ANTOINE P. MARTIN* AND BRYAN MERCURIO†

TABLE OF CONTENTS

I. INTRODUCTION

II. TPP ON FINANCIAL SERVICES LIBERALIZATION
   1. INCREASING MARKET ACCESS
   2. APPLYING INVESTMENT STANDARDS TO FINANCIAL SERVICES

III. LIBERALIZATION OF FINANCIAL SERVICES WITHOUT SAFEGUARDS?
   1. MAIN CONCERNS
   2. CARVE-OUT AND PRUDENTIAL MECHANISMS UNDER GATS
   3. CARVE-OUT AND PRUDENTIAL MECHANISMS UNDER TPP
   4. QUESTIONING THE EFFECTIVENESS OF CARVE-OUT PROVISIONS

THEORETICAL QUESTIONING

CASE LAW QUESTIONING

*Dr Antoine P. Martin (LLB, LLM, PhD) is a Research Associate focusing on political economy, international trade, investment and financial services at The Chinese University of Hong Kong, Faculty of Law.
† Bryan Mercurio (BA, JD, LLM, PhD) is Professor and Vice-Chancellor’s Outstanding Fellow of the Faculty of Law, The Chinese University of Hong Kong.

Acknowledgment: This research is supported by Hong Kong General Research Fund (GRF) Project No. 14613717, entitled, “When Regimes Clash on Capital Controls: Managing the Conflicting Norms and Standards of the IMF, WTO and International Investment Agreements”.

LIBERALIZATION COMMITMENTS, FINANCIAL STABILITY SAFEGUARDS AND CAPITAL CONTROLS: PRACTICE EVOLUTIONS FROM GATS TO TPP AND MEGAREGIONAL TRADE AGREEMENTS
5. TPP VS GATS: DISPUTE SETTLEMENT

6. COMPARISON WITH OTHER FTAS

IV. THE ISSUE OF OPERATING REGULATORY CARVE-OUTS AGAINST POLITICS

V. CONCLUDING REMARKS

I. INTRODUCTION

Recent economic crises and the reported difficulties faced by governments, attempting to preserve their economic and financial systems from global instability, without breaching trade commitments, have led to calls from commentators to increase the autonomy of governments to control cross border capital movements. These so-called ‘capital controls’, however, are not a new phenomenon and have been discussed at great length by economists over the past decades, as a potential alternative to the capital market liberalization policies historically promoted by the International Monetary Fund (IMF).¹ Various arguments have been formulated with a clear lack of consensus. To some, controls imposed on inwards (foreign investment) and outwards capital movements are a necessary step to preserve immature markets from global financial volatility.² To others, such measures – especially inwards capital controls – may alter the composition of foreign capitals (from short-term portfolio investments to long-term investments) but overall have very limited efficiency in the long-run.³ Some, alternatively, have emphasised


negative impacts in terms of capital availability, increase in the cost of financing and the fostering of capital evasion which is distorting the rational decision-making process of business decision-makers. Hence, over the past years, the IMF progressively operated a position shift, acknowledging the idea that capital management measures indeed make part of the States’ financial stability policy toolbox.

This article proposes to place the capital control debate into perspective by evaluating how the drafters of the most recent Free Trade Agreements (FTAs) managed the issue of necessary regulatory interference in times of economic, financial and monetary instability.

In particular, the provisions of the Trans-Pacific Partnership (TPP) Agreement – aimed at fostering trade between twelve Asia-Pacific partner countries – are worth


6 Instability here corresponds to the definition of economic crises as formulated by Korinek, i.e. ‘situations in which an emerging economy loses access to international financial markets and experiences a feedback loop in which declining aggregate demand, falling exchange rates and asset prices, and deteriorating balance sheets mutually reinforce each other – a common phenomenon in recent emerging market crises. Individual market participants take aggregate prices and financial conditions as given and do not internalize their contribution to financial instability when they choose their actions. As a result they impose externalities in the form of greater financial instability on each other, and the private financing decisions of individuals are distorted toward excessive risk-taking.’ See Anton Korinek, The New Economics of Prudential Capital Controls: A Research Agenda, 59(3) IMF ECON. REV. 523 (2011).


8 The twelve partner countries include Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam.
taking as an example of modern practice. Even though its implementation has been compromised given President Donald Trump’s announcement of the United States’ (U.S.) withdrawal, the agreement remains one of the largest and most comprehensive regional FTAs ever negotiated. Led by the U.S., the signatory countries make up 33 per cent of the world’s GDP and 40 per cent of global trade. With such economic strength, the TPP therefore had the potential not only to be a tool for the liberalization of regional trade but also to engage in rule-making and set standards in a number of trade-related areas. Hence, it is our view that the text of this mega-regional agreement is worth evaluating, as it is likely to provide significant legal input into future trade agreements.

The supply of financial services is one amongst the numerous negotiating topics in the TPP. Perceived as a means of fostering foreign investment and cross-border capital flows, the agreement, on the one hand, promotes and liberalises the financial services sector by easing regulated financial institutions’ and investors’ access to regional financial supply markets and by promoting investments in financial institutions and cross-border trade in financial services. On the other hand, and similar to other FTAs and bilateral investment agreements (BITs), the TPP also provides for certain safeguards and equips partner countries with a way to monitor, regulate and control capital flows under certain circumstances. It is this aspect of financial regulation which is the focus of this article.

The article proceeds as follows: Section 1 reviews the market access provisions of the TPP relating to foreign financial service suppliers. Section 2 focuses on the regulatory prudential safeguards or ‘carve-outs’ included in liberalization agreements to ensure that partner countries/members retain a certain freedom to regulate on financial stability matters, and compares the TPP provisions to the WTO’s General Agreement on Trade in Services (GATS). It furthermore considers the ability of dispute settlement mechanisms to preserve regulatory freedom, and finishes with a

---


11 For instance, financial services, electronic commerce, competition policy, state-owned enterprises, the environment, etc. See WTO trade topics, WORLD TRADE ORGANIZATION, https://www.wto.org/english/tratop_e/tratop_e.htm (last visited Feb. 16, 2017).

12 TPP, supra note 7, at Chapter 11, Financial Services.

brief analysis of whether and how other FTAs safeguard financial stability. Lastly, Section 3 discusses the carve-out from a political perspective with a view to consider whether prudential measures will be relied upon in order to preserve financial stability or whether such provisions will in practice be ignored or untrusted.

Some commentators suggest that U.S. investment and trade policy leaves no room for capital controls aimed at preventing and mitigating financial crisis.\(^{14}\) We reach the opposite conclusion, finding that the TPP, as well as standards in existing U.S. FTAs, leave significant room for regulatory exceptions, particularly in times of financial instability. Moreover, and importantly, we find that although common elements exist between the TPP and GATS regarding exceptions and measures taken for prudential reasons, the TPP agreement is a significant evolution from the standards on financial services under the GATS.

