

COLOMBIA'S POLICY SPACE FOR PRUDENTIAL  
REGULATION: AN ANALYSIS FROM ITS  
INTERNATIONAL TRADE COMMITMENTS

*EL ESPACIO DE COLOMBIA PARA  
EXPEDIR REGULACIÓN PRUDENCIAL:  
UN ANÁLISIS DESDE SUS COMPROMISOS  
COMERCIALES INTERNACIONALES\**

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## ABSTRACT

Prudential regulation is aimed to protect consumers of financial services and the preservation of the integrity and the stability of the financial system. The adoption of this type of regulation has been proven to be vital for the economic stability of countries. Since the creation of the World Trade Organization (WTO), international commitments towards the liberalization on trade in services, including financial services, have had a direct impact on the policy space of countries for adopting prudential regulation. Such is the case of Colombia, as Member of the WTO and as party of different regional trade agreements (RTAs). This article makes a comparative analysis of the scope of the prudential regulation exceptions that Colombia has negotiated in relevant RTAs *vis-à-vis*, the so-called “*prudential carve-out*” under the General Agreement on Trade in Services (GATS). This comparative analysis intends to show that, from this perspective, Colombia’s policy space for adopting prudential measures has been limited considerably, especially with respect to discriminatory measures.

**Keywords author:** WTO law, trade in financial services, prudential regulation.

**Keywords plus:** users, financial system, economic stability, regional trade agreements, Colombia, exceptions to regulation.

## RESUMEN

*La regulación prudencial tiene como objetivo proteger a los consumidores de los servicios financieros y preservar la integridad y la estabilidad del sistema financiero. La expedición de este tipo de regulación ha demostrado ser vital para la estabilidad económica de los países. Desde la creación de la Organización Mundial del Comercio (OMC), se han asumido compromisos internacionales con el fin de liberalizar el comercio de servicios, entre estos, los financieros, los cuales han tenido un impacto en la discrecionalidad que tienen los países para adoptar regulación prudencial. Tales el caso de Colombia como miembro de la OMC y como parte de distintos acuerdos comerciales regionales (ACR). El presente artículo hace un análisis comparativo del alcance de las excepciones que, en materia de regulación prudencial, ha negociado Colombia en ciertos ACR relevantes, vis-à-vis la llamada "excepción cautelar" contenida en el Acuerdo General sobre el Comercio de Servicios (AGSC). Este análisis comparativo pretende demostrar que, desde esta perspectiva, la discrecionalidad de Colombia para adoptar regulación prudencial ha sido limitada considerablemente, en especial, en lo referente a medidas discriminatorias.*

**Palabras clave autor:** regulación de la OMC, comercio de servicios financieros, regulación prudencial.

**Palabras clave descriptor:** usuarios, sistema financiero, estabilidad económica, acuerdos comerciales regionales, Colombia, excepciones a la regulación.

## SUMMARY

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## INTRODUCTION

The aftermath of the financial crisis shows that its impact on Latin America has been less severe than in other regions and, particularly in Colombia, it has been categorized as “*marginal*”<sup>1</sup>. The minor magnitude of the crisis effects in this country has been attributed principally to the strict prudential regulations adopted since the mortgage crisis of the late 90s<sup>2</sup>. The concept of prudential regulation covers domestic regulations that intend to protect individual financial entities and individuals and/or the stability of the financial system as a whole<sup>3</sup>.

In trade law, it has been of great debate the extent on which international commitments on services limit the policy space to adopt prudential measures<sup>4</sup>. Specifically, this debate is critical when the prudential measure at issue is inconsistent with one or more of the commitments of the respective international agreement and therefore, it is necessary to resort to a justification or legal defense.

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- 1 For the effects of the crisis in Latin America, see: A. Jara et ál., *The Global Crisis and Latin America: Financial Impact and Policy Responses*, *BIS Quarterly Review*, 53-68 (2009). For the specific effects in Colombia, see: Autorregulador del Mercado de Valores de Colombia, *Impacto de la crisis financiera internacional en el sistema financiero colombiano y en su regulación*. <http://www.amvcolombia.org.co/attachments/data/Impactodelacrisis.pdf> (2009).
  - 2 On the mortgage crisis see: M. Arango, *Evolución y crisis del sistema financiero colombiano*, 11 *Cepal Serie Estudios y Perspectivas*, 1-101 (2006).
  - 3 See: D. Dietrich, J. Finke & C. Tietje, *Liberalization and Rules on Regulation in the Field of Financial Services in Bilateral Trade and Regional Integration Agreements*, 1-60, 33-34 (GTZ, Halle, 2010); and A. Persaud, *Macro-Prudential Regulation: Fixing Fundamental Market (and Regulatory) Failures, Crisis Response-Public Policy for the Private Sector*, Note 6 *The World Bank Group*, 1-8 (2009). In this context, several members have indicated that it is clear that paragraph 2 (a) of the Annex is broad enough to cover macro prudential regulation. See: Committee on Trade in Financial Services, S/FIN/M/71. November, 2011. S/FIN/M/72. May, 2012; S/FIN/M/73. July, 2012; and S/FIN/M/74. November, 2012.
  - 4 For Uruguay Round discussions, see GATT documents: MTN.GNS/FIN/1. July, 1990; MTN.GNS/FIN/2. August, 1990; MTN.GNS/FIN/3. October, 1990; and, MTN.GNS/FIN/3. November, 1990. For WTO discussions see documents: Committee on Trade in Financial Services. S/FIN/M/25. May, 2000; S/FIN/M/26. June, 2000; S/FIN/M/27. August, 2000; S/FIN/M/59. September, 2009; S/FIN/M/71. November, 2011; S/FIN/M/72. May, 2012; and, S/FIN/M/26. June, 2012. For discussions on different forums, see: M. Vander Stichele, *21st Century Issues: Changes in Financial Services and Regulatory Challenges* (UNCTAD, Global Services Forum, 2012), [http://unctad.xiii.org/en/Presentation/uxiii2012GSF\\_S3\\_Vander%20Stichele\\_2.pdf\(2010\)](http://unctad.xiii.org/en/Presentation/uxiii2012GSF_S3_Vander%20Stichele_2.pdf(2010))

Under the previous premise, *i.e.* the existence of a prudential measure inconsistent with an international trade commitment, this essay shows that via RTAs Colombia has reduced its prudential regulation policy space considerably<sup>5</sup>. For this purpose, a comparative analysis will be made between the extent of the so-called “*prudential carve-out*” contained in the Annex on Financial Services (the “*Annex*”) of the General Agreement on Trade in Services (GATS), and similar exceptions in relevant RTAs<sup>6</sup>.

