreement relating to the treaty’ between the parties or of their ‘accept[ance by the parties] as an instrument related to the treaty.’”<sup>140</sup> Thus, context documents may comprise of the entire GATS Agreement, including its preamble and annexes, schedules of specific commitments of the respondent-party, provisions of covered agreements other than GATS, and GATS schedules of other Members.<sup>141</sup> When inquiring into context documents, the Appellate Body first examined “the immediate context in which the relevant entry [was] found.”<sup>142</sup> Second, the Appellate Body examined “the context provided by the structure of the GATS itself.”<sup>143</sup> Third, the Appellate Body looked “beyond the GATS to other covered agreements” where it also considered other Member’s Schedules.<sup>144</sup>

Here the main word under scrutiny—prudential—is an adjective, which within the most immediate textual context of the word qualifies another word—reasons.<sup>145</sup> To support the panel’s finding, the most important context to be considered in treaty interpretation is the textual context in which the word was used.<sup>146</sup> In

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<sup>138</sup> U.S. – *Gambling and Betting Services*, *supra* note 45, ¶ 168; *see also* U.S. – *Continued Zeroing*, *supra* note 123, ¶ 268.

<sup>139</sup> Vienna Convention on the Law of Treaties art. 31, May 23, 1969, 1155 U.N.T.S. 33 [hereinafter *Vienna Convention*].

<sup>140</sup> U.S. – *Gambling and Betting Services*, *supra* note 45, ¶ 175.

<sup>141</sup> *See id.* ¶¶ 178-187.

<sup>142</sup> *Id.* ¶ 179.

<sup>143</sup> *Id.* ¶ 180.

<sup>144</sup> *Id.* ¶ 181.

<sup>145</sup> *See* discussion *supra* Part III.A.2.i.

<sup>146</sup> Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, ¶ 114, WT/DS58/AB/R (Oct. 12, 1998) (“A treaty

this case it is not the *measure* itself that must be prudential—but the *reasons* for that measure.<sup>147</sup> Although a prudential measure and a measure implemented for prudential reason are not mutually exclusive, and in most cases the two will likely overlap, this textual distinction may be material to the ultimate determination of what measures may be permissible under the prudential carve-out clause.<sup>148</sup> Oversimplifying the complexity of financial regulations, consider that it will be a relatively simpler task for a WTO panel to analyze whether the reasons for the measure are *prudential* versus whether the measure itself is *prudential*. It is easier to find consensus on what is a *prudential* reason versus what measures may be implemented for those reasons, because for every prudential reason there are likely to be multiple *prudential* measures that could be implemented. In other words, a *prudential measure* requirement would give less discretion to the sovereign Country-Member as to what measures to implement, while under the *prudential reason* requirement a Country-Member will be able to exercise more discretion as to what measures to implement.

Looking at the context of the entire first sentence of the prudential carve-out clause, the prudential carve-out provision provides concrete examples of prudential reasons: “protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.”<sup>149</sup> Thus, for example, a prudential reason may be the protection of the depositors. In this example whether a particular measure does or does not protect the depositors at this point seems to be irrelevant. The Panel Report inquired into the genuineness of that prudential reason—a fact

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interpreter must begin with, and focus upon, the text of the particular provision to be interpreted. It is in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty must first be sought.”); *see also* *Japan – Alcoholic Beverages II*, *supra* note 117, p. 12 (“Article 31 of the Vienna Convention provides that the words of the treaty form the foundation for the interpretive process: interpretation must be based above all upon the text of the treaty.”) (internal quotations omitted).

<sup>147</sup> *See* discussion *supra* Part III.A.2.i.

<sup>148</sup> *See* *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.831 (“The meaning of the two expressions cannot be the same and, in our opinion, this is an important aspect to be borne in mind when interpreting this provision.”).