### II. TPP ON FINANCIAL SERVICES LIBERALIZATION

The TPP aims to promote market access facilitation in various trade sectors and the aim of the Financial Services Chapter (Chapter 11)—to assist in the development of financial services through the promotion of foreign investments in financial institutions and cross-border trade in financial services— is no different. This is to be achieved by increasing market access to financial service suppliers (1.1) and easing the recognition of foreign services providers as foreign investors benefiting from the standards of international investment law (1.2).

#### 1. Increasing market access

A key goal of TPP Chapter 11 is to facilitate market access to foreign financial services operators. Hence, it includes the key standards of international economic law applicable to cross-border trade in services, as provided for in the GATS.

For instance, the TPP includes the widely recognized cornerstone principles of international economic law, namely the principles of National Treatment (under which the parties must treat financial service providers from other partner countries equal to that of national providers) as provided for in Article XVII of the GATS and

---

Most-Favoured-Nation (according to which parties will provide the same treatment to investors from all other partner countries) as provided in Article II of the GATS.

Likewise, Article 11.5 includes a strong liberalization provision for ‘Market Access for Financial Institutions’ which is in line with the standards provided in Article XVI of the GATS. More specifically, Article 11.5 prohibits the parties from placing limits on the number of foreign financial institutions engaging in local trade in financial services and from imposing quotas on the total value of financial service transactions or on the number of operations and outputs realized by foreign TPP entities. It also prohibits instituting and relying on the so-called Economic Test Needs (ETN) which have traditionally imposed licensing procedures on foreign entities prior to the entry of a new foreign product in a domestic market. In addition, Article 11.13 insists on the importance of ensuring ‘transparent regulations and policies governing the activities of financial institutions and cross-border financial service’, in line with the general transparency requirements provided in Article II of the GATS.

2. Applying investment standards to financial services

Another key goal of TPP Chapter 11 is to open the financial services sector to foreign investments by recognizing foreign financial services providers as foreign investors benefitting from the standards of international investment law.

To a large extent, this is done by incorporating and reiterating the main provisions of TPP’s Investment Chapter (Chapter 9), into Chapter 11, especially – but not limited to – the Minimum Standard of Treatment requirement (which includes fair and equitable treatment and full protection and security under customary international law), the Expropriation and Compensation requirement, and the freedom of transfers requirement aimed at guaranteeing the right of investors to repatriate profits.

Moreover, the TPP provides the parties as well as the foreign financial services providers with the benefit of two dispute settlement mechanisms, addressing the needs of both, the governments and the risk-averse financial foreign investors. In consonance with the WTO dispute settlement mechanism and as is standard in FTAs, Chapter 11 provides an avenue for a party to challenge a counterpart’s

15 ‘Section B of Chapter 9 (Investment) is hereby incorporated into and made a part of this Chapter […]’, TPP, supra note 7, Article 11.2(2).
16 Id., as protected under Article 9.6 of the Investment Chapter.
17 Id., as protected under Article 9.8 of the Investment Chapter.
18 Id., as protected under Article 9.9 of the Investment Chapter. In Annexes 9-E and 9-F, Chile filed reservations as to a right to regulate in order to ensure currency stability and the normal operation of domestic and foreign payments.
measure relating to the regulation or supervision of financial institutions, markets or instruments via a State-to-State dispute resolution mechanism. In such a situation, Article 11.21 stipulates that Chapter 28 would be invoked and the dispute would solely operate at the governmental level without the direct involvement of industry actors (and without the ability of the affected industry to recoup losses). While being in contrast with the WTO system, Chapter 11 is in line with the general FTA practice since the NAFTA agreement (1993) provides a venue for Investor-State Dispute Settlement (ISDS). In such circumstances, Article 11.22 allows an investor to invoke investor-State arbitration as provided under Chapter 9, meaning that an investor of one party can directly challenge and obtain compensation for the mistreatment of its investments by the host authorities.

In other words, in addition to providing market access to foreign financial services providers, the TPP contains an important investment dimension which deliberately applies to the financial services sector. However, it should be noted that this feature and the various standards of treatment provided in the TPP are commonly found in modern FTAs as well as within international investment treaties. In fact, while the approach of the TPP differs from the approach followed in the NAFTA, it is otherwise very much in accordance with the practice of the United States in its multitude of agreements negotiated since that time, with similar provisions being found also in the agreements entered into with Australia, Chile, Korea, the Dominican Republic and Central America to cite but a few.

**III. Liberalization of Financial Services Without Safeguards?**

The opening of financial services markets often raises questions relating to safeguards, particularly in relation to financial stability preservation. Therefore, the question that must be asked is whether the TPP includes safeguards – such as the initiation of controls on either the inflow or outflow of capital (capital controls) – in case particular economic conditions lead to financial instability. If so, the extent to which these would differ from the current GATS standards is also worth considering.

---

19 *Id*, at Article 11.21. On the role of dispute settlement in TPP, see *infra* §5.


21 NAFTA Chapter 5 on Investment and Article 1101(3) expressly excludes Chapter 14 on Financial Services from its scope of protection.

1. **Main Concerns**

Analysing the influence of the TPP Agreement’s provisions on financial instability is difficult because the agreement is intrinsically about facilitating cross-border financial services development.\(^{23}\) As a recent IMF staff note pointed out, in fact, whilst FTAs are about creating comprehensive frameworks for trade in financial services as a conduit of liberalised capital flows, their purpose is *not* to control capital flows *per se*.\(^ {24}\) Thus, the TPP does not provide a direct reference to the controlling and monitoring of financial movements.

For this reason and as mentioned above, however, the method has raised concerns amongst commentators that implementing the agreement would in practice prevent host authorities from taking measures to preserve financial stability from unpredictable capital flows.\(^ {25}\) Sceptics, in fact, have come to the conclusion that U.S. trade and investment policy is incompatible with the need of States to control financial services and preserve financial stability.\(^ {26}\) For example, Gallagher claims that U.S. IIAs do not allow the carving-out (i.e. preserving) of a host country’s measures on capital controls, or temporary safeguards on inflows and outflows in times of crisis and, more generally, leave little room for deploying measures for the prevention and mitigation of a financial crisis.\(^ {27}\) More extreme activists have even argued that ‘the TPP would empower financial firms to use extrajudicial tribunals to challenge financial stability measures that do not conform to their expectations’.\(^ {28}\)

In the absence of regulatory derogations, in other words, critics claim that the very

\(^{23}\) See, e.g., TPP, *supra* note 7, Article 11.3 on National Treatment, Article 11.4 on Most-Favoured-Nation Treatment, Article 11.5 on Market Access for Financial Institutions or Article 11.7 on New Financial Services.

\(^{24}\) ‘… when a country undertakes a commitment to open up its market for the cross-border supply of a particular financial service, there is typically a commensurate commitment to allow the capital flows that are an essential part of the service itself [but] the host country typically does not, however, make an across-the-board commitment to liberalize capital movements’, *Reference Note on Trade in Financial Services Prepared by the Strategy, Policy, and Review and Legal Departments, INT’L MONETARY FUND* (2010), https://www.imf.org/external/np/pp/eng/2010/090310.pdf [hereinafter IMF Reference Note].