This article is structured as follows. Part I will provide a general background of the GATS commitments that could be violated by a prudential measure. Part II analyzes the scope of the “*prudential carve-out*” of the Annex. Finally, Part III outlines the extent of the prudential exceptions of Colombia's RTAs *vis-à-vis* the scope of the “*prudential carve-out*” of the Annex.

## I. GATS BACKGROUND

GATS set the first legally binding multilateral rules on trade in services. Initially it was intended to cover all services; notwithstanding, sector-specific negotiations were conducted on financial services, telecommunications and maritime transport. The specific commitments on financial services are reflected in the Annex. In addition, although not part of the GATS, the Understanding on Commitments in Financial Services provides an alternative for Members to make in their Schedules specific commitments in this sector.

### A. Scope of Application of the GATS

The GATS applies only to “*measures by Members affecting trade in services*”<sup>7</sup>. Thus, for determining if a measure is subject to the

5 Currently Colombia has in force more than 10 RTAs, 6 in negotiation and 2 in process of ratification.

6 The RTAs analysed: (i) Colombia-EFTA (entry into force with Switzerland and Lichtenstein, 1 July, 2011); (ii) Colombia-Canada (15 August, 2011); (iii) Colombia-United States (15 May, 2012); and, (iv) Colombia- EC-Perú (subject to ratification procedures).

7 GATS: General Agreement on Trade in Services, Article I: 1, 15 April, 1994. Marrakesh

GATS and the Annex rules, three aspects must be assessed: (i) if it is a “*measure*” for GATS purposes; (ii) if the measure is “*affecting trade*”; and (iii) if the measure is affecting “*services covered by the GATS*”.

## 1. Measures Covered by the GATS

Article XXVIII (a) of the GATS defines “*measures*” as “*any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form*” (emphasis added). It is clear that by including the reference to “*any other form*” the scope of the GATS covers not only measures of general application, as laws and regulations, but also their application<sup>8</sup>.

WTO jurisprudence has developed this distinction in the context of Article 6.2 of the Dispute Settlement Understanding (DSU), when determining the “*measures at issue*” of a dispute. For instance, the Appellate Body in its report on *EC – Computer Equipment* indicated that “[w]e consider that “*measures*” within the meaning of Article 6.2 of the DSU are not only measures of general application, i.e., normative rules, **but also can be the application of tariffs by customs authorities**” (emphasis added)<sup>9</sup>.

This shows that GATS covers both measures of general application as such, e.g. laws, regulations, as well as the way in which they are applied. This is of great importance for the subject under analysis since, prudential regulation usually affords to national authorities discretionary power as to the application of prudential criteria and conditions. Hence, usually the inconsistency of prudential measures does not derive from the law or regulation “*as such*” but “*as applied*” by the relevant authority.

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Agreement Establishing the World Trade Organization, Annex 1B, The Legal Texts: the Results of the Uruguay Round of Multilateral Trade Negotiations 284 (1999), 1869 UNTS 183, 33 I. L. M. 1167 (1994).

8 The Panel in *China-EP* recognized that this was a broad definition. See: Panel Report, *China-EP*, WT/DS413/R, para. 7.219 (adopted 31 August, 2012.)

9 Appellate Body Report, *EC-Computer Equipment*, WT/DS68/AB/R, para. 65 (adopted 22 June, 1998.)

Finally, it is important to note that GATS applies to “*measures*” taken by central, regional or local governments and authorities or non-governmental bodies in the exercise of powers delegated by governmental authorities<sup>10</sup>.

## 2. Measures “Affecting Trade in Services”

The Appellate Body has indicated that two key legal issues must be examined for determining if a measure is “*affecting trade in services*”. First, whether there is “*trade in services*”, and second, whether it “*affects*” such trade in services<sup>11</sup>.

GATS Article I: 2 (a) defines “*trade in services*” as the supply of a service: (i) from the territory of one Member into the territory of any other Member (mode 1); (ii) in the territory of one Member to the service consumer of any other Member (mode 2); (iii) by a service supplier of one Member, through commercial presence in the territory of any other Member (mode 3); and, (iv) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member (mode 4).

With respect to the second issue, the Appellate Body has indicated that the term “*affecting*” reflects the broad scope that drafters intended to give to the GATS comprising all measures that have “*an effect on*” trade in services.

*“In addressing this issue, we note that Article I:1 of the GATS provides that ‘[t]his Agreement applies to measures by Members affecting trade in services’. In our view, the use of the term ‘affecting’ reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word ‘affecting’ implies a measure that has ‘an effect on’, which indicates a broad scope of application. (...) There is nothing at all in these provisions to suggest a limited scope of application for the GATS. We also agree that Article XXVIII(c) of the GATS does not narrow ‘the meaning of the term’ ‘affecting’ to ‘in respect of’”<sup>12</sup>.*

<sup>10</sup> GATS, Article I: 3(a).

<sup>11</sup> Appellate Body Report. *Canada-Autos*. WT/DS139/AB/R. para. 155 (adopted 19 June, 2000).

<sup>12</sup> Appellate Body Report. *EC- Bananas III*. WT/DS27/AB/R. para. 220 (adopted 25 September, 1997).

Article XXVIII(c) of the GATS provides a non-exhaustive list of measures which are deemed to be “*measures by Members affecting trade in services*”, which comprises: (i) the purchase, payment or use of a service; (ii) the access to and use of, in connection with the supply of a service, services which are required by those Members to be offered to the public generally; and, (iii) the presence, including commercial presence<sup>13</sup>, of persons of a Member for the supply of a service in the territory of another Member.

Finally, it is important to note that WTO jurisprudence has established that the determination of whether a “*measure*” is “*affecting*” trade in services within the meaning of Article I: 1 of the GATS should not be made on the grounds of whether it violates a substantive obligation of this agreement; for the contrary, this is an analysis that should be made before any examination of consistency with GATS substantive obligations<sup>14</sup>.

### 3. Measures Affecting “Services Covered by the GATS”

Pursuant to Article I: 2(b) of the GATS, the expression “*services*” “*includes any service in any sector except services supplied in the exercise of governmental authority*”<sup>15</sup>. This broad concept includes financial services, which, according to paragraph 5 of the Annex, comprise “*any service of a financial nature offered by a financial service supplier of a Member. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance)*”<sup>16</sup>.

13 Pursuant to Article XVIII(d) of the GATS “*commercial presence*” means any type of business or professional establishment, including through: (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office; within the territory of a Member for the purpose of supplying a service.

14 The Appellate Body in *Canada-Autos*, reversed the Panel finding that the measure at issue was “*affecting*” trade in services because it was inconsistent with certain substantive obligations, and not by whether the measure falls within Article I: 1 of the GATS. See: Appellate Body Report. *Canada-Autos*. paras. 148-152.