<sup>149</sup> GATS, *supra* note 9, Annex on Financial Services, art. 2.a.

intensive inquiry—when analyzing the “for” element in the phrase “for prudential reasons.”<sup>150</sup> Although the Panel Report found that “prudential” means “precautionary” or “preventative” by pointing out that the prudential reasons listed in the text are all examples of “precautionary” or “preventative,”<sup>151</sup> those reasons are not any more “precautionary” as they are “wise” or “reasonable.” The list of examples in the provision supports virtually all of the definitions of “prudential” stated in the dictionaries.<sup>152</sup> Nonetheless, the non-exhaustive list of “prudential” reasons indicates an intention to leave the definition of “prudential” broader than just the examples in the list.<sup>153</sup>

Looking into the broader context [the entire GATS Agreement] may be more helpful from the perspective of identifying what are *not* “prudential reasons”, rather than what are. If another part of the GATS already provides an exception for some measure(s), the reason for providing that exception effectively cannot be a “prudential” reason for purposes of the prudential exception provision, because otherwise the former exception provision would be reduced to “redundancy” or “inutility.”<sup>154</sup> The prudential exception provision may not serve as a catch-all provision to encompass those measures which fail under some element of one of the other exceptions. For example, economic integration agreements are an exception.<sup>155</sup> The reason for exempting integration agreements from GATS commitments is that those agreements liberalize trade between at least some countries, and some liberalization is better than none.<sup>156</sup> Therefore, a reason for the prudential measure under the

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<sup>150</sup> See discussion *supra* Part III.A.2.iii.

<sup>151</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶¶ 7.868-7.869.

<sup>152</sup> See discussion *supra* Part IV.A.1.

<sup>153</sup> *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶¶ 7.869-7.871.

<sup>154</sup> See *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.840 (citing *US – Gasoline*, *supra* note 130, p. 23) (footnotes omitted); see also *US Offset Act*, *supra* note 131, ¶ 271; *Japan – Alcoholic Beverages II*, *supra* note 117, p. 12.

<sup>155</sup> See generally GATS, *supra* note 9, art. V.

<sup>156</sup> *Cf.* GATS, *supra* note 9, art. V.4. (To qualify for the exception an integration agreement, “[it] shall be designed to facilitate trade between the parties

prudential carve-out clause may not be to liberalize local trade between some countries or preventing regional market barriers, because such a scenario is already covered. Similarly, a Country-Member should not be able to claim that the reason for the measure is to address the “serious balance-of-payment and external financial difficulty or threat thereof,” because such a reason is already covered by Article XII of the GATS.<sup>157</sup> Otherwise, for example, a Country-Member could implement a *discriminatory* measure aimed to prevent a threat of a balance-of-payment difficulty, which is prohibited under Article XII(2)(a), so long as such discriminatory measure would be “for prudential reasons”—preventing the threat of a balance-of-payment crisis. To be clear, a Member is free to claim exceptions under various provisions of GATS simultaneously; however, under the prudential carve-out clause analysis, as a matter of law, some reasons should not be considered prudential—reasons that already prompted negotiators to create specific exceptions in other GATS provisions.

Finally, Members’ Schedules attached to the GATS may also serve as context for treaty interpretation purposes.<sup>158</sup> For example, if a Member’s Schedule provides an interpretation of what may be a “prudential reason” for the purposes of the prudential exception provision, then such interpretation will be used by the panels and the Appellate Body as context for treaty interpretation. In the present case, Argentina’s Schedule did not contain any reference to the prudential carve-out clause.<sup>159</sup>

3. *Object and Purpose.* - When no clear meaning could have been discerned, the Appellate Body in *U.S. – Gambling and Betting Services* turned to the object and purpose of the GATS for further guidance.<sup>160</sup> When considering the Preamble to the GATS, which is context, to discern the object and purpose of the prudential provision, the Panel Report emphasized “the right of the Members to

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to the agreement and shall not in respect of any Member outside the agreement raise the overall level of barriers to trade in services . . .”).

<sup>157</sup> See generally GATS, *supra* note 9, art. XII.

<sup>158</sup> *U.S. – Gambling and Betting Services*, *supra* note 45, ¶ 181.

<sup>159</sup> *Argentina – Schedule of Specific Commitments*, GATS/SC/4 (Apr. 15, 1994).

<sup>160</sup> *U.S. – Gambling and Betting Services*, *supra* note 45, ¶ 187.

regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives.”<sup>161</sup> The panel emphasized this objective to give Country-Members broad discretion in identifying what is and what is not prudential.<sup>162</sup> However, there must be some limits on such discretion; otherwise, the prudential carve-out clause will render the entire GATS meaningless with respect to financial services.