\(^{25}\) In particular, see Gallagher, *supra* note 14; *See also Philip J. MacFarlane, The IMF’s Reassessment of Capital Controls after the 2008 Financial Crisis: Heresy or Orthodoxy? 19 UCLA J. INT’L L. & FOREIGN AFF. 167, 194 (2015).*

\(^{26}\) *Id.*

\(^{27}\) Gallagher, *supra* note 14 at 17. *See also Kevin P Gallagher & Jose Antonio Ocampo, IMF’s New View on Capital Controls, 48(12) ECON. & POL. WKLY. 12 (2013). See also MacFarlane, *Id.*

idea of ensuring domestic financial stability – in particular through capital controls – would be in ‘fundamental violation’ of the core principles of the TPP agreement.29

This article disagrees with the above conclusions and finds that the TPP does leave parties with significant room to take regulatory measures. For instance, while Article 11.6 of the TPP obliges parties to provide access to domestic markets, it also gives them the right to impose an authorization and registration requirement on foreign providers so as to balance freedoms and regulatory minimum requirements.30

The following subsections will review the prudential carve-out under the GATS (2.2), the prudential measures in the TPP (2.3), and the potential effectiveness of the provision (2.4). In addition, the section goes on to discuss how the dispute settlement mechanism has been drafted to allow a certain degree of preservation of financial stability (2.5) and how the TPP standards are not a radical departure from past practice but rather, essentially in line with the standards provided for in other FTAs (2.6).

2. Carve-out and prudential mechanisms under GATS

This section reviews the place of safeguards in the GATS Agreement, as this multilateral agreement remains the benchmark and in some ways, should set the minimum standard for subsequent FTAs.

The Preamble of the GATS Agreement, first and foremost, protects and promotes ‘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’.31 Similarly, the so-called ‘positive approach’ to commitments followed in the instrument, ensures that governments only commit to opening sectors on an individual, voluntary and progressive basis,32 whilst services ‘supplied in the exercise of governmental authority’ such as monetary matters dealt with by institutions like central banks fall outside the scope of the Agreement.33

Article VI of the GATS then considers domestic regulations, essentially stipulating that domestic measures of general application should be conducted in a ‘reasonable,

29 Gallagher, supra note 14 at 13, 14.
30 In relation to new financial services, however, this authorization and registration requirement cannot lead to a refusal unless prudential reasons are being alleged. See TPP, supra note 7, Article 11.7, Chapter 11 - Financial Services.
31 GATS, supra note 13.
32 Id, Part IV. On the ‘positive list’ approach, see, e.g., IMF Referene Note, supra note 24, at 12.
33 GATS, supra note 13.
objective and impartial manner’ whilst at the same time, the responsible
governments commit to provide mechanisms for reviewing their legitimacy and
compensating affected parties if needed.34 Article VI, however, makes no reference
to financial regulatory matters.

Article XIV on ‘General Exceptions’ also allows for the taking of exceptional
measures deemed ‘necessary to protect public morals or to maintain public order,
protect human, animal or plant life or health, secure compliance with laws or
regulations which are not inconsistent with the provisions of this Agreement’ so
long as these are not ‘arbitrary or unjustifiable discrimination’ or ‘disguised
restriction’ to trade in services. These Article XIV exceptions were formulated
following the 1995 Uruguay Round when financial stability was yet not a crucial
negotiation focus and thus do not expressly consider exceptional measures taken to
regulate financial services for the sake of financial and monetary stability. It should
be added, nonetheless, that the Appellate Body in US—Gambling described ‘public
order’ as referring ‘to the preservation of the fundamental interests of a society, as
reflected in public policy and law’, and considered that issues such as organized
crime or money laundering would fall under its scope.35 It is possible, therefore, that
Article XIV could be used as a means to justify regulatory measures aimed at
preserving financial stability if the latter were to be assimilated into a public order
matter. This argument was in fact considered in a recent WTO panel report
involving measures taken during Argentina’s recent economic crisis.36

Article XIX, entitled ‘Negotiation of Specific Commitments’, also indicates that ‘the
process of liberalization shall take place with due respect for national policy
objectives and the level of development of individual Members [so that] there shall
be appropriate flexibility for individual developing country Members for opening
fewer sectors, liberalizing fewer types of transactions, progressively extending market
access in line with their development situation’. However, the provision is more about
providing governments time and space to cautiously liberalize through established
guidelines and procedures, and clearly does not relate to the issue of domestic
regulation in times of financial distress and instability. It is thus inapplicable to the
situation we discuss in this article.

The only GATS provisions actually offering a specific ‘carve-out’ exceptions in times
of financial and monetary distress can be found in Article XII and in the
Agreement’s Annex on Trade in Financial Services. Article XII on ‘Restrictions to
Safeguard the Balance of Payments’ grants Members the authority to adopt or

34 Id, Articles VI(1) & VI(2).
36 See infra, §2.4.
maintain restrictions on trade in services notwithstanding existing commitments. Restrictions may apply in case of ‘serious balance-of-payments and external financial difficulties or threat’ but it is specified that ‘such restrictions shall not be adopted or maintained for the purpose of protecting a particular service sector’. Furthermore, the involved government must submit to a balance of payment assessment procedure – taking into account the nature and the extent of the external difficulties – before the Ministerial Conference. In addition, the GATS Annex on Financial Services contains a ‘Domestic Regulation’ provision allowing for ‘prudential reasons’, i.e. the taking of measures prevailing in existing multilateral commitments. The Annex, indeed, states that ‘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’.  

3. **Carve-out and prudential mechanisms under TPP**

Having clarified how the main multilateral initiative on trade in financial services deals with financial stability safeguard mechanisms, we now shift attention to considering the regulatory safeguards provided for in the TPP.

In many respects, and as mentioned before, Chapter 9 on Investment is almost a carbon copy of the standards and norms seen in most other IIAs. That being said, the TPP does go beyond the usual norm of providing protection and stability to investors in that it ensures that each party retains the general right to ‘adopt[], maintain[] or enforce[] any measure otherwise consistent … that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives’. In fact, Chapter 10 on Trade in Services – which aims to liberalise and ease the supply of cross-border financial services – similarly recognizes a general State authority and ‘right to regulate and to introduce new regulations on the supply of services in order to meet its policy objectives.  

Furthermore, it is worth noting that the TPP provides two significant safeguards especially oriented towards the ability of parties to regulate financial services so as to control capital flows and to ensure financial stability.