15 Article II: 1(c) establishes that “*a service supplied in the exercise of governmental authority*” means any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers.

16 Paragraph 5 of the Annex lists non-exhaustively certain activities that are deemed to be financial services, which are classified in two groups: insurance and insurance-related services and banking and other financial services.



For the purposes of financial services, “*services supplied in the exercise of governmental authority*” means:

(i) Activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies.

(ii) Activities forming part of a statutory system of social security or public retirement plans.

(iii) Other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government.

#### 4. Conclusion

Prudential regulation, “*as such*” or “*as applied*” by the domestic authorities, usually has an effect on trade in financial services, as defined by GATS. Therefore, prudential measures adopted by WTO Members will, in most cases, need to be analyzed in light of each Member’s specific services commitments. For example, traditional prudential regulation on minimal capital requirements for banking institutions or on merger and acquisitions of financial institutions has an effect on the supply of services under mode 3 “*commercial presence*”, since it relates to the constitution, acquisition or maintenance of a juridical person.

Bearing this in mind, the following section presents an analysis of the principal and most relevant GATS commitments in order to identify its relation with prudential regulation.

#### *B. GATS Relevant Obligations*

This section will outline the scope of the three principal commitments of the GATS that could be infringed by a prudential measure, *i.e.* the most-favoured-nation treatment, the market access and the national treatment obligation. By no means this implies that prudential regulation may not be inconsistent with other GATS obligations, however, for the purposes of showing the

relation of prudential regulation and GATS disciplines, this paper focuses only in these three commitments.

### 1. The MFN Obligation

Article II: 1 of the GATS establishes that measures affecting trade in services must provide a “*Most-Favoured-Nation-Treatment*” (MFN): “*With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country*”.

This obligation has been interpreted extensively in the field of trade in goods but not so in the field of trade in services. Notwithstanding, the Appellate Body has indicated that Article II: 1 of the GATS requires a comparison between the treatment granted to suppliers from different countries, in a two-step enquiry process: (i) whether the services or service suppliers at issue are “*like*”; and, (ii) whether the “*measure*” accords “*treatment less favourable*” to a service or a service supplier of a Member<sup>17</sup>.

With respect to the first element of the two-step enquiry process, it must be noted that there is no Appellate Body jurisprudence that has interpreted the term “*like*” under the GATS. However, Panels dealing with this element have stated certain guidelines for its interpretation. For instance, Panels have indicated that to the extent that the service suppliers, subject to the measure, supply the same services, the services that they provide are deemed to be “*like*”<sup>18</sup>. Additionally, regarding the relation between origin-neutral measures and “*likeness*” the panel in *China - Publications and Audiovisuals Products* indicated that:

*“When origin is the only factor on which a measure bases a difference of treatment between domestic service suppliers and foreign suppliers, the*

<sup>17</sup> See: Appellate Body Report. *Canada-Autos*. para. 171; and Appellate Body Report. *EC-Bananas III*, paras. 229-234.

<sup>18</sup> Panel Report. *EC- Bananas III*. para. 7322; and, Panel Report. *Canada-Autos*, para. 10248.

*'like service suppliers' requirement is met, provided there will, or can, be domestic and foreign suppliers that under the measure are the same in all material respects except for origin. We note that similar conclusions have been reached by previous panels. We observe that in cases where a difference of treatment is not exclusively linked to the origin of service suppliers, but to other factors, a more detailed analysis would probably be required to determine whether service suppliers on either side of the dividing line are, or are not, 'like'*<sup>19</sup>.

Applying this same reasoning and finding that the measure at issue was not exclusively linked to the origin of service suppliers, the Panel in *China-EPS* interpreted the term “like” in the context of Article XVII of the GATS<sup>20</sup>. The Panel recognized that it could not transpose automatically the criteria of “likeness” that jurisprudence has constructed under other agreements on trade in goods, since there are important dissimilarities between these two areas “*notably the intangible nature of services, their supply through four different modes, and possible differences in how trade in services is conducted and regulated*”<sup>21</sup>.

Following this approach, the Panel interpreted this expression resorting to its ordinary meaning in light of its context, and concluded that the “likeness” of services and services suppliers should be analyzed on a case-by-case basis, taking into account the evidence provided as a whole. It further added that “[i]f it is determined that the services in question in a particular case are essentially or generally the same in competitive terms, those services would, in our view, be ‘like’ for purposes of Article XVII”<sup>22</sup>.

Due to the text similarities between Article II: 1 and Article XVII of the GATS, there is no reason why future Panels won't adopt this same interpretation. Therefore, for the purposes of the MFN obligation “like services” should be understood as services that are in a competitive relationship with each other.

19 Panel Report. *China-Publications and Audiovisual Products*. WT/DS363/R, para. 7975 (adopted 19 January, 2010.) (original footnote omitted)

20 Panel Report. *China-EPS*. para. 7696-7697.

21 *Op. cit.*, para. 7697.

22 *Ibidem*, para. 7702.

Concerning the second step of the enquiry process –whether the “*measure*” accords “*treatment less favourable*” –it must be taken into account that the Appellate Body has indicated that for interpreting Article II: 1 of the GATS is in “*safer grounds*” to do so in light of MFN and MFN-type obligations in the GATT 1994<sup>23</sup>. Following this approach the Appellate Body in its report on *EC-Bananas III* concluded that this provision covered not only *de jure* but also *de facto* discrimination<sup>24</sup>. Furthermore, the Appellate Body recalled that under GATT jurisprudence it has been found that the essence of the MFN obligation “*is that like products should be treated equally, irrespective of their origin*”<sup>25</sup>.

In this point, it is important to address whether for a consistency examination under this provision the policy objective of the “*measure*” is relevant. In other words, if a measure is consistent with the MFN obligation on the grounds that it pursues a legitimate objective. The Appellate Body has indicated that the “*aims and effects*” of a measure are in any way relevant in determining whether that measure is inconsistent with Article II of the GATS<sup>26</sup>. This means that, for the purposes of a consistency examination of a prudential measure with Article II of the GATS, its policy objective *i.e.* “*prudential reasons*”, is not relevant.

It is worth noting that recent jurisprudence on the area of trade in goods has analysed if the measure pursues a legitimate objective, for determining if it accords a “*less favourable treatment*”. This interpretation has been adopted by the Appellate Body in the context of Article 2.1 of the Agreement on Technical Barriers to Trade (“*TBT Agreement*”), which establishes the MFN and National Treatment obligation for technical regulations. Specifically the Appellate Body indicated that:

*“Accordingly, where the technical regulation at issue does not de jure discriminate against imports, the existence of a detrimental impact on competitive opportunities for the group of imported vis-à-vis the group of domestic like products is not dispositive of less favourable treatment under*

23 Appellate Body Report. *EC- Bananas III*, para. 231.

24 *Op.cit.*, para. 234.