GATS has other objects and purposes which weight against the “right of the Members to regulate.” GATS Preamble recognizes “the growing importance of trade in services for the growth and development of the world economy,” and aims “to establish . . . rules for trade in services with a view to the expansion of such trade under conditions of . . . progressive liberalization. . . .”<sup>163</sup> Therefore, as much as the object and purpose of the prudential exception provision may be to recognize national policy objectives, it is also not to permit too broad of an exception, because progressive liberalization and expansion of trade in services are also GATS objectives. Consequently, if the claimed prudential reason for the measure does not go against the objective of liberalized trade, then the object and purpose of the preamble that recognizes the national policy objective should prevail and provide broader discretion to the implementing Country-Member. And inversely, if the prudential reason is facially trade restrictive, then the free-trade objective should be weighed against the national policy objective.

4. *Other Things Taken into Account Together with the Context.* – Pursuant to the third paragraph of Article 31 of the *Vienna Convention* the Appellate Body in *U.S. – Gambling and Betting Services* continued its analysis by taking into account any “**subsequent practice** establishing the agreement of the parties regarding the interpretation of the treaty.”<sup>164</sup> Although not examined by the Appellate Body in the

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<sup>161</sup> See *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.872.

<sup>162</sup> See *id.* at ¶¶ 7.870-7.873.

<sup>163</sup> GATS *supra* note 9, Preamble.

<sup>164</sup> *U.S. – Gambling and Betting Services*, *supra* note 45, ¶ 190 (emphasis added); see also *id.* at ¶¶ 191-192 (“[I]n order for ‘practice’ within the meaning of Article 31(3)(b) to be established: (i) there must be a common, consistent, discernible pattern of acts or pronouncements; and (ii) those acts or



*U.S. – Gambling and Betting Services*, Article 31 paragraph 3 also requires to take into account with the context “[a]ny **subsequent agreement** between the parties regarding the interpretation of the treaty or the application of its provisions” and “[a]ny **relevant rules of international law** applicable in the relations between the parties.”<sup>165</sup> Moreover, the fourth paragraph of the Article 31 requires giving a **special meaning** to a term “if it is established that the parties so intended.”<sup>166</sup>

There is no identifiable subsequent practice between the WTO Members which could constitute an “agreement” to be used in interpreting the prudential exception clause.<sup>167</sup> Nor there is any special meaning that can be discerned from the text, other than “prudential” has an “intrinsically evolutionary nature,” because the list of prudential reasons in the prudential exception provision was written as non-exhaustive.<sup>168</sup>

As part of the relevant rules of international law, the Panel Report emphasized that in the past the Appellate Body “in applying concepts equally important for society, such as those covered by Article XX of the GATT 1994 [general exceptions], [Country-Members] are entitled to determine the level of protection they consider appropriate.”<sup>169</sup> Thus, in interpreting ambiguous or vague terms or words such as “prudential,” the tendency should favor

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pronouncements must imply *agreement* on the interpretation of the relevant provision.”) (original emphasis) (citing *Japan – Alcoholic Beverages II*, *supra* note 117, p. 13); *Japan – Alcoholic Beverages II*, *supra* note 117, p. 14 (Appellate Body found that panel reports adopted by the GATT contracting parties do not constitute subsequent practice within the meaning of Article 31(3)(b) of the *Vienna Convention*).

<sup>165</sup> *Vienna Convention*, *supra* note 139, art. 31.3 (emphasis added).

<sup>166</sup> *Id.* at art. 31.4.

<sup>167</sup> Perhaps Country-Members may be able to use integration agreements or international cooperative enforcement agreements to affect the meaning and the interpretation of the prudential exception clause.

<sup>168</sup> See generally *Argentina – Measures Relating to Trade in Goods and Services*, *supra* note 56, ¶ 7.873 (citations omitted).

<sup>169</sup> *Id.* at ¶ 7.870 (citing Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, ¶ 176, WT/DS161/AB/R, WT/DS169/AB/R).

giving the Country-Members deference to determine their reasons as they consider appropriate.