The first of these safeguards pertains to payments and transfers and can be found in various places throughout the agreement. Under Chapter 10, TPP generally provides

---

38 TPP, *supra* note 7. Annex 9-G furthermore ensures that claims related to public debt be left out of the scope of the protection granted to foreign investors.
39 *Id.*, Article 10.8.
that ‘Each Party shall permit all transfers and payments that relate to the cross-border supply of services to be made freely and without delay into and out of its territory […] in a freely usable currency at the market rate of exchange that prevails at the time of transfer’. Against this focused liberalization goal, however, the agreement makes it clear that ‘a Party may prevent or delay a transfer or payment through the equitable, non-discriminatory and good faith application of its laws’ relating to – amongst other matters – (a) bankruptcy, insolvency or the protection of the rights of creditors; (b) issuing, trading or dealing in securities, futures, options or derivatives; (c) financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities’. Similarly, Chapter 11 allows a party to ‘prevent or limit transfers by a financial institution or cross-border financial service supplier […] through the equitable, non-discriminatory and good faith application of measures relating to maintenance of the safety, soundness, integrity, or financial responsibility of financial institutions or cross-border financial service suppliers’. Finally, a specific provision of Chapter 29 (‘Exceptions and General Provisions’) reiterates that restrictive ‘Temporary Safeguard Measures’ may be taken ‘with regard to payments or transfers for current account transactions in the event of serious balance of payments and external financial difficulties or threats thereof’.

The second safeguard, or ‘carve-out’ provision, relates directly to trade in financial services under Chapter 11. In particular, Article 11.11 provides that as long as the agreement’s requirements (essentially investment protection standards) are observed, ‘a Party shall not be prevented from adopting or maintaining measures for prudential reasons’. The concept of ‘prudential measures’ has been much discussed in the literature, but prudential reasons, as defined in a footnote of the agreement, overall relate to ‘the maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions or cross-border financial service suppliers as well as the safety, and financial and operational integrity of payment and clearing systems’. Restrictions on financial services taken on prudential grounds, in other words, can be applied ‘for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system’. In addition, Article 11.11 allows the taking of ‘non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related

---

40 Id., Article 10.12.
41 Id.
42 Id., Article 11–11.3.
43 Id., Article 29.3.
44 See next section.
45 TPP, supra note 7, Chapter 11 - Financial Services.
46 Id., Article 11–11.1 (emphasis added).
credit policies or exchange rate policies, while exceptional constraints may be imposed on transfers or to permit host governments to adopt or enforce measures necessary to secure compliance with laws or regulations, as provided under GATS Article XIV.

In relation to financial services, the TPP is however just another in a long line of similar looking U.S. FTAs/IIAs with the usual carve-out provision allowing the parties to take prudential measures for the preservation of financial stability and with explicit recognition of prudential measures.

4. Questioning the effectiveness of carve-out provisions

It is clear from the above comparison that the TPP prudential measures carve out is very similar to that of the GATS. Thus, if one believes that the GATS provides an acceptable level of regulatory control over financial stability matters then one would have to accept that the TPP also provides for the same level.

Theoretical questioning

Problematically, the last sentence of the GATS Annex and the TPP carve out provision conclude by stipulating that ‘[w]here such [prudential] 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’ (emphasis added).

This sentence has created confusion and led to various interpretations which inevitably question the effectiveness of the prudential carve-outs under the GATS Annex on Financial Services and Article 11.11 of the TPP and whether they would actually permit governmental regulatory action. On one side, trade liberalization sceptics suggest that this sentence is poorly drafted and has a self-cancelling effect on the carve-out clauses such that it makes the clauses non-functional and

47 Id.
48 ‘[…] through the equitable, non-discriminatory and good faith application of measures relating to maintenance of the safety, soundness, integrity, or financial responsibility of financial institutions or cross-border financial service suppliers’. See, id., Article 11–11.3.
49 Id., Article 11–11.4.
50 The Jordan – U.S FTA is the only agreement that provides no regulatory carve-out clause. Except for the Jordan FTA.
51 For the sake of clarity, Article 11.11.1 TPP reads ‘Party shall not be prevented from adopting or maintaining 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 institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system. If these measures do not conform with the provisions of this Agreement to which this exception applies, they shall not be used as a means of avoiding the Party’s commitments or obligations under those provisions’. 
ineffective. Thus, despite the explicit addition of a carve-out provision, any action taken in reliance of the clause would nevertheless be deemed to be inconsistent with WTO, and now, TPP obligations. To the critics, therefore, State sovereignty is undermined as the carve-out provisions do not allow governments to address systemic risks without breaching WTO and TPP liberalization commitments.  

Reading the carve-out provisions with State regulatory needs in mind rather leads to an alternative and more rational interpretation. The wording clearly suggests that in special circumstances measures which would normally be inconsistent with WTO (and TPP) rules are allowable for prudential reasons, provided that the prudential clause is not used as a mere excuse to initiate protectionist measures and escape the general obligations under the agreement. This seems to be the better reading of the provision. It is practically difficult to understand why signatories would knowingly approve a set of contradictory and self-cancelling provisions that would deprive them of all regulatory space to manoeuvre. This reading of the provision has been accepted by various States and institutions as well in the majority of the academic literature. In doing so, most commentators seem to agree on the polemical and speculative nature of the former argument which attempts to cast a doubt on the effectiveness of the carve-out for prudential measures.

In fact, both the GATS Annex on Financial Services and Chapter 11 of the TPP provide an additional tool capable of granting strength to prudential measure provisions: recognition. Like Article 11.12 of the TPP, Paragraph 3 of the GATS

---

53 ‘As the second sentence makes clear, prudential measures are only allowed under GATS rules if they don’t violate any of the GATS rules, which are very expansive, or operate to reduce a member country’s commitments or obligations’, in Lori Wallach & Todd Tucker, Memorandum - Answering Critical Questions about Conflicts between Financial Reregulation and WTO Rules Hitherto Unaddressed by the WTO Secretariat and Other Official Sources, 4, PUBLIC CITIZEN, https://www.citizen.org/documents/Memo%20Unanswered%20questions%20memo%20for%20Geneva.pdf. See also, To Promote Economic Stability, Nations Must Free Themselves from WTO Financial Deregulation Dictates, PUBLIC CITIZEN, https://www.citizen.org/documents/IntroductionToWTODeregulation.pdf.