25 *Ibidem*, para. 190.

26 Appellate Body Report. *EC- Bananas III*, para. 241.

*Article 2.1. Instead, a panel must further analyze whether the detrimental impact on imports stems exclusively from a legitimate regulatory distinction rather than reflecting discrimination against the group of imported products. In making this determination, a panel must carefully scrutinize the particular circumstances of the case, that is, the design, architecture, revealing structure, operation, and application of the technical regulation at issue, and, in particular, whether that technical regulation is even-handed, in order to determine whether it discriminates against the group of imported products*<sup>27</sup>.

Although this interpretation was made in light of the context and purpose of the TBT Agreement, this recent Appellate Body statements may lead the way towards implementing again in the “*less favourable treatment*” analysis the “*aims and effects*” test so that *bona fide* distinctions in domestic regulation are found to be consistent with MFN and/or National treatment obligations under WTO law<sup>28</sup>.

Notwithstanding, the transposition of this interpretation to the “*less favourable treatment*”, tested under the MFN or national treatment obligations under GATS, does not fit perfectly. It must be recalled that in the TBT Agreement the balance between trade commitments and non-trade objectives is not reflected on a specific or general exception as it is in GATS. Within this framework and context, the interpretation of the Appellate Body was adopted, meaning that this balance, which is expressly recognized as an objective of the TBT Agreement<sup>29</sup>, must be taken into account in the “*less favourable treatment*” test under Article 2.1.

27 Appellate Body Report. *US- Clove Cigarettes*. WT/DS406/AB/R. para. 182 (adopted 24 April, 2012)

28 Under GATT 1947 jurisprudence panels used recurrently this test. See for instance: *United States-Restrictions on Imports of Tuna*. GATT B.I.S.D. (39th Supp.) (1993); *United States-Restrictions on Imports of Tuna (Tuna/Dolphin II)*. DS29/R (1994) (unadopted); *United States-Measures Affecting Alcoholic and Malt Beverages*. GATT BISD (39th Supp.) (1993); and *United States-Taxes on Automobiles*. DS31/R (1994) (unadopted).

29 “Recognizing that no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate, subject to the requirement that they are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade, and are otherwise in accordance with the provisions of this Agreement”.

This is not the case of GATS where such balance of trade commitments and non-trade objectives is reflected on the general exception of Article XIV of the GATS. Although this exception may not cover all non-trade objectives that a government may pursue, those were the objectives that negotiators decided to permit under this agreement.

Finally, pursuant to Article II: 2 of the GATS a “*member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions*”. Despite the fact that some Members may include prudential measures as MFN exception, in principle, pursuant to the Guidelines for the Scheduling of Specific Commitments under the GATS, prudential measures that fall under paragraph 2(a) of the Annex should not be scheduled<sup>30</sup>.

## 2. The MFN Obligation and Prudential Regulation

Having understood the extent of the MFN obligation under the GATS, it is important to determine in which manner prudential measures may be found to be inconsistent with this obligation. This will be illustrated through a hypothetical case.

Under the Revised Basel Concordat on Principles for the Supervision of Banks’ Foreign Establishments<sup>31</sup> it is recommended to apply a “*dual key*” supervision approach whereby, for banks conglomerates, the supervisory authorities of both the home and host countries have to assess the quality of the other’s supervision of an internationally active bank. Under this approach “*if the host regulator considered the parent regulator’s supervision insufficient, the host regulator had the right to discourage or prohibit the foreign bank from operating within its jurisdiction or to set stringent conditions for the bank’s continued operation therein*”<sup>32</sup>.

30 Council for Trade in Services. *Guidelines for the Scheduling of Specific Commitments under the General Agreement in Trade on Services*. S/L/92. 28 March, 2001. para. 20.

31 Committee on Banking Regulation and Supervisory Practices. Revised Basel Concordat on Principles for the Supervision of Banks’ Foreign Establishments. 22 I.L.M 900, 901 (1983).

32 D. Alford, *Core Principles for Effective Banking Supervision: an Enforceable International*

The implementation of the “*dual key*” supervision approach would grant the discretion to a local authority to impose stringent conditions to banks of certain origins for operating in its jurisdiction, if it finds that its parent regulator’s supervision is insufficient. This clearly shows a potential situation of “*less favourable treatment*” for banks originating in countries where parent regulator’s supervision is found to be insufficient, and therefore stringent conditions for establishment are imposed, *vis-à-vis* the foreign banks which parent regulator’s supervision is found to be sufficient, and therefore to which more flexible conditions are applied.

This hypothetical situation illustrates how local authorities, in the implementation of recommended prudential regulation, might treat different and less favorably service suppliers of the same service on an origin ground. This type of prudential regulation, as well as any other that is not origin-neutral, could be found to be inconsistent with the MFN obligation of Article II: 1 of the GATS.

### 3. Market Access Obligation

Article XVI: 1 of the GATS provides that: “*With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule*”.

Paragraph 2 of this same article lists the type of measures that Members shall not maintain or adopt in the sectors where they have undertaken market-access commitments<sup>33</sup>. The Appellate

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*Financial Standard?*, 28 *Boston College International and Comparative Law Review*, 2, 237 -289, 242 (2005).

33 This limitations are: (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test; (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the



Body in *US – Gambling* stated that for demonstrating that there is a violation of GATS Article XVI: 2: “[F]irst, [the claiming party] must establish that a responding party has undertaken relevant market access commitments in its GATS Schedule and thereafter, it must ‘identify’ (...) with supporting evidence, how the challenged laws constitute impermissible ‘limitations’ falling within the meaning of one of the subparagraphs of Article XVI: 2”<sup>34</sup>.

Prudential measures can take the form of market access limitations<sup>35</sup>. For example, a country may restrict the legal form in which a bank may supply its services under Mode 3 (commercial presence) in order to secure depositors, *i.e.* commercial presence must take the form of a partnership or excluding representative offices. This measure falls under paragraph e) of Article XVI: 2 of the GATS “measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service”.

A prudential measure could also take the form of a quantitative restriction if, for instance, a Member provides that only a certain number of reinsurance companies can supply on a cross-border basis (mode 1). This would be a limitation on the number of service supplier in the form of a numerical quota, which falls under paragraph a) of this same article.

#### 4. National Treatment Obligation

Article XVII of the GATS establishes the “*National Treatment*” obligation in trade in services: “*In the sectors inscribed in its*

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requirement of an economic needs test; (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test; (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and (f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign share-holding or the total value of individual or aggregate foreign investment.