5. *Supplementary Means of Interpretation.* - Finally, when the above steps led to an ambiguous interpretation, the Appellate Body *U.S. – Gambling and Betting Services* turned to the supplementary means of interpretation.<sup>170</sup> Supplementary means of interpretation include “the preparatory work of the treaty and the circumstances of its conclusion.”<sup>171</sup> This is where documents that did not meet the requirements to be considered as context, may nonetheless be used in treaty interpretation as preparatory work.<sup>172</sup> Thus far in the analysis, the meaning of “prudential” remains unsatisfying. However, from considering other things with the context, it is evident that the word may have been left vague intentionally to give greater deference to the Country-Members to determine their level of protection. Nonetheless, the context of other provisions of the GATS showed some reasons that may not be prudential for purposes of the prudential exception provision.<sup>173</sup> Thus, supplementary means of interpretation are important for either confirming that the vagueness of the word was intentional or to clarify what “prudential reasons” mean.

First, all negotiations after the adoption of the Annex on the Financial Services related to clarifying the meaning of the prudential exception clause, such as the seven times the Committee on Trade in Financial Services debated on the prudential exception provision, are irrelevant and do not constitute supplementary means of interpretation, because they were not “preparatory work.”<sup>174</sup> Work in preparation of the Annex on the Financial Services began when the Working Group on Financial Service including Insurance was formed in June of 1990.<sup>175</sup> The Working Group held four official meetings,

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<sup>170</sup> See, e.g., *U.S. – Gambling and Betting Services*, *supra* note 45, ¶¶ 195, 236, 248.

<sup>171</sup> *Vienna Convention*, *supra* note 139, art. 32.

<sup>172</sup> See, e.g., *U.S. – Gambling and Betting Services*, *supra* note 45, ¶ 197.

<sup>173</sup> See discussion *supra* Part IV.A.2.

<sup>174</sup> The seven meeting reports of the Committee on Trade in Services can be found by WTO document numbers S/FIN/M/25 to 31.

<sup>175</sup> PANAGIOTIS DELIMATIS & NILS HERGER, *FINANCIAL REGULATION AT THE CROSSROADS*, 280 (2011).

and among other issues, discussed the text of the prudential exception provision.<sup>176</sup>

During the first meeting the Chairman of the Working Group offered five different approaches for the prudential carve-out clause, the first four ranging from narrow to broad in scope: (1) an exception only to a qualified national treatment provision, (2) permitting all “reasonable” prudential and fiduciary measures, (3) variation of first and second options with enumerated examples of permissible measures, (4) unqualified right to claim the exception, and (5) defining precise permissible measures to reduce legal uncertainties.<sup>177</sup> After the discussion on the topic was concluded, the Chairman stated that it was not possible to draw a preliminary conclusion as to which approach to use and that, in his opinion, there should be “wide room for flexibility in order to allow for the necessary prudential organizational measures.”<sup>178</sup> After the first meeting of the Working Group three formal proposals regarding the prudential-carve out clause were circulated on behalf of: the European Communities, United States, and Malaysia.<sup>179</sup>

The proposal from the European Communities was circulated before the second meeting of the working group which excepted “reasonable measures to safeguard the integrity of the financial system, provided that these measures are not applied in a

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<sup>176</sup> The reports of the meetings can be found in WTO documents MTN.GNS/FIN 1 to 4.

<sup>177</sup> Working Group on Financial Service Including Insurance, *Note on the Meeting of 11-13 June 1990*, ¶ 78, MTN.GNS/FIN/1 (July 5, 1990), [https://www.wto.org/gatt\\_docs/English/SULPDF/92100236.pdf](https://www.wto.org/gatt_docs/English/SULPDF/92100236.pdf).

<sup>178</sup> *Id.* at ¶ 95.