56 Id.
Annex on Financial Services allows Members to recognize prudential measures taken by their counterparts, either unilaterally or through multilateral instruments, thereby legitimizing or confirming their authority against existing commitments. The only condition is that the claiming country should recognize the authority of similar measures taken by other partners under the MFN requirements.\(^57\)

**CASE LAW QUESTIONING**

With little case law exploring these issues, the debate has largely been of a theoretical and academic nature. There is no FTA-based jurisprudence on ‘prudential provisions’ but five investment tribunals have considered whether measures taken by Argentina during a financial crisis could qualify as non-compensable exceptions for ‘necessity’ reasons. The CMS, Sempra, Enron, LG&E and Continental Casualty cases all suggest that both customary international law and the relevant Argentine BITs provided grounds for allowing exceptions to commitments. In reality, however, it is fair to say that the reasoning in the cases were often tedious, sometimes conflicting, so that the tribunals overall failed to reach a consensus as to the thresholds possibly justifying exceptions. In particular, only LG&E and Continental Casualty effectively admitted that a margin of manoeuvre had to be allowed, whilst equivalent outcomes were only reached in the CMS, Sempra and Enron cases as a result of annulment proceedings.\(^58\)

More recently, a WTO Panel Report (September 2015) provided additional insight into the issues when it was called upon to determine whether a set of defensive anti-abuse measures taken by Argentina for tax-transparency and financial surveillance reasons were consistent with obligations under the GATS.\(^59\) The Panel’s approach differed from that of the investment cases by virtue of the fact that this was a trade dispute focusing on ‘regulatory exceptions’ under GATS Article XIV and ‘prudential

---


\(^{58}\) Three cases originally rejected the idea before being eventually annulled. For more details, see comments by the authors reflecting the investment tribunals’ approaches to the doctrine of necessity. See Antoine Martin, Investment Disputes after Argentina’s Economic Crisis: Interpreting BIT Non-Precluded Measures and the Doctrine of Necessity under Customary International Law, 29 J. INT’L ARB. 49 (2012) [hereinafter Martin]. For an investment and WTO approach, see also Antoine Martin & Bryan Mercurio, Prudential Measures: Towards A Right To Regulate For The Preservation of Financial Stability? (forthcoming, 2017).

measures’ under Paragraph 2 of the Annex. Its conclusions, nonetheless, are very much in line with the general conclusions of the investment arbitral tribunals in that it clearly and firmly supported the idea that States have a right to take regulatory measures despite existing commitments, provided that these were taken for prudential reasons, on a non-discriminatory basis and that such measures were not aimed at avoiding commitments.

In brief, the panel in Argentina–Financial Services considered the difference between ‘general exceptions’ aimed at preserving public order under Article XIV of GATS and prudential measures under Paragraph 2 of the GATS Annex on Financial Services in order to find that although the exceptional and prudential nature of the attacked measures was legitimate, their design and the way they were operated breached the MFN standard.60 Interestingly, the Panel distinguished the common concept of ‘prudential measures’ from measures which in practice were ‘taken for prudential reasons’ or ‘preventive or precautionary reasons’, and concluded that, when considering whether a carve-out provision applies, ‘it is the reason which must be "prudential" and not the measure per se’.61 Moreover, the Panel held that the meaning of ‘prudential reasons’ would necessarily vary in time so that governments seeking to ‘prevent a risk, injury or danger that does not necessarily have to be imminent’ shall be given ‘sufficient freedom to define the prudential reasons that underpin their measures, in accordance with their own scale of values’, as provided in the preamble of GATS.62 For the same reason, the Panel rejected the time limitation argument which Panama had brought forward and which had also been considered extensively in investment disputes.63 An ‘imminent’ danger, it said, ‘may give rise to long-lasting measures to avoid the recurrence of similar situations in the future’64 and concluded that ‘the measures for prudential reasons envisaged in paragraph 2(a) of the Annex on Financial Services may be urgent measures to confront an imminent risk, temporary or provisional measures, or even permanent (or long-lasting) measures, which might be taken even in the absence of an imminent risk’.65 The Panel’s approach to these issues is important because while its decision was appealed, the Appellate Body did not explicitly reverse it. To the contrary, the Appellate Body reiterated the Panel’s interpretation66 and reiterated that a Member

60 The Panel, clearly emphasised a necessity to establish whether the design, structure and operation of the measure offered an ‘end and means relationship with the objectives pursued’, id., 7.688.
61 Id., 7.861.
62 Id., 7.871.
63 See Martin, supra note 58.
64 Argentina – Measures, supra note 59, at 7.890.
65 Id.
shall not be prevented from taking measures for prudential reasons.\textsuperscript{67} In this respect, the Appellate Body confirmed the Panel’s conclusions regarding a Member’s right to regulate.\textsuperscript{68}

The important point for our purposes is that both investment tribunals and the WTO dispute settlement body concurred with the idea that agreements with carve-out provisions are to be considered as effective and enforceable regulatory safeguards. Furthermore, as far as financial regulations are concerned, the WTO panel identified the protection of the tax system against the risks posed by harmful tax practices as a ‘primordial’ goal ‘of the utmost importance’.\textsuperscript{69} Hence, measures aimed at controlling capital flows for the sake of preserving financial stability would similarly fall under the scope of prudential and carve-out provisions as long as they do not discriminate against trading partners and are not aimed at merely avoiding existing commitments. Given the weight of these decisions, it thus seems clear that prudential carve-outs can be effective in practice at safeguarding a party’s right to regulate in order to protect financial stability.

5. TPP vs GATS: Dispute settlement

These considerations remain fairly theoretical and in reality nothing would prevent investors from other TPP parties to rely on Chapter 9 (Investment) to bring an arbitration claim questioning the legitimacy of a restrictive measure and alleging a breach of investment protection standards.\textsuperscript{70} This is understandable, as the mere claim of legitimacy of a measure or an exception does not make it so – due process demands that an aggrieved investor have the opportunity to challenge the measure and, if successful, claim for monetary damages.

The TPP does, however, contain a fairly interesting – though not unique – dispute settlement mechanism, i.e. a specific system based on a mix between an ISDS tribunal and a consultative State-to-State body aimed at fostering discussion and consensus between parties – prior to the arbitration phase – when establishing the legitimacy of a prudential measure taken for the sake of preserving financial and monetary stability.\textsuperscript{71} More specifically, this mechanism provides for a specific conciliation procedure ensuring that challenged governments may submit a written request to the claimant’s authorities in-charge for financial services for a joint determination on the issue of whether and to what extent Article 11.11 (Exceptions)

\textsuperscript{67} Id., ¶6.254-6.255, 6.272.
\textsuperscript{68} Id., ¶6.260.
\textsuperscript{69} Id., 7.555.
\textsuperscript{70} TPP, supra note 7, Article 11.21.
\textsuperscript{71} Id., Article 11.22.
constitutes a valid defence to the claim.\textsuperscript{72} In addition to granting individual States a right to regulate, the provision requires the parties to consider sovereign regulatory needs and provides an opportunity to discuss the dispute ‘in good faith’ rather than commencing formal arbitration proceedings.\textsuperscript{73} In the event that the parties to the dispute fail to reach a mutually acceptable solution or otherwise fail to agree on the legitimacy of the measure, a Joint Committee would have authority to issue an interpretation on the issue which ‘shall be binding’ on an arbitral tribunal should the dispute go to arbitration.\textsuperscript{74} Should the dispute proceed to arbitration, the TPP makes it extremely clear that the drafter’s intent is that an arbitral tribunal ‘shall find that the measure is not inconsistent with the Party’s obligations in the Agreement and accordingly shall not award any damages with respect to that measure’ as long as the said measure ‘is determined to have been adopted or maintained by a Party for prudential reasons in accordance with procedures in Article 11.22 (Investment Disputes in Financial Services)’.\textsuperscript{75}

In contrast, the WTO dispute settlement mechanism is State-to-State, meaning it is for the government of the complainant to file and prosecute the claim against the offending Member.\textsuperscript{76} The goal of WTO dispute settlement is to ensure that Members comply with their obligations and not to punish offending Members or reward successful litigants. In most cases, settlement is therefore about altering the offending measure(s) at issue and to return the equilibrium to the point where the expectations of the WTO “bargain” is restored between the Members.\textsuperscript{77} Affected companies and industries are not directly involved nor do they stand to directly benefit in the form of say, monetary damages. Of course, service providers that

\textsuperscript{72} Id., Articles 11.20, 11.22.2.