34 Appellate Body Report. *US-Gambling*. WT/DS285/AB/R. para. 143 (adopted 20 April, 2005.) This same approach has been followed by the Panels in *China- Audiovisual*. WT/DS363/R. para. 71353 (adopted 19 January, 2010); and Panel Report. *China- EPS*. para. 7511.

35 *Op.cit.*, 23. para. 12.



*Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers”.*

The Panels in *China -Audiovisuals* and *China- EPS* applied the following three-part test to assess whether a Member’s measure is inconsistent with Article XVII of the GATS:

- “(i) [The respondent party] *has made a commitment on national treatment in the relevant sector and mode of supply, regard being had to any conditions and qualifications, or limitations, set out in its Schedule;*
- (ii) [The respondent party’s] *measures are ‘measures affecting the supply of services’ in the relevant sector and mode of supply; and*
- (iii) [The respondent party’s] *measures accord to services or service suppliers of any other Member treatment less favourable than that [the respondent party] accords to its own like services and service suppliers”*<sup>36</sup>.

With respect to the first element, it is required to determine if the Member in concern has adopted any specific commitments in the relevant service in its Schedules. As to the second requirement, the considerations under section 1 of this paper shall also apply. Regarding the third element, Article XVII:3 of the GATS provides that a measure is deemed to afford a less favourable treatment “*if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member*”.

In this vein, the Panel in *China -EPS* found that: “*We deduce from this that, subject to all other Article XVII conditions being fulfilled, formally identical or different treatment of service suppliers of another Member constitutes a breach of Article XVII:1 if and only if such treatment modifies the conditions of competition to their detriment*” (emphasis added) .

Prudential regulation could be discriminatory and it might affect the conditions of competition in detriment of foreign

36 See: Panel Report, *China- Audiovisuals.*, para. 71272; and Panel Report, *China-EPS*, para.7641.

financial services suppliers<sup>37</sup>. Regulatory authorities could impose higher requirements to foreign suppliers of financial services than to domestic suppliers. For example, a regulation establishing a higher minimum capital requirement to foreign banks than to domestic banks that only have local operations, on the grounds that the systemic risks originating from foreign banks are higher than those arising from banks that limit its operations domestically<sup>38</sup>.

For the purposes of evaluating this type of prudential measures under Article XVII of the GATS, it is important to determine whether the “*aim and effects*” of the measure can be taken into account for the “*less favourable treatment*” test. However, as noted previously, the Appellate Body has clarified that this type of test is not relevant in determining whether that measure is inconsistent with Article XVII of the GATS<sup>39</sup>. Therefore, the “*prudential reason*” aspect of the measure would only be relevant for the purposes of justifying the measure under Paragraph 2 (a) of the Annex.

## 5. Conclusions

As demonstrated, prudential regulation may in some instances conflict with GATS obligations. Although, GATS commitment are subject to the conditions, qualifications and limitations established by Members in their Schedules, according to the Schedules Guidelines, such conditions, qualifications and limitations should not reflect measures that are covered by any of the exception of GATS. In turn, prudential regulation might be in a number of situations inconsistent with GATS commitments.

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37 P. Delimatsis, *Financial Innovation and Prudential Regulation-The New Basel III Rules* (TI-LEC Discussion Paper No. 2012-016, 1-27, 11, 2012). <http://dx.doi.org/10.2139/ssrn.2044694>

38 Dietrich proposes this example as an illustration of the importance of the meaning of the second sentence of paragraph 2(a) of the Annex and its impact on the prudential carve-out, when evaluating discriminatory measures. See: D. Dietrich, J. Finke & C. Tietje, *Liberalization and Rules on Regulation in the Field of Financial Services in Bilateral Trade and Regional Integration Agreements*, 35 (GTZ, Halle, 2010).

39 *Op. cit.*, p. 26.

Under this panorama, the applicability of the “*prudential carve-out*” is vital.

## II. THE “*PRUDENTIAL CARVE-OUT*” UNDER THE GATS

The Working Group on Financial Services of the Group of Negotiations on Services during the Uruguay Round, identified prudential regulation (covering the issues of the “*carve-out*” and the harmonization of prudential regulation) as one of the priority elements that had to be provided for agreeing on a wider liberalization process on the financial sector<sup>40</sup>. There was a common understanding between negotiators of the importance of prudential regulation, but also a concern on where to draw the line between the measures that would be consistent with the commitments and those that would not<sup>41</sup>.

This sensitive issue was addressed in paragraph 2(a) of the Annex by means of an exception to any violation under the GATS to the extent that the Member concerned has taken the relevant measures for “*prudential reasons*”<sup>42</sup>. This exception is the so-called “*prudential carve-out*” and it provides 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. Where such measures do not conform with the provisions of the Agreement, they shall not be used*

40 See: GATT Document MTN.GNS/FIN/1. July, 1990. para. 2

41 *Op. cit.*, para 78. The negotiations initiated on the grounds of five proposals that differ on scope. Additionally, there were proposals from the United States (MTN.GNS/FIN/W/2), the European Union (MTN.GNS/FIN/W/1) and Malaysia on behalf of the SEACEN countries (MTN.GNS/FIN/W/3). For the discussion on these proposals see GATT documents MTN.GNS/FIN/ 1 to 4. For further analysis of the negotiation history see J. Marchetti, *The GATS Prudential Carve-Out, in Financial Regulation at the Crossroads: Implications for Supervision, Institutional Design and Trade*, 279-295 (Delimatsis & Herger, Ed., Kluwer Law International, Alphen aan den Rijn, 2011).

42 Leroux finds that “*the most sensitive issue in the context of an agreement liberalizing trade in financial services is the preservation of that ability of Members and their national regulators to adopt and maintain measures for prudential reasons*”. E. Leroux, *Trade in Financial Services under the World Trade Organization*, 36 *Journal of World Trade*, 3, 413-432, 430 (2002).

*as a means of avoiding the Member's commitments or obligations under the Agreement*".

As to the legal nature of this provision, it must be noted that the Appellate Body has established two criteria for determining whether a rule constitutes an "exception". First, a provision is an exception if it is not a rule establishing legal obligations in itself; and second, if it has the function of authorizing a limited derogation from other rules that do establish obligations<sup>43</sup>.

Although, paragraph 2(a) of the Annex uses a different language from that used in other WTO exceptions *e.g.* Article XX of the GATT and Article XIV of the GATS, it is clear that it is not establishing any obligation in itself. Moreover, the use of the expression "[n]otwithstanding any other provisions of the Agreement" reflects its function of authorizing derogation from the obligations contained in the GATS<sup>44</sup>.