<sup>179</sup> See DELIMATIS & HERGER, *supra* note 175, at 280 (citing Working Group on Financial Service Including Insurance, *Communication from the European Communities*, MTN.GNS/FIN/W/1 (July 10, 1990); Working Group on Financial Service Including Insurance, *Communication from the United States*, MTN.GNS/FIN/W/2, (July 12, 1990); Working Group on Financial Service Including Insurance, *Communication of the Delegation of Malaysia*, MTN.GNS/FIN/W/3 (Sept. 12, 1990)).

manner which would constitute a means of *arbitrary* or *unjustifiable discrimination*.”<sup>180</sup>

The proposal from the United States was also circulated before the second meeting which called for “a provision which permits a Party to take *reasonable* actions *necessary* for *prudential* reasons, for the protection of investors and depositors, or for the protection of persons to whom a fiduciary duty is owed by a financial service provider.”<sup>181</sup> Additionally, United States had introduced an informal paper titled “Provisions regarding financial services” according to which “all of the proposed provisions were subject to article 9 that stated that nothing in this agreement shall prevent a party from taking *reasonable* actions *necessary* for prudential reasons.”<sup>182</sup> During the second meeting the representative of the United States stated that “[r]easons other than prudential ones . . . most often represent the kind of reasons that the agreement would seek to curtail.”<sup>183</sup> With respect to proposed article 9, which included the words “reasonable” and “necessary,” Switzerland expressed that it “might require further specification to increase its juridical clarity.”<sup>184</sup>

The proposal from Malaysia, submitted before the third meeting, had a section titled “Domestic regulation (prudential regulation).”<sup>185</sup> Under this section the prudential carve-out clause

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<sup>180</sup> Working Group on Financial Service Including Insurance, *Communication from the European Communities*, art. 13.1, MTN.GNS/FIN/W/1 (July 10, 1990), [https://www.wto.org/gatt\\_docs/English/SULPDF/92100245.pdf](https://www.wto.org/gatt_docs/English/SULPDF/92100245.pdf) (emphasis added).

<sup>181</sup> Working Group on Financial Service Including Insurance, *Communication from the United States*, p. 2, MTN.GNS/FIN/W/2, (July 12, 1990), [https://www.wto.org/gatt\\_docs/English/SULPDF/92100258.pdf](https://www.wto.org/gatt_docs/English/SULPDF/92100258.pdf) (emphasis added).

<sup>182</sup> Working Group on Financial Service Including Insurance, *Note on the Meeting of 12-13 July 1990*, ¶ 46, MTN/GNS/FIN/2 (Aug. 10, 1990), [https://www.wto.org/gatt\\_docs/English/SULPDF/92110082.pdf](https://www.wto.org/gatt_docs/English/SULPDF/92110082.pdf) (emphasis added) [hereinafter *Second Meeting*] (The informal paper could not be located.).

<sup>183</sup> *Second Meeting*, *supra* note 182, ¶ 37.

<sup>184</sup> *Second Meeting*, *supra* note 182, ¶ 56.

<sup>185</sup> Working Group on Financial Service Including Insurance, *Communication of the Delegation of Malaysia*, p.6, MTN.GNS/FIN/W/3 (Sept. 12, 1990), [https://www.wto.org/gatt\\_docs/English/SULPDF/92110111.pdf](https://www.wto.org/gatt_docs/English/SULPDF/92110111.pdf) [hereinafter *Communication from Malaysia*] (Malaysian proposal was made on behalf

would have the broadest scope of the three formal propositions at the time:

Compliance of the MFTS [Multilateral Framework on Trade in Services] and sectoral annotations on financial services should not impinge on a supervisory authority's right to: (a) Exercise *adequate* and *proper* supervision over the foreign financial institutions operating in its country; (b) Implement rules and regulations to ensure that foreign financial institutions maintain *sound* and *prudent* practices and policies; (c) Take *necessary* action for the *protection* of depositors and investors; and (d) Allow flexibility to governments to impose measures for maintenance of *stability in the financial system*.<sup>186</sup>

During the third meeting of the Working Group, when discussing this proposal, the representative of Japan stated that the concept of prudential measures might differ from country to country.<sup>187</sup>

After these three meetings and three proposals, the Chairman of the Ad Hoc Working Group to the Group of Negotiations on Services proposed the following change:

The "measures" referred to in Article XIV:1 [General Exceptions] of the Agreement shall include *reasonable* measures taken for *prudential* reasons to assure the protection of investors, depositors, policyholders or persons to whom a fiduciary duty is owed by a

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South East Asian Central Banks [SEACEN] Countries of Indonesia, Malaysia, Thailand, Nepal, Sri Lanka, Korea, the Philippines, Singapore and Myanmar.).

<sup>186</sup> *Id.* at 6-7.

<sup>187</sup> Working Group on Financial Service Including Insurance, *Note on the Meeting of 13-15 September 1990*, ¶ 22, MTN/GNS/FIN/3 (Oct. 16, 1990), [https://www.wto.org/gatt\\_docs/English/SULPDF/92110180.pdf](https://www.wto.org/gatt_docs/English/SULPDF/92110180.pdf) [hereinafter *Third Meeting*].

financial service provider, or to ensure the integrity and stability of a party's financial system.<sup>188</sup>

By the end of 1990 at the Ministerial Conference held in Brussels, two versions of an annex on financial services were proposed.<sup>189</sup> The prudential carve-out clause of the version submitted by Canada, Japan, Sweden and Switzerland was identical to the Ad Hoc Working Groups Chairman's proposal quoted above.<sup>190</sup> The second proposal made on behalf of the SEACEN Countries contained similar language with two key differences with respect to the prudential carve-out clause: first, the word "reasonable" was omitted, and second, measures for prudential reasons were not subject to the dispute settlement.<sup>191</sup>

The negotiations work on the future Annex on Financial Services continued through 1991 under the auspices of the Group of Negotiations in Services.<sup>192</sup> Canada, Japan, Sweden, and Switzerland presented an addendum to their proposal at the Ministerial Conference in Brussels which added:

[M]easures shall not be applied in a manner which would constitute a means of arbitrary or unjustifiable (a) *restriction* on the provision of financial services by financial service providers of another Party or (b) *discrimination* between domestic and foreign financial service providers or between countries.<sup>193</sup>

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<sup>188</sup> Report by the Chairman of the Sectoral Ad Hoc Working Group to the GNS, p. 10, MTN.GNS/W/110 (Nov. 6, 1990) [emphasis added], available at [https://www.wto.org/gatt\\_docs/English/SULPDF/92110245.pdf](https://www.wto.org/gatt_docs/English/SULPDF/92110245.pdf).

<sup>189</sup> DELIMATIS & HERGER, *supra* note 175, at 281 [footnote omitted].

<sup>190</sup> See Trade Negotiations Committee, *Communication from Canada, Japan, Sweden and Switzerland*, MTN.TNC/W/50 (Dec. 2, 1990), [https://www.wto.org/gatt\\_docs/English/SULPDF/92120056.pdf](https://www.wto.org/gatt_docs/English/SULPDF/92120056.pdf).

<sup>191</sup> See Trade Negotiations Committee, *Communication from Malaysia*, p. 2, MTN.TNC/W/52 (Dec. 4, 1990), <https://docs.wto.org/gattdocs/q/.%5CUR%5CTNC%5CW52>.

<sup>192</sup> DELIMATIS & HERGER, *supra* note 175, at 282.

<sup>193</sup> Trade Negotiations Committee, *Communication from Canada, Japan, Sweden and Switzerland*, p. 4, MTN/TNC/W/50/Add.2 (Oct. 15, 1991),

Based on these submitted proposals, negotiations led to the current text of the prudential carve-out clause.<sup>194</sup>

Comparison of the negotiated and final versions of the text and comments made by the negotiators provides guidance for the interpretation of the clause. First, the negotiators considered the option for defining or listing all prudential actions which would be permitted, but did not. Instead the clause is written in terms of prudential reasons; thus, leaving greater deference to the Country-Members in implementing measures. This confirms the finding in the Panel Report that the reasons must be prudential and not the measures.

Second, the comparison of the latest two formal proposals shows that there was likely a compromise among countries whose positions were to have: a “reasonable” measures requirement, exclude from the exception particular ways in which measures could be applied—which is most similar to the second sentence of the current text, and to make the prudential carve-out clause subject to the WTO dispute settlement process.

However, none of these observations speak directly as to what “prudential” means. There was one comment that may help understanding what “prudential” reasons are: “Reasons other than prudential ones . . . most often represent the kind of reasons that the agreement would seek to curtail.”<sup>195</sup> Also, negotiators did not consider using the word “safeguard” which is the more common word used throughout the WTO Agreements used for identifying “preventative” measures.

