THE EVOLVING PRUDENTIAL EXCEPTIONS IN REGIONAL TRADE AGREEMENTS

Yueh-Ping (Alex) YANG*

ABSTRACT

Paragraph 2(a) of the Annex on Financial Services of the General Agreement on Trade in Services (GATS), known as the "GATS Prudential Exception", plays a crucial role in connecting international trade laws and international financial laws. Commentators, however, are less satisfied with it. To explore other possible prudential exceptions, in this paper, I investigate the regional trade agreements reported to the World Trade Organization that contain a prudential exception. I compare the different nexus requirements, control mechanisms, and other special variations contained therein and find that Europe, Latin America, and China are the three major promoters of changes. Based on these findings, I map out the trend of the evolving prudential exceptions in bilateral settings. I identify a general trend toward a more restrictive use of the prudential exception, which moves slightly toward more financial liberalization. I also identify some progressive ways toward financial liberalization for policymakers to consider, including strengthening the nexus requirement, clarifying rather than strengthening the control mechanism, and starting from some specific prudential measures.

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This investigation suggests the importance of pacing when developing the prudential exception.

KEYWORDS: *prudential exception, anti-avoidance clause, for prudential reasons, Argentina — financial services, regional trade agreement, financial liberalization, prudential regulation, international finance*

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I. INTRODUCTION

Paragraph 2(a) of the Annex on Financial Services (hereinafter "Financial Annex") of the General Agreement on Trade in Services (hereinafter "GATS"), known as the "GATS Prudential Exception",[1] plays a crucial role in connecting international trade laws and international financial laws. Broadly speaking, international financial laws mainly aim at preserving the safety and soundness of financial sectors while reducing regulatory arbitrage; thus, they impose prudential regulations on financial sectors to control the risks therein. International trade laws, in contrast, mainly pursue trade liberalization; thus, when they apply to financial sectors, they form a major push toward liberalizing the regulation of cross-border financial activities. Between prudential regulation and financial liberalization, the GATS Prudential Exception acts as a bridge harmonizing the two goals in the context of the World Trade Organization (hereinafter "WTO").[2]

This is, however, not an easy task. During the negotiation of the GATS Prudential Exception, negotiators put forward various proposals, in particular for designing the required nexus between a measure and the claimed prudential reasons (the issue of the "nexus requirement") and controlling the potential abuse of the prudential exception (the issue of the "control mechanism").[3] When they finalized the GATS Financial Annex in 1999, they left the GATS Prudential Exception with a relatively open-ended wording, which permits an economy to limit the trade in financial services if the limit is "for prudential reasons" and does not constitute "a means of avoiding the Member's commitments or obligations" under the GATS. This vague wording inevitably requires further clarification.[4] After nearly

[1] There is a debate about whether to describe Paragraph 2(a) of the Financial Annex as an exception or a carve-out, and the Panel Report of *Argentina — Financial Services* characterized it as an exception. Following the Panel's opinion, throughout this paper, I will use the capitalized "GATS Prudential Exception" to refer to Paragraph 2(a) of the Financial Annex and lower-case "prudential exception" to refer to similar clauses contained elsewhere (including in the Trade in Services Agreement as well as in other regional trade agreements).

[2] For studies discussing the potential role of the GATS Prudential Exception in harmonizing international trade laws and international financial laws, see e.g., Thomas Cottier & Markus Krajewski, *What Role for Non-discrimination and Prudential Standards in International Financial Law?*, *in* INTERNATIONAL LAW IN FINANCE REGULATION AND MONETARY AFFAIRS 271 (Thomas Cottier et al. eds., 2012); Régis Bismuth, *Financial Sector Regulation and Financial Services Liberalization at the Crossroads: The Relevance of International Financial Standards in WTO Law*, 44(2) J. WORLD TRADE 489 (2010); Dan Juma, *Tempering Services Liberalization with Regulation: The World Trade Organisation and the International Financial Architecture*, 14 INT'L TRADE & BUS. L. REV. 247 (2011).

[3] *See infra* Part II.A.1.

[4] For the studies on the GATS Prudential Exception, see e.g., J. Steven Jarreau, *Interpreting the General Agreement on Trade in Services and the WTO Instruments Relevant to the International Trade of Financial Services: The Lawyer's Perspective*, 25 N. CAL. J. INT'L L. & COM. REG. 1 (1999); Eric H. Leroux, *Trade in Financial Services Under the World Trade Organization*, 36(3) J.