Turning to the conditions for its applicability, it is worth noting that the scope of this exception has not yet been interpreted by WTO jurisprudence. However, from the text of this provision, two requirements for its application can be identified: (i) the measure must be taken for "*prudential reasons*"; and (ii) it shall not be used as a means of avoiding the Member's commitments or obligations under the GATS. The first requirement defines the policy objective that a measure must seek for falling under the exception, and the second one, the required degree of connection between the measure and the objective.

In this light, the first task of an adjudicating body of the WTO when analyzing the applicability of the "*prudential carve-out*" would be to determine if the reason underlying the measure is

43 Appellate Body Report. *US- Wool Shirts and Blouses*. WT/DS33/AB/R.p.15 (adopted 23 May, 1997)

44 The Secretariat of the WTO has indicated that "*a measure falling within the ambit of the carve-out, although inconsistent with other provisions of the GATS, would still be legally permitted. This is made clear by the expression 'notwithstanding any other provisions of the Agreement' that opens the paragraph*". In other words, "*measures for prudential reasons*" could include measures that are inconsistent with a Member's MFN obligations, or specific commitments on financial services. Council for Trade in Services, Committee on Trade in Financial Services. *Financial Services Background Note* by the Secretariat. S/C/W/312 S/FIN/W/73. para. 28.

“prudential” or not. Although there is no definition, paragraph 2(a) of the Annex contains a non-exhaustive list of “*prudential reasons*”<sup>45</sup>. This list includes as prudential reasons the “*protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier*” as well as to “*ensure the integrity and stability of the financial system*”.

The extent of this indicative list of reasons shows that the terms “*prudential reasons*” in paragraph 2(a) of the Annex is broad in extent since it covers both “*micro*” and “*macro*” prudential regulation. “*Micro-prudential regulation*” is related to the stability and protection of individual financial entities and individuals, while “*macro-prudential regulation*” concerns with the stability of the financial system as a whole<sup>46</sup>.

Although, WTO Members have rejected any proposal of adopting a common understanding of the terms “*prudential reasons*” in light of international standards<sup>47</sup>, for the purposes of interpreting these terms, it would be likely that an adjudicating body would find useful guidance in them<sup>48</sup>. For this purpose a Panel could resort to these standards as evidence of the “ordinary meaning” of the terms “*prudential reasons*”<sup>49</sup>.

Firstly, international standards could be deemed to be an industry source for the purposes of determining the ordinary meaning of these terms. In the case *China - EPS*, the Panel in-

45 The Secretariat of the WTO has indicated that “[it] is worth noting that this list of ‘prudential reasons’ is only indicative, as evidenced by the term ‘including’ that precedes it”. See: Secretariat, *Background Note*, para. 29.

46 *Op. cit.*, 4.

47 On June 2000 Australia made a proposal in this sense; however, there was no support in the Committee. See: Committee on Trade in Financial Services. S/FIN/M/25 to 27. See also discussion on Ecuador’s proposal, *supra* note 3.

48 For instance, the Basel Committee, the International Organization of Securities, Commissions or the International Association of Insurance Supervisors.

49 Pursuant to Article 3.2 of the DSU, one of the objectives of the dispute settlement system is to “clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law”. The Appellate Body has found that the expression “customary rules of interpretation” refers to the “general rule of interpretation”, contained in Article 31 of the Vienna Convention on the Law of Treaties. See: Appellate Body Report. *US-Gasoline*. WT/DS4/AB/R. p. 17 (adopted 22 June, 1998). According to article 31.1 of the Vienna Convention a “treaty shall 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”.

indicated that there was “*no basis to completely disregard industry sources as potential relevant evidence of an ordinary meaning of a specific term in a particular industry*”<sup>50</sup>.

Secondly, it may be used as other international rules not binding to the WTO Members that provide evidence of the ordinary meaning. The Panel in *EC-Biotech* noted that international rules, despite not being applicable to all WTO Members, may provide evidence of the ordinary meaning of a term<sup>51</sup>. Although they are not rules, it is possible that a Panel uses this same reasoning to resort to international standards as evidence of the ordinary meaning of the terms “*prudential reasons*”.

Having said that, it is worth noting that the Secretariat of the WTO has indicated that “[a]ny measure adopted for prudential reasons is covered a priori” by paragraph 2(a) of the Annex. This implies that if a Panel finds that a reason underlying the adoption of a measure that is inconsistent with GATS is “*prudential*”, that measure is justified under this exception unless it is demonstrated that the “*prudential measure*” is used as a means of avoiding the commitments under GATS. This analysis shall be conducted by a Panel in the context of the second requirement of the “*prudential carve-out*”.

The second requirement reflects the line that Members have drawn for determining when exactly a prudential measure would be consistent or not with WTO law: “[prudential measures] *shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement*”.

Doctrine has understood this requirement as intended to avoid abuse in the use of the exception<sup>52</sup>. This can be confirmed

50 Panel Report. *China - EPS*, para. 7.89.

51 Panel Report. *EC-Biotech*. WT/DS291/292/293/R. para. 7.92 (adopted 21 November, 2006.) See also: B. Bart De Meester, *Testing European Prudential Conditions for Banking Mergers in the Light of Most Favoured Nation in the GATS*, 11 *Journal of International Economic Law*, 3, 609-647, 644-645 (2008).

52 See for instance: B. De Meester, *Testing European Prudential Conditions for Banking Mergers in the Light of Most Favoured Nation in the GATS*, 11 *Journal of International Economic Law*, 3, 644 (2008). E. Leroux, *Trade in Financial Services under the World Trade Organization*, 36 *Journal of World Trade*, 3, 430-431 (2002). J. Marchetti, *The GATS Prudential Carve-Out*, in *Financial Regulation at the Crossroads: Implications for Supervision, Institutional Design and Trade*, 291-292 (Delimatsis & Herger, Ed., Kluwer

by the negotiation history, where negotiators manifested their interest, in providing a carve-out so long as this was not a loophole for circumventing the commitments in financial services<sup>53</sup>.

Being a requirement that intends to impede the abusive use of the exception, jurisprudence related to the doctrine of “*abus de droit*” may shed some light for the interpretation of this sentence. The Appellate Body, in the context of the application of the exception contained in Article XX of the GATT, has indicated that the doctrine of “*abus de droit*” prohibits the abusive exercise of a state’s rights and enjoins that whenever the assertion of a right “*impinges on the field covered by [a] treaty obligation, it must be exercised bona fide, that is to say, reasonably*” (emphasis added)<sup>54</sup>.