\textsuperscript{73} In fact, the TPP provision even allows a third member not party to the dispute to participate in discussions regarding the matter; See Id., Article 11.22.. Moreover, the TPP still allows opportunity for the parties to resolve disputes related to prudential measures through a state-to-state dispute settlement mechanism.

\textsuperscript{74} Id., Article 11.22.2-3. For a similar conclusion, see Official Executive Summary of Chapter 11, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/pp-full-text. It should be noted, also, that as set forth under Annex 11-E, Brunei Darussalam, Chile, Mexico and Peru do not consent to arbitration or damage compensation under Investment Chapter 9 for a breach of Minimum Standard of Treatment as incorporated into Chapter 11, in relation to any situation that took place or ceased to exist before the fifth or even seventh (Mexico) anniversary of the date of entry into force of TPP.

\textsuperscript{75} TPP, supra note 7, Article 11.11.1 (emphasis added).

\textsuperscript{76} GATS, supra note 13. With regard to GATS, the Annex adds that the ‘panels for dispute on prudential issues and other financial matters shall have the necessary expertise relevant to the specific financial services under dispute’, but this does little beyond guaranteeing the competence panelists. See GATS, Annex on Financial Services.

\textsuperscript{77} For more on the dispute settlement process in the WTO, see SIMON LESTER, BRYAN MERCURIO & ARWEI DAVIES, WORLD TRADE LAW ch. 3 (2nd ed. 2012).
would also qualify as foreign investors under a relevant investment treaty are not to be prevented from initiating an arbitration claim in parallel to the WTO proceedings. The format and structure of the dispute settlement mechanism suggests that the ability of the TPP and other modern comprehensive trade/investment agreements to preserve financial stability is greater than that of the GATS or even NAFTA.\textsuperscript{78} Simply put, in the domain of financial services, TPP allows businesses and investors to have the means to obtain reparation for breaches of the treaty, but at the same time, crafts a special regime for disputes involving measures taken in good faith and for prudential reasons whereby the decision to recognize (or otherwise) the legitimacy of the exceptional nature of the measures is to be removed from ISDS proceedings.

Despite strong criticisms suggesting that dispute settlement in TPP is designed to allow investors to counter financial public policymaking and some commentators claiming that U.S FTAs in general lack a ‘State-to-State dispute system with [as] appropriate screening mechanism’,\textsuperscript{79} it is thus our opinion that the TPP – in line with modern U.S. FTA Practice – rather seeks equilibrium between the practicality of arbitral litigation and the preservation of a forum for State-to-State discussions.

6. \textit{Comparison with other FTAs}

While the TPP conforms to the U.S. FTA practice and significantly departs from the incomplete GATS standards on financial services, the agreement does differ from the practice of other regions and nations.

The European approach to financial services and stability safeguards is in line with, but not quite as consistent as, that of the U.S. This can be seen even in the two most recent EU FTAs with Singapore and Canada. While the EU–Singapore FTA contains an investment chapter as well as a chapter on dispute settlement and a general chapter on Services, Establishment and E-commerce,\textsuperscript{80} issues of financial services and their potential impact on financial stability have been largely set aside;

\textsuperscript{78} See, \textit{e.g.}, the U.S – Korea FTA at Article 13.19, the U.S – Chile FTA at Article 12.18, the U.S – Colombia FTA at Article 12.19, the U.S – Morocco FTA at Article 12.18, the U.S – Oman FTA at Article 12.19, the U.S – Panama FTA at Article 12.19, the U.S – Singapore FTA at Article 10.19, as well as the NAFTA Agreement at Article 1415.

\textsuperscript{79} See, \textit{e.g.}, Gallagher, \textit{supra} note 14 at 18: ‘Given that BITs and FTAs current lack a state-to-state dispute system with appropriate screening mechanisms, these are likely to be used most by the private sector to file claims in response to measures taken to mitigate the global financial crisis’.

that is, financial services provisions are a mere sub-section of the services chapter\(^81\) which – in contrast with the telecommunication sub-section\(^82\) – does not contain a specifically drafted dispute settlement mechanism. In other words, although the services chapter contains a prudential carve-out provision applicable to financial services ‘ensuring the integrity and stability of the Party’s financial system’\(^83\) investor disputes involving prudential measures would fall under the scope of the investment chapter and would not benefit from a specific and tailored mechanism such as the one provided in TPP. Instead, the issue would be completely left to the arbitral tribunal established under the ISDS mechanism. In contrast, the Canada–EU FTA includes a more comprehensive approach to financial services and stability. In line with the approach taken in the TPP, the investment provisions do not directly apply to disputes relating to financial services.\(^84\) Instead, Chapter 15 on Financial Services allows for general exceptions to the liberalization commitments – particularly for prudential reasons and especially when these are recognized by the other parties\(^85\) – and provides for dispute settlement tools specifically adapted for financial services which include the use of a Financial Services Committee to produce a binding joint determination as to the legitimacy of a disputed prudential measure.\(^86\)

In addition, the Canada–EU FTA also contains rare and noteworthy provisions demonstrating the political intent of the parties to strengthen the role and enforceability of prudential carve-outs. More specifically, Annex X of the agreement highlights a clear understanding between the governments as to the necessity to reaffirm their commitment to strengthening financial stability through ‘a dialogue on the regulation of the financial services sector’ within the Financial Services Committee in charge of financial services disputes. Discussions, it adds, ‘shall be based on the principles and prudential standards agreed at multilateral level’.\(^87\) Furthermore, Annex XX provides specific guidance as to how prudential carve-out measures should be applied. In this regard, the article makes it clear that prudential measures should be taken in good faith and to strengthen domestic financial systems. The Annex follows this by providing a list of non-exhaustive ‘High-Level Principles’, including a right of each party to ‘determine its own appropriate level of prudential regulation […] and enforce measures that provide a higher level of prudential