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twenty years, however, the world economy still lacks a consensus on how to interpret the GATS Prudential Exception to make it effective yet balanced. The Panel Report[5] and the Appellate Body Report[6] of the *Argentina — Financial Services* dispute, adopted in 2015 and 2016, respectively, for the first time interpreted the GATS Prudential Exception[7] and addressed a number of related interpretative issues. They, however, fell short of clarifying the two major issues confronting the GATS Prudential Exception, *i.e.*, the nexus requirement and the control mechanism.[8]

In contrast to the stagnation at the multilateral level, many economies have shifted their focus to bilateral agreements and have made significant progress. Current studies, however, pay less attention to the evolution of prudential exceptions in this bilateral context.[9] To fill this gap, I conduct a comprehensive comparative study by reviewing all the regional trade agreements (hereinafter "RTAs") notified to the WTO[10] that contain a prudential exception and comparing these prudential exceptions to each

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WORLD TRADE 413 (2002); Kern Alexander, *The World Trade Organization and Financial Stability: The Balance Between Liberalisation and Regulation in the GATS* (Univ. of Cambridge, Ctr. for Fin. Analysis and Pol'y, Working Paper No. 5, 2003); VU Nhu Thang, *Applicability of GATS Prudential Exception to Insurance Services: Some Interpretative Issues*, 4(2) MANCHESTER J. INT'L ECON. L. 88 (2007); Mamiko Yokoi-Arai, *GATS' Prudential Carve out in Financial Services and Its Relation with Prudential Regulation*, 57 INT'L & COMP. L. Q. 613 (2008); Joseph Windsor, *The WTO Committee on Trade in Financial Services: The Exercise of Public Authority Within an Informal Forum*, 9(11) GERMAN L.J. 1805 (2008); Byungsik Jung, *Standard of Review for Jurisprudence on Prudential Measures*, 1 ILSP L.J. 49, 53 (2009); Panagiotis Delimatsis & Pierre Sauvé, *Financial Services Trade After the Crisis: Policy and Legal Conjectures*, *in* INTERNATIONAL LAW IN FINANCE REGULATION AND MONETARY AFFAIRS, *supra* note 2, at 288; Mary McAllister Shepro, *Preserving National Regulatory Autonomy in Financial Services: The GATS' Prudential Carve-out* 12 (Dec. 31, 2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2418764; Carlo Maria Cantore, *"Shelter from the Storm": Exploring the Scope of Application and Legal Function of the GATS Prudential Carve-out*, 48(6) J. WORLD TRADE 1223 (2014); Gabriel Gari, *GATS Disciplines on Capital Transfers and Short-term Capital Inflows: Time for Change?*, 17(2) J. INT'L ECON. L. 399 (2014); Inu Barbee & Simon Lester, *Financial Services in the TTIP: Making the Prudential Exception Work*, 45 GEORGETOWN J. INT'L L. 953 (2014); Samuel Trujillo, *Demystifying the Prudential Carve-out: A Proposal*, 43 CON-TEXTO 157 (2015); John Anwesen, *The Prudential Carve-out Clause: Is Risk the New Corrupt Moral?*, 4(2) PENN ST. J. L. & INT'L AFF. 749 (2016); Andrew D. Mitchell et al., *Dear Prudence: Allowances Under International Trade and Investment Law for Prudential Regulation in the Financial Services Sector*, 19(4) J. INT'L ECON. L. 787 (2016); Yueh-Ping (Alex) Yang, *Haste Makes Waste: WTO, Pilot Free Trade Zones and Financial Experiments*, 34(4) WISC. INT'L L.J. 854 (2017).

[5] Panel Report, *Argentina — Measures Relating to Trade in Goods and Services*, WT/DS453/R (adopted May 9, 2016) [hereinafter *Argentina — Financial Services* Panel Report].

[6] Appellate Body Report, *Argentina — Measures Relating to Trade in Goods and Services*, WT/DS453/AB/R (adopted May 9, 2016).

[7] *Argentina — Financial Services* Panel Report, *supra* note 5, ¶ 7.809.

[8] *See infra* Part II.C.