Therefore, one may assert that the second requirement demands that there is a “*reasonable*” connection between the “*prudential reason*” and the measure at issue. In WTO jurisprudence it has been established that “the ordinary meaning of the word “*reasonable*”, can be defined as “*not irrational or absurd*”, “*proportionate*”, “*sensible*”, and “*within the limits of reason, not greatly less or more than might be thought likely or appropriate*”<sup>55</sup>.

In the context of paragraph 2(a) this means that there must be a “*reasonable means to ends*” connection between the measure and the “*prudential reason*”. In other words, there must be a relation that is “*not irrational or absurd*” or that is “*proportionate*”, “*sensible*”, and “*within the limits of reason, not greatly less or more than might be thought likely or appropriate*”.

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Law International, Alphen aan den Rijn, 2011); M. Yokoi-Arai, *GATS' Prudential Carve Out in Financial Services and its Relation with Prudential Regulation, International and Comparative Law Quarterly*, 57, 613-648, 639-640 (2008); N. Munin, *Legal Guide to GATS*, 31, 417 (Kluwer Law International, Alphen aan den Rijn, 2010); and The Secretariat *Background Note*, para. 31.

53 See for instance Canada, Japan, United States and Switzerland statements on the meetings of 11 to 13 June, 1990. GATT Document MTN.GNS/FIN/1. July, 1990.

54 Appellate Body Report. *US-Shrimp*. WT/DS58/AB/R. para. 158 (adopted 6 November, 1998) The Appellate Body also added that “[t]he task of interpreting and applying the *chapeau* is, hence, essentially the delicate one of locating and marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of the other Members under varying substantive provisions”, para. 159.

55 Panel Report. *China -Raw Materials*. WT/DS394/395/398/R. para. 7.696 (adopted 22 February, 2012)



This interpretation is confirmed by the fact that, contrary to other exceptions under WTO law, nowhere in the text of this provision there is an expression that requires that the relation should be “*necessary*”<sup>56</sup> or “*effective*”<sup>57</sup>. This shows that this is a flexible requirement that do not encompass that the measure has the “*function of accomplishing the legitimate objective pursued*”, as in the case of “*effective*”<sup>58</sup> or that it is not more restrictive than “*necessary*”.

Furthermore, this broad interpretation of the second requirement is also coherent with GATS objective of “*early achievement of progressively higher levels of liberalization*” –not immediate liberalization – while “*maintaining 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*”.

Finally, for the purposes of determining if a measure is “*used as a means of avoiding the Member’s commitments or obligations under the Agreement*” (emphasis added), a Panel should not be bound exclusively by the characterization of the measure objective made by the Member adopting it. As it is in the case of determining whether a measure is “*necessary*” for the purposes of Article XIV of the GATS, a Panel should “*find guidance in the structure and operation of the measure and in contrary evidence proffered by the complaining party*”<sup>59</sup>.

In conclusion, for a measure to be justified under the “*prudential carve-out*”, a Member would have to prove that the measure was adopted for a “*prudential reason*” and that there is a “*reasonable means to ends*” connection between the measure and said reason.

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56 For instance, Article XX of the GATT and XIV of the GATS require that the measures to be necessary to protect, inter alia, public morals or to maintain public order; necessary to protect human, animal or plant life or health. There is a well-established jurisprudence under GATT about the necessity test, e.g. Appellate Body Report. *Brazil-Measures Affecting Imports of Retreaded Tyres*. WT/DS332/AB/R (adopted 17 December, 2007).

57 Article 2.4 of the TBT agreement refers to “*ineffective or inappropriate means*” and Article XX of the GATT uses the term “*arbitrary or unjustifiably*” and “*necessary*”.

58 Panel Report. *US- Tuna II*. WT/DS381/R. para. 7.723 (adopted 13 June, 2012).

59 Appellate Body Report. *US-Gambling*. para. 304.



### III. PRUDENTIAL EXCEPTIONS UNDER COLOMBIA'S RTAS

The analysis has been conducted over the exceptions for prudential measures contained in the RTAs that Colombia has in force or in process of ratification with countries that have an important role in the financial market, *i.e.* United States, Canada, European Union and with the European Free Trade Association (EFTA)<sup>60</sup>. For this purpose, first, it is analyzed the scope of the policy objectives requirements; second, the scope of the degree of connection requirements; and finally, any other additional requirements that the RTAs may demand.

#### *A. Policy Objective Requirements*

The first group of requirements refers to the policy objectives that a measure must seek for falling under the prudential exception. The analysis shows that there is no reference in the RTAs provisions that restricts the “*prudential reasons*” to which Colombia may resort to, in order to invoke the exception as a justification of a violation to its obligations under the respective RTA commitments on financial services.

All RTAs have non-exhaustive lists of “*prudential reasons*” that cover at least the same reasons listed in paragraph 2(a) of the Annex of the GATS. The RTAs with the United States and Canada clarify that the terms “*prudential reasons*” “*includes the maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions or cross-border financial service suppliers*”<sup>61</sup>.

In addition, it is noteworthy that none of the RTAs limits the scope of the “*prudential reasons*” to those reasons contained in international standards. Notwithstanding, in the RTAs with

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60 The prudential measures exceptions are contained in: (i) Article 6 of Annex XVI of the Colombia - EFTA agreement; (ii) Article 1110 of the Colombia-Canada agreement; (iii) Article 12.10.1 of the Colombia-United States agreement; and, (iv) Article 154 of the Colombia- EC- Perú agreement.

61 See: note 1 of Chapter 11 of the Colombia-Canada Agreement and note 4 of Chapter 12 of the Colombia-United States Agreement.

EFTA<sup>62</sup> and the EUA<sup>63</sup>, there is a “*best endeavours*” obligation to ensure that certain international standards are implemented and applied<sup>64</sup>. Although, these references do not impose a restriction to the scope of the concept “*prudential reasons*”, the fact that there is a provision recognizing and promoting the implementation of those international standards, makes more clear that a Panel established under those agreements would resort to those standards as an interpretative instrument for determining if a reason alleged is “*prudential*” or not.

In conclusion, there is nothing in the provisions of the RTAs that make the policy objective requirement more burdensome than the one contained in paragraph 2(a) of the Annex of the GATS.

### *B. Degree of Connection Requirements*

This second group refers to the degree of connection required between the measure and the “*prudential reason*”. The RTAs with the United States and Canada use similar language as the second sentence of paragraph 2(a) of the Annex. Contrary, the RTAs with EFTA and the EUA demand that the measure ought not to be “*more burdensome than necessary to achieve their aim*”<sup>65</sup>. This reference implies that a measure must sort a “*necessity test*” to fall under the exception.