\(^{81}\) Id., Sub-Section 6, Ch. 8.  
\(^{82}\) Id., Article 8.44.  
\(^{83}\) Id., Article 8.50.  
\(^{84}\) Canada-European Union: Comprehensive Economic and Trade Agreement, Ch. 10 [hereinafter CETA], http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter/.  
\(^{85}\) Id., Ch. 15, Articles 16, 15 & 5 respectively.  
\(^{86}\) Id., Ch. 15, Articles 19 & 20.  
\(^{87}\) Id., Annex X, Understanding on the Dialogue on the Regulation of the Financial Services Sector.
protection than those set out in common international prudential commitments’.®®

The Annex also provides that ‘[r]elevant considerations in determining whether a measure meets the requirements of Article 15.1 include the extent to which a measure may be required by the urgency of the situation and the information available to the party at the time when the measure was adopted’.®® Finally, the Annex defines a valid prudential measure as having a non-manifestly disproportionate prudential objective in the pursuance of the resolution of matters involving the recovery of non-viable financial institutions and ‘the preservation or the restoration of financial stability in response to a system-wide financial crisis’.®°

The caveat here, however, is the explicit statement that disguised restrictions on foreign investment and arbitrary or unjustifiable discrimination would not be considered as acceptable prudential measures under Article 15.1.®¹

In some other economies, the issue of financial services and stability is treated in a largely disparate manner. This is the case with the ASEAN, as the ASEAN Framework Agreement on Services fails to even mention financial services while the ASEAN Comprehensive Investment Agreement (ACIA)®² contains more substance but is of little assistance in terms of financial stability. More specifically, the ACIA provides investment protection standards which are generally in line with international practice,®³ including the exceptions for balance of payment difficulties or related difficulties®⁴ and public order.®⁵ The ACIA also provides for ISDS via an ICSID arbitration tribunal,®⁶ but provides little safeguards in terms of financial stability preservation. More to the point, the agreement does not contain a TPP-type dispute settlement mechanism in relation to Financial Services disputes.

®° Id., Annex XX of The Financial Services Chapter, Understanding between Canada and the EU - Guidance on the application of Article 15.1 (Prudential Carve-out) and Article 20 (Investment).
®¹ Id.
®² Id.
®³ Id.
®⁴ Id.
®⁵ Id.
®⁷ Id., Article 5 - National Treatment, Article 6 - Most-Favoured-Nation Treatment, Article 11 - Treatment of Investment, Article 13 - Transfers, Article 14 - Expropriation and Compensation.
®⁸ ‘In the event of serious balance-of-payments and external financial difficulties or threat thereof, a Member State may adopt or maintain restrictions on payments or transfers related to investments’, Id., Article 16 Measures to Safeguard the Balance-of-Payments.
®⁹ Id., Article 17 - General Exceptions.
®¹° Id., Section B - Investment Dispute between an Investor and a Member State.
Interestingly, the investment agreement between ASEAN and China does not contain provisions on ‘prudential measures’ per se. It incorporates paragraph 2 of the GATS Annex on Financial Services as the legally applicable rule.97 It also permits the parties to take measures ‘in the event of serious balance of payments and external financial difficulties’ provided that they are not discriminatory or excessive, that they avoid unnecessary damages and remain temporary with a progressive phase out,98 or in relation to transfers and repatriation of profits ‘where, in exceptional circumstances, movements of capital cause, or threaten to cause, serious economic or financial disturbance in the Party concerned’.99 The agreement, however, does not make reference to the settlement of investment disputes in the area of financial services which means that the necessity to act prudentially to preserve financial stability will not benefit from a Committee interpretation and might not be considered a legally attenuating circumstance by investment tribunals. Similarly, the ASEAN–China Agreement on Trade in Services only ensures that the GATS and its Annex shall apply in case of disputes.100 Moreover, while the Agreement establishing the ASEAN-Australia New-Zealand Free Trade Area101 includes a provision on prudential measure as part of the Chapter 8 Annex on Financial Services,102 it does not provide a special dispute mechanism or any specific guidance to arbitrators on measures taken for the preservation of financial stability.103

Disparity can also be seen within Australia’s practice in this regard.104 For instance, safeguards such as financial stability exceptions based on prudential reasons, arbitration disputes and State-to-State consultations binding on arbitrators are included in agreements with Chile105 or Korea,106 which puts these agreements in close alignment to the TPP. However, the recently adopted China-Australia Free Trade Agreement (ChAFTA) does not contain any State-to-State consultation.

---

97 Id., Article 16.2.
99 Id., Article 10.
102 Id., Article 3 ‘Domestic Regulation’.
103 Id., Article 8 provides that disputes shall be solved under Ch. 17 through an expert arbitral tribunal.
105 See, the Australia-Chile FTA, Ch.12 on financial services, Articles 12.3-5, 12.11 & 12.18.
106 See the Australia-Korea FTA, Ch.8, Articles 8.2-4, 8.10 & 8.18-19.
mechanism.\(^\text{107}\) Thus, financial stability related litigation between investors and States is left to arbitrators without the benefit of party intervention and interpretation.\(^\text{108}\)

IV. **The Issue of Operating Regulatory Carve-outs Against Politics**

All in all, considering the amount of criticism formulated against financial services liberalization and its impact on financial stability policymaking, the TPP provides governments with legal grounds for indirectly controlling cross-border capital movements and safeguarding financial stability. Certain criteria apply, such as the necessity to preserve the safety, soundness and integrity of (a) cross-border financial institutions, (b) payment and clearing systems, (c) the pursuit of monetary and related credit or exchange rate policies, as well as the obligation to ensure that the measures do not aim at passing disguised arbitrary discrimination regulations. Yet, the inclusion of safeguard and carve-out clauses is significant as it provides States committed to liberalise financial services with significant leeway in regard to the key issue of preserving the economic and financial stability, whether on a domestic or regional scale.

A question remains, however, as to the effectiveness of carve-out provisions in practice. Not that the provisions prohibit exceptions to the liberalisation commitments: as previously shown, most commentators and States alike endorse the efficiency of prudential measures from a strictly legal point of view, and case law, while sparse and still evolving, has adopted a flexible approach which matches the majority view of the commentators and States of the interpretation of treaty provisions on the matter. More specifically on this latter point, the recognition of the Panel in *Argentina – Financial Services*\(^\text{109}\) that a margin should be left for States to determine the prudential scope of their measures seems to match the explicit understanding on the matter as it appears in the EU – Canada EPA.\(^\text{110}\)

Therefore, the genuine dilemma is not about deficiencies in the text or emerging jurisprudence, rather, the controversy is about the politics surrounding prudential measures, and about whether the mutual intent of States to admit exceptions and prudential carve-outs is genuine or mere window dressing designed to appease. An

\(^{107}\) See *China-Australia FTA (ChAFTA)* Article 3: Domestic Regulations; Article 16.6 Measures to Safeguard the Balance of Payments.


\(^{109}\) *Argentina – Measures*, supra note 59.