[9] An exception, which compared the prudential exceptions of eight major RTAs, was the study done by Andrew D. Mitchell, Jennifer K. Hawkins and Neha Mishra. *See generally* Mitchell et al., *supra* note 4.

[10] For a full list of the reported RTAs, see World Trade Organization, *List of All RTAs*, https://rtais.wto.org/UI/PublicAllRTAList.aspx (last visited Aug. 6, 2018)

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other.[11] The investigation results suggest that three regions (Europe, Latin America, and China) are quite active in adopting new prudential exceptions. The results further present multiple models of prudential exceptions, ranging from different nexus requirements and different control mechanisms to other special provisions. These models can inspire policymakers to understand the different expectations of developed and developing economies and design a more suitable prudential exception in the future.

I structure this paper in the following manner. In Part II, I briefly outline the negotiating history of the GATS Prudential Exception and identify the interpretative issues underlying the current version. In Part III, I analyze 100 RTAs that contain a prudential exception and compare the different nexus requirements, control mechanisms, and other special variations therein. In Part IV, I summarize the above findings, demonstrate that there is a general trend toward more financial liberalization in bilateral settings, and identify the specific ways adopted therein that pace financial liberalization. I anticipate that this paper can provide empirical evidence of the evolution of the prudential exception in the bilateral context and can inspire future developments.

II. THE PAST AND PRESENT OF THE GATS PRUDENTIAL EXCEPTION

A. The Negotiating History of the GATS Prudential Exception

The financial sector was a sensitive issue during the negotiation of the GATS in the Uruguay Round. On the one side, Japan, as well as other Asian and Latin American developing economies, desired a lower level of market access commitments. On the other side, the United States envisioned more market access commitments from other Members. Due to the significant gap between both sides, when the GATS entered into force in 1995, negotiators had no choice but to set aside the negotiation of financial services for a while. Only after many Members agreed to expand their market access commitments did they agree on the Financial Annex which entered into effect on March 1, 1999.[12]

At the beginning of the negotiation of the Financial Annex in 1990, at least five distinct versions of prudential exceptions were on the table, including: (i) a prudential carve-out limited to a qualified national treatment provision; (ii) permitting all "reasonable" prudential and fiduciary measures; (iii) a variation of the reasonableness requirement, enumerating examples of permissible measures; (iv) providing for an unqualified right to

[11] The full list of these 100 RTAs is provided in the Appendix to this paper.

[12] For a comprehensive account of the negotiating history of the Financial Annex, see generally Jarreau, *supra* note 4, at 9-31.

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take such measures; and (v) defining as precisely as possible the prudential actions that would be permitted, so as to reduce legal uncertainties.[13] Negotiators, however, did not reach a preliminary conclusion as to which approach to choose.[14]

Subsequently, many Members put forward their separate proposals. To name few major examples here:[15]

1. The European Community — The European Community (hereinafter "EC") proposed a provision combining both a reasonableness requirement and an arbitrary or unjustifiable discrimination control. Specifically, the draft provision permitted any "*reasonable* measures to safeguard the integrity of the financial system" and controlled the abuse of this exception by preventing its application from constituting "a means of *arbitrary or unjustifiable discrimination* against financial services providers of other parties."[16]

2. The United State — The United States, in turn, proposed a provision combining both a reasonableness requirement and a necessity requirement, which permitted "*reasonable* actions *necessary for* prudential reasons, for the protection of investors and depositors, or for the protection of persons to whom a fiduciary duty is owed by a financial service provider."[17]

3. Canada et al. — Canada, Japan, Sweden, and Switzerland proposed a provision adopting both the reasonableness requirement and the "for prudential reason" requirement, which applied the prudential exception to "*reasonable* measures taken *for prudential reasons,* to assure the protection of investors, depositors, policy holders or persons to whom a fiduciary duty

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[13] Working Grp. on Fin. Serv. Including Ins., *Note on the Meeting of 11-13 June 1990*, ¶ 78, MTN.GNS/FIN/1 (July 5, 1990).

[14] *Id.* ¶ 95.

[15] For a comprehensive introduction of the different versions presented during the negotiation, see Anwesen, *supra* note 4, at 781-87.

[16] Working Grp. on Fin. Serv. Including Ins., *Communication from the European Communities*, art. 13.1, GATT Doc. MTN.GNS/FIN/W/1 (July 10, 1990) (emphasis added). The draft provision proposed by the EC reads:

> