WTO Ruling Clarifies Flexibility in Member Governments’ Regulation of Financial Services

Summary

On April 14, 2016, the Appellate Body of the World Trade Organization (WTO) circulated its report in the Argentina – Financial Services dispute (DS453). The dispute was initially brought by Panama before a WTO first instance tribunal (the Panel) to challenge actions taken by Argentina against services and service suppliers from jurisdictions—like Panama—that do not exchange information for purposes of tax transparency and the prevention of money laundering and terrorist financing. The Panel made a number of findings in its report circulated on September 30, 2015, many of which were appealed by both Argentina and Panama.

Through its reversal of a number of Panel findings of inconsistency with the WTO’s General Agreement on Trade in Services (GATS), the Appellate Body handed an important victory to Argentina. Rare for WTO respondent parties, Argentina walked away from the appeal without a single implementation obligation regarding the challenged measures. The Panel’s findings, as modified by the Appellate Body Report, signal to WTO Members that they will be accorded wide—but not unrestrained—latitude in adopting and implementing measures taken for prudential reasons and affecting the financial services sector. For trade practitioners and academics that closely follow the development of WTO jurisprudence, the Appellate Body’s decision harmonizes WTO case law on core concepts relevant to a non-discrimination analysis, while recognizing the peculiarities of the services sector.

The Challenged Measures

The dispute was brought by Panama in 2013 against Argentine measures affecting services and service suppliers from jurisdictions—like Panama—that do not exchange information with Argentina for purposes of tax transparency, the prevention of money laundering and terrorist financing. Argentina labeled such jurisdictions


2 Panel Report, Argentina – Financial Services, WT/DS453/R, circulated September 30, 2015, available at: https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds453_e.htm. The findings by the Appellate Body, together with those Panel findings that were not subject to appeal, will be adopted by the WTO Dispute Settlement Body as final within 30 days of circulation of the Appellate Body’s report.

3 Following the creation of the WTO Panel, Panama’s status had changed: Panama had been included in the list of cooperative countries, even though it had not concluded a double taxation convention or information exchange agreement with Argentina, and even though it was not in the process of negotiating one with Argentina.
“non-cooperative” based on a classification system under its 2013 law. Under that law, a “cooperative jurisdiction” is one that has an agreement with Argentina for the effective exchange of information or fulfills certain requirements for starting negotiations on this issue.

On the basis of its “non-cooperative” and “cooperative” classification, Argentina put in place eight measures that affect the cross-border financial services trade between Argentine customers and tax payers and Panamanian financial service suppliers. The eight measures—covering a wide array of regulations relating to tax; access to the reinsurance sector, foreign exchange and capital markets; and registration of branches of foreign companies—comprise the following:

- Withholding tax on payments of interest or remuneration (measure 1);
- Presumption of unjustified increase in wealth (measure 2);
- Transaction valuation based on transfer prices (measure 3);
- Payment received rule for the allocation of expenditures (measure 4);
- Requirements relating to reinsurance services (measure 5);
- Requirements for access to the Argentine capital market (measure 6);
- Requirements for the registration of branches (measure 7); and
- Foreign exchange authorization requirement (measure 8).4

Argentina claimed that it took the eight measures pursuant to international efforts and recommendations issued by the Global Forum of the Organization for Economic Co-operation and Development (OECD)5 as well as provisions of the Financial Action Task Force (FATF).6

**Key Findings of the Panel**

The Panel found that all eight measures violate the most-favored nation (MFN) principle under Article II:1 of the GATS: by favoring cooperative over non-cooperative jurisdictions, the Panel considered that Argentina had not accorded “no less favorable treatment” (or non-discriminatory treatment) to the “like” services and services suppliers of different WTO Members. With respect to some measures (measures 2, 3 and 4), the Panel also found that Argentina breached the national treatment requirement under GATS Article XVII which requires that WTO Members accord “no less favorable treatment” to “like” foreign (Panamanian) services and suppliers than that accorded to domestic (Argentine) services and service suppliers.7 For both, the Panel found that Argentina had modified the conditions of competition to the detriment of Panamanian services and service suppliers.