#### B. Second Sentence of the Prudential Carve-out Clause

If the measure falls within the scope of the Annex, the Country-Member identifies a reason that is prudential, and the

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<https://docs.wto.org/gattdocs/q/.%5CUR%5CTNC%5CW50A2.PDF> [emphasis added].

<sup>194</sup> See generally DELIMATSI & HERGER, *supra* note 175, at 282 (“Formal records contain very little – if any – information about the negotiations that followed these submissions.”).

<sup>195</sup> *Second Meeting*, *supra* note 182, ¶ 37.

measure was implemented “for” that reason, as analyzed by the panel report, can anything else hinder the application of the prudential exception provision? The answer “No” would render the second sentence of the provision meaningless; thus, the answer is necessarily “Yes, because of the second sentence of the provision.” Basically, the second sentence would disqualify an otherwise qualified exception. The Panel Report did not attempt to interpret the second sentence of the clause which states: “Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement.”<sup>196</sup> The first part of the sentence necessarily presumes that there may be measures for prudential reasons conforming to the agreement, which may be permitted to be used as means of avoiding the Member’s commitments. The second part’s “means of avoiding” is what future WTO panels or the Appellate Body may need to interpret.

Recall that a proposal of a provision with a sentence similar to the final text appeared as:

[M]easures shall not be applied in a manner which would constitute a *means of arbitrary or unjustifiable (a) restriction* on the provision of financial services by financial service providers of another Party or (b) *discrimination* between domestic and foreign financial service providers or between countries.<sup>197</sup>

If a panel finds that “means of avoiding” requires determining the intentions of a Member in order to weed out disguised discriminatory measures, then such intent may be discerned from the objective structure of the regulatory measure.<sup>198</sup>

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<sup>196</sup> GATS, *supra* note 9, *Annex on Financial Services*, § 2.a.

<sup>197</sup> See *Communication from Canada, Japan, Sweden and Switzerland*, *supra* note 193; see also discussion *supra* Part IV.A.5.

<sup>198</sup> See, e.g., *Japan – Alcoholic Beverages II*, *supra* note 117.



## VI. CONCLUSION

In summary, to answer the question of what is and what is not a prudential reason, generally a fact intensive multi-layered inquiry is required. Dictionary definitions are vague and do not provide any definitions for “prudential” that are any more helpful than if the drafters would write “measures for *good* reasons.” Context of the clause is very helpful in providing two main categories of reasons that are prudential: (1) “protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier”, and (2) “to ensure the integrity and stability of the financial system.”<sup>199</sup> Further, context of the entire GATS Agreement shows that a “prudential” reason cannot be: “any” reason, because that would render the word “prudential” meaningless; merely “preventative” or “precautionary” reason, because all and any reasons either prevent or are precautionary against some event; and any of the reasons that have specific exemption provisions in the GATS, because that would render those exemption provisions meaningless. Moreover, negotiators did not consider using the term “safeguarding reasons,” utilizing the commonly used word “safeguard” to convey something “preventative” or “precautionary” as used throughout various WTO agreements; thus, another reason to conclude that “prudential” does not mean “preventative” or “precautionary.”

Two main objects and purposes of WTO agreements related to this provision are: recognition of national policy objectives and progressive liberalization of international trade. If a reason for a measure does not go against the objective of liberalized trade in services or goods, then the remaining object and purpose to be considered is the national policy objective, providing broader discretion to the implementing Country-Member.

The current interpretation of the prudential carve-out clause in the Panel Report gives more discretion to Country-Members, as some have anticipated, by finding that reasons and not measures must be prudential. However, such discretion is not unqualified even under the current interpretation. If the “reasonableness” requirement

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<sup>199</sup> See GATS, *supra* note 9, Annex on Financial Services, § 2.

was negotiated away during the Uruguay Round, and in return the clause was made subject to the WTO dispute settlement process, ironically, “rationality” made its way back into the text through panel’s interpretation of the word “for” when it was left to, as critics would say, the “runaway jurists.”