\(^{110}\) See *supra* note 84.
optimistic point of view would assert that politics ought to be about collaboration between States and the political intent behind prudential provisions should genuinely seek to preserve policy space for the parties to initiate exceptional regulations aimed at preserving economic equilibrium, whilst at the same time ensuring that the measures are not disguised protectionism. To this extent, the EU – Canada FTA provides a useful example of a commitment to dialogue and cooperation since, as far as the FTA’s Annexes are concerned, the possibility to enact prudential measures is presented as part of a collective effort to mutually maintain financial stability.111 Sceptics, however, might rather see prudential provisions as a nicely designed safeguard which is never actually meant to be used by others. After all, the sceptics would assert, a government would not admit that a prudential measure is a legitimate policy choice considering that it is likely to be detrimental to its own immediate or long-term interests. In a system where self-interest would prevail over mutual cooperation and solidarity, one could then ask whether prudential measures with a low impact on a foreign economy would be admitted more easily than a measure with a major impact. Likewise, it may be useful to question the extent to which regional and international politics influence the recognition of prudential measures as provided by most FTAs.

The reality is that the wording of carve-out provisions remains fairly vague and the sceptics’ point of view cannot be dismissed right away. The TPP as well as the various FTAs analysed for the purpose of this article have, on the one hand, set up a specific mechanism whereby Joint Determination by a State-to-State Committee would bind arbitrators for the sake of preserving financial stability. Most carve-out provisions, however, also contain a clause under which the arbitral tribunals shall have the final word provided that the Committees fail to reach an agreement within sixty days or three months. For example, Article 11.22(2)(c) of the TPP provides that disputes should be left to the discretion of arbitrators should no agreement be reached by the State Parties and no Joint Determination be achieved within 120 days, while the U.S – Korea FTA provides for a 60 days’ timeframe and the EU – Canada FTA provides for a three month period.112 Should States follow the optimistic path,

---

111 The Understanding on the Dialogue on the Regulation of the Financial Services Sector (Annex 13-C of the CETA agreement) clarifies that ‘The Parties reaffirm their commitment to strengthening financial stability. The dialogue on the regulation of the financial services sector within the Financial Services Committee shall be based on the principles and prudential standards agreed at the multilateral level. The Parties undertake to focus the discussion on issues with cross-border impact, such as cross-border trade in securities (including the possibility of taking further commitments on portfolio management), the respective frameworks for covered bonds and for collateral requirements in reinsurance, and to discuss issues related to the operation of branches’.

112 Free Trade Agreement between the United States of America and the Republic of Korea, June 30, 2007, Article 13.19(c),
tribunals might be left with only a minor role to play in determining the consistency of prudential regulations with relevant international treaties. On the other hand, should the parties fail to negotiate in good faith or otherwise fail to compromise or reach consensus, (for political, economic or other reasons) the pessimistic perspective might prevail and the validity of a prudential regulation would be left to the discretion of a panel of arbitrators. In the first option, the limited time provision would constitute a last recourse solution but, in the second option, it would be no less than a carve-out to the carve-out provision. Hope remains that to reduce the amount of subjective comments and policy second-guessing, tribunals might follow the ‘cause and effect’ relationship criteria adopted by the WTO Argentina – Financial Services Panel and which aims at assessing whether a measure taken for prudential purposes is, at the end of the day, proportional to the designated prudential objectives. The system, although imperfect, indeed seems to offer a rather objective assessment mechanism.

Another continuing debate will be over the wording and terms used to describe the extent to which an exceptional measure may be deemed legitimate. For instance, Article 11.11 of the TPP allows the taking of exceptional measures applied in an ‘equitable, non-discriminatory and good faith’ manner but prohibits measures ‘which would constitute a means of arbitrary or unjustifiable discrimination’. This is common legal language taken from the WTO. For instance, Article XIV of the GATS similarly relates to the prevention of ‘arbitrary or unjustifiable discrimination’ or ‘disguised restriction’ to trade in services whilst the EU – Singapore provision on the prudential carve-out stipulates that prudential measures ‘shall not be more burdensome than necessary to achieve their aim and shall not constitute a means of arbitrary or unjustifiable discrimination’.114 The Framework Agreement on the ASEAN Investment Area, also, provides various carve-out provisions and stipulates that exceptional measures shall ‘avoid unnecessary’ damages.115 Such ‘constructive ambiguity’ may not be desirable from an academic perspective or even to a government formulating policy, but it is unavoidable in international treaty negotiations where specificity is the enemy of consensus and agreement. Of course, since the text of the GATS and other agreements does not indicate, say, when a measure shall become inequitable or more burdensome than necessary, there is a risk that a gap could develop between the drafters’ intent and the arbitrators’ interpretations of the text and conclusions. This may have been the case in the aforementioned investment disputes, when the arbitral tribunals engaged in policy-second guessing by suggesting that Argentina’s economic crisis was not yet serious

https://ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file12_1
2723.pdf. See also CETA, supra note 84, Article 20.

113 Argentina – Measures, supra note 59, ¶¶7.684–7.688. See also ¶7.891.

114 EU-Singapore Free Trade Agreement, supra note 80, Ch. 8, Article 8.50 (May 2015).

115 FRAMEWORK AGREEMENT ON THE ASEAN INVESTMENT AREA, Article 15.
enough to justify necessary measures, or by considering that Argentina was responsible for its own crisis and thus not legitimate in imposing constraints on foreign investors.\textsuperscript{116} While some agreements, including the TPP, have attempted to mitigate this risk through insertion of the government viewpoint into the process via the cooperation-based Joint Determinations, the effectiveness of this process remains untested.

\section*{V. Concluding Remarks}

This article demonstrates that while the TPP encourages the liberalization of cross-border trade in financial services, it leaves room for regulatory interference in times of financial instability or threats thereof. Unlike the conclusions of certain trade sceptics, we find that the TPP could assist in preserving the ability of governments to control capital flows and regulate for prudential reasons in times of financial and monetary duress. This is not to say that the TPP is particularly innovative, which it in fact is not. In reality, the TPP continues a longstanding trend of the U.S. to virtually mimic the GATS in providing for a regulatory carve-out for prudential measures in order to safeguard financial stability. Where U.S. practice, including the TPP, differs from the GATS is how it treats dispute settlement. Instead of merely relying on a State-to-State dispute settlement mechanism, the TPP utilizes both standard ISDS via its investment chapter as well as a specialised form of dispute settlement unique to financial services whereby the governments insert themselves into the process via a joint declaration which is binding on any future arbitral tribunal. In this respect, governments are assured that an arbitral tribunal cannot ignore or even downplay measures taken to forestall or protect against legitimate risks to financial stability. Upon careful analysis and reflection, we thus conclude that the TPP both promotes liberalisation of the financial services sector, while at the same time recognising and protecting the long-standing right of governments to regulate in good faith for the sake of domestic, regional and international financial and monetary stability. We therefore see little merit in the view that the agreement will constrain and/or hamper governments in taking measures to promote financial and monetary stability or prevent financial crisis.

\footnote{116 See Martin, supra note 58, at 68.}