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4 For further description of the measures, see Appellate Body Report, Section 5.
5 The Panel noted that the Global Forum is an intergovernmental body operating under the OECD. It is open to any jurisdiction that commits to implementing the Global Forum’s tax transparency and information exchange standards and agrees to take part in the peer review process. (Panel Report, para. 2.55).
6 The Panel noted that FATF is an intergovernmental body whose mandate is to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, financing of terrorism and the proliferation of weapons of mass destruction, among other threats to the integrity of the financial system. (Panel Report, para. 2.60).
7 The Panel dismissed Panama’s additional claims that selected measures were inconsistent with market access obligations under Article XVI of the GATS and the MFN obligation under the agreement regulating trade in goods (GATT Article 1).
The Panel dismissed Argentina’s attempts to defend or “justify” six of its measures (measures 1, 2, 3, 4, 7 and 8) under Article XIV(c) of the GATS, which allows WTO Members to take measures to prevent “deceptive and fraudulent practices” that are “necessary” to secure compliance with GATS-consistent laws or regulations.

The Panel also examined whether Argentina could justify the two remaining measures (measures 5 and 6) under the so-called “prudential carve-out” contained in paragraph 2(a) of the GATS Annex on Financial Services, a provision that has never before been invoked in a WTO dispute. The Panel found that since paragraph 2(a) is an “exception,” the burden of proof lies with the respondent Member to demonstrate that the relevant measures are covered by the provision. The Panel examined the concept of “prudential reasons,” finding that the expression refers to those “causes” or “reasons” that motivate financial sector regulators to act to prevent a risk, injury or danger, which do not have to be imminent. The Panel also found that a measure taken “for” prudential reasons denotes a rational relationship of cause and effect between the measure and the prudential reason, and would be determined from a case-by-case analysis of the design, structure, and architecture of the measure. Here, the Panel accepted as “prudential” the reasons given by Argentina with respect to measure 5 (the protection of the insured, the solvency of insurers and reinsurers, and the avoidance of the possible systemic risk of the insolvency and failure of direct insurance companies) and with respect to measure 6 (investor protection, the reduction of systemic risk, and the prevention of money laundering and terrorist financing offenses).

Despite the Panel’s deference to financial regulators to determine the prudential motivations that they choose to pursue, the Panel found that measures 5 and 6 were not designed rationally to serve the stated prudential reasons. On that basis, the Panel found that the prudential carve-out did not justify the distinction that Argentina made in the way it treated service suppliers from cooperative and non-cooperative jurisdictions.

**Key Findings on Appeal**

The four main issues and findings on appeal can be summarized as follows:

**Likeness.** First, Argentina successfully appealed the Panel’s finding that, in the non-discrimination analysis under both GATS Articles II:1 and Article XVII, the relevant services and service suppliers were “like.” The Appellate Body found that, as in the trade in goods context, “likeness” may be established on the basis of criteria relating to the competitive relationship between the services and service suppliers at issue; must be “market-based;” and must be determined on a case-by-case basis. The Appellate Body also highlighted issues specific to the services context, such as the fact that a GATS analysis must include an integrated analysis of both the services and service suppliers.

The Appellate Body also addressed in which circumstances “likeness” can be “presumed.” Again drawing on trade in goods jurisprudence, the Appellate Body found that where a measure provides for a distinction based exclusively on origin, there will or can be services or services suppliers that are the same in all respects except for origin, and likeness can be presumed. In such circumstance, a complainant will not be required to establish likeness on the basis of relevant criteria described above. However, the Appellate Body was careful to note that the “greater complexity” of trade in services might mean that the scope of the presumption would be more limited.

In this case, since the Panel had not made a finding that the distinction between “cooperative” and “non-cooperative” jurisdictions in the measures at issue was based exclusively on origin—and the Panel had in
fact observed that the classification of a country as cooperative or not was based on the regulatory framework inextricably linked to origin—the Appellate Body found that likeness could not be presumed. In reversing the Panel, the Appellate Body explained that it took no view on whether the service and service suppliers of cooperative and non-cooperative countries are like.

**When to examine regulatory aspects that might justify “less favorable treatment.”** Second, the Appellate Body overturned the Panel’s finding of “treatment no less favorable” under Articles II:1 and XVII. The Appellate Body found that, under GATS Article II:1 and Article XVII, a measure fails to confer “treatment no less favorable” simply if it detrimentally modifies the conditions of competition as between or among the relevant like services or service suppliers. In its analysis, the Panel had erroneously taken into account an extraneous factor, namely, the regulatory aspects of the supply of the service that provide a possibility for Argentina to access tax information on foreign suppliers providing services in Argentina. The Appellate Body clarified that, as with a non-discrimination analysis in the trade in goods (GATT) context, regulatory aspects or concerns that could potentially justify inconsistent measures are more appropriately addressed as part of an assessment of “exceptions.” Since the Panel’s findings on “treatment no less favorable” lacked a proper basis, the Appellate Body reversed the Panel’s findings that the eight measures violated Article II:1 and Article XVII of the GATS.