There is a well-established WTO jurisprudence of this test in the context of GATT and GATS exceptions. The main purpose of it is to determine whether a WTO -consistent alternative measure, which the Member concerned could “*reasonably be expected to employ*” is available, or whether a less WTO inconsistent measure is “*reasonably available*”<sup>66</sup>. This shall be determined by “*a*

62 Article 6.3 of Annex XVI.

63 Article 155-4.

64 These provisions refer to the Basel Committee’s *Core Principles for Effective Banking Supervision*, the standards and principles of the International Association of Insurance Supervisors and the International Organization of Securities Commissions’, *Objectives and Principles of Securities Regulation*.

65 Article 6.2 of Annex XVI of EFTA agreement and Article 154.2 of the EUA agreement.

66 Appellate Body Report. *Korea-Various Measures on Beef*. WT/DS169/AB/R. para. 166 (adopted 10 January, 2010). This same approach has been followed for analyzing GATS

*process of weighing and balancing a series of factors*”, including principally “*the contribution of the measure to the realization of the ends pursued by it*” and “*the restrictive impact of the measure on international commerce*”<sup>67</sup>.

In light of this, a prudential measure that is inconsistent with the obligations of the RTAS with EFTA and the EUA cannot be justified if there is a “*reasonably available*” less trade restrictive measure that achieves the prudential objective pursued by the measure at issue. This of course is a requirement more burdensome than the “*reasonable means to ends*” standard of the Annex of the GATS, where it is sufficient to show that the measure pursues reasonably the prudential objective and still, if an alternative of lesser trade restrictive measure exists, the measure at issue would be justified.

In conclusion, Colombia’s policy space for adopting prudential measures, *vis-à-vis* the GATS, has been limited by means of the “*necessity*” requirement established in the EFTA and the EUA agreement.

### C. Other Requirements

The EFTA and EUA agreements establish an additional requirement for the application of the prudential measure. These agreements indicate that the prudential measure adopted “*shall not discriminate against financial services or financial service suppliers of another Party in comparison to [its] own like financial services or like financial service suppliers*”<sup>68</sup>.

What this additional requirement implies is that, under those two RTAs, the “*prudential carve-out*” cannot justify a violation of the national treatment obligation in those agreements. In other words, measures that are “*necessary*” for achieving a prudential objective cannot be justified if they discriminate against financial services or financial service suppliers of EFTA or the EUA in

exceptions. See for instance, Appellate Body Report. *US-Gambling*, paras. 304-311.

67 Appellate Body Report. *US Gambling*, para. 306.

68 Appellate Body Report. *US- Gambling*, 65.

comparison to Colombia's financial services or financial service suppliers.

The effect of such requirement are better illustrated in the example referred previously: a regulatory authority establishes a higher minimum capital requirement to foreign banks than to domestic banks that only have local operations, because it finds that the systemic risks originating from foreign banks are higher than those arising from banks that limit its operations domestically. Minimum capital requirements determined on the basis of systemic risks is a clear prudential reason that seeks the protection of depositors and consumers of financial services and the integrity of the whole financial system<sup>69</sup>. However, due to the national treatment requirement, this measure could not be applied to banks whose investment is covered by the EFTA or EUA agreement, despite the fact that they have international operations, because it would be discriminating against financial services suppliers of EFTA or the EU in comparison to Colombia's financial service suppliers that only have local operations.

This situation clearly reduces Colombia's policy space for adopting prudential measures; furthermore, it may have an effect on the evaluation of the measure under other agreements (RTAs and GATS). For example, if this type of measure is applied excluding EFTA and EUA financial service suppliers, it may be argued that, in light of the prudential objective pursued, there is no reasonable justification for excluding those suppliers, apart from that it is an obligation assumed under EFTA and the EUA agreement. Therefore, since there would be no "*prudential reason*" that would justify the exclusion of those financial service suppliers, the compatibility of the measure with the degree of connection requirements of other agreements may be undermined, since it might be found to be "*unreasonable*".

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69 *Óp. cit.*, 31.

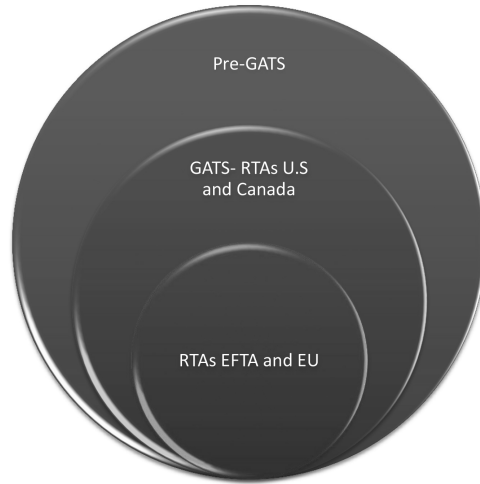
#### IV. CONCLUSIONS

Through RTAS Colombia has reduced its policy space for prudential regulation *vis-à-vis* its commitments under the GATS by imposing more burdensome and demanding requirements for applying the prudential measure exceptions. Although the limitations were agreed on a bilateral basis, in practice this has a multilateral impact since the requirements act in a cumulative manner. This can be illustrated in the case of non-discriminatory prudential measures: if a measure of this type is adopted and it does not meet all the requirements set in GATS and RTAS for applying the prudential exception, Colombia would either have to remove completely the measure or apply it in a discriminatory way—in case the inconsistency derives from an RTA—. Still, in this latter case, this discriminatory application could undermine its compatibility with the degree connection requirements of other international agreements, given that the only reasons that explains such treatment would be the need to comply with those RTAS that demand national treatment. This reason, in light of the prudential objective pursued, would not justify such discriminatory treatment.

Therefore, in practice, when adopting a prudential measure that is inconsistent with the financial services obligations under GATS and the RTAS, Colombia has to assess whether the measure complies with all the requirements of those agreements, otherwise, lack of compliance might affect the complete applicability and consistency of the measure with the international commitments in this area.

Colombia's policy space for adopting prudential regulation in light of the scope of the "*prudential carve-outs*" established in GATS and the RTAS, can be illustrated in the following way:

## Policy Space



In conclusion, this is yet another example of how the proliferation of RTAs is creating new regulatory challenges to Colombia's domestic authorities. As illustrated in this paper, financial authorities when adopting prudential regulation must assess its consistency with Colombia's international commitments in trade and services. As demonstrated, this analysis requires a clear understanding of the specific commitments, of the rules of treaty interpretation and must be conducted in a holistic manner, due to the differences of scope of comparable provisions in each international agreement.

The conclusions of this analysis, in many cases, will lead to contradictory results, where the same measure may be consistent with some but not all agreements. When this occurs, authorities will have to conduct a subsequent analysis that focuses on the potential consequences of modifying the measure in order to adjust it in a manner that makes it consistent with all international commitments; or on the potential consequences of applying the regulation in a discriminatory manner.

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