**Measures “necessary” to secure compliance with GATS-consistent laws.** Third, Panama unsuccessfully appealed the Panel’s intermediate finding that the six measures concerned were “necessary to secure compliance with” certain GATS-consistent laws and regulations under paragraph (c) of GATS Article XIV. The Appellate Body noted the two parts of this defense to be proven by Argentina: first, that the design of the inconsistent measure reveals that it secures compliance with specific rules, obligations or requirements under laws or regulations that are GATS-consistent; and second, a more in-depth and holistic analysis of the relationship between the inconsistent measure and relevant law or regulations, including an assessment of the contribution and trade-restrictiveness of the measures, or in its weighing and balancing of the relevant necessity factors. The Appellate Body found that Panama failed to show that the Panel erred in finding that the measures at issue are “designed” to, and are “necessary” to secure compliance with the relevant Argentine laws or regulations.

**Measures falling within the scope of the prudential carve-out.** Fourth, although Argentina did not appeal the Panel’s dismissal of its attempt to justify two measures—measures 5 and 6—under the prudential carve-out, Panama unsuccessfully appealed the threshold issue of whether these measures fall within the scope of paragraph 2(a). The Appellate Body disagreed with an argument by Panama that the prudential carve-out covers only measures constituting “domestic regulation,” finding, instead, that the provision covers all types of measures affecting the supply of financial services within the meaning of paragraph 1(a) of the GATS Annex on Financial Services.

**Implications of the WTO Decision**

In its ruling, the Appellate Body has clarified that the likeness analyses in the GATS and GATT contexts are more or less the same, thereby providing valuable guidance to domestic regulators seeking to comply with the WTO’s cornerstone rules on non-discrimination. Regulators and future WTO panels will also value the Appellate Body’s guidance that, as with the GATT, where a measure is inconsistent with the non-discrimination provisions of the GATS, consideration of the regulatory reasons for taking such a measure has no place in an assessment of
consistency with substantive obligations, and can only be used to justify actions in the context of the relevant “exceptions” provisions.

The reasoning not appealed by the Panel on the prudential carve-out stands as final and may well inform how a future panel might interpret the prudential carve-out. Those findings signal that WTO adjudicators will accord deference in determining the prudential motivations that WTO Members choose to pursue. The Panel decided not to second-guess the objectives pursued by Argentina, which is consistent with the way that WTO adjudicators have dealt with other non-trade policy motivations (e.g., health and safety, environment). The one requirement, however, is that there must be a rational relationship between the measure and its prudential reasons. Financial regulators do not warrant special deference relative to other types of regulators.

Finally, the reports of the Panel and Appellate Body provide some indication of the posture WTO adjudicatory bodies will take to the work of other international bodies in the fields of tax transparency, money laundering and counter terrorism. That work, though not directly addressed, provides an important backdrop to the analysis: the Panel reflected arguments made by Argentina that its measures were guided by recommendations by the OECD’s Global Forum and the FATF, and at times, the Panel even used these international efforts as evidence of a global consensus on prudential and accepted approaches to tax transparency, and other forms of financial services regulation. While the Appellate Body managed to side-step the more controversial issue of whether services and services suppliers from cooperative and non-cooperative jurisdictions can be treated as like—and therefore, whether it is appropriate for financial services regulators to distinguish between them—there is no doubt that such issues are likely to feature even more in WTO dispute settlement in the future. In the wake of events like the release of the “Panama Papers” implicating certain “off-shore” tax havens, there have been calls for greater regulation of the financial services sector at the global and domestic regulatory levels. The *Argentina – Financial Services* dispute highlights that all WTO Members have an interest in the work of international financial regulatory bodies, and that all countries that stand to be affected should be part of the global dialogue in those bodies.

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<table>
<thead>
<tr>
<th>Name</th>
<th>Email</th>
<th>Phone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Todd J. Friedbacher</td>
<td><a href="mailto:tfriedbacher@sidley.com">tfriedbacher@sidley.com</a></td>
<td>+41 22 308 0030</td>
</tr>
<tr>
<td>Andrew W. Shoyer</td>
<td><a href="mailto:ahower@sidley.com">ahower@sidley.com</a></td>
<td>+1 202 736 8326</td>
</tr>
<tr>
<td>Jan Yves N. Remy</td>
<td><a href="mailto:jery@sidley.com">jery@sidley.com</a></td>
<td>+1 202 736 8151</td>
</tr>
<tr>
<td>Claus D. Zimmermann</td>
<td><a href="mailto:czimmermann@sidley.com">czimmermann@sidley.com</a></td>
<td>+32 2 504 6413</td>
</tr>
</tbody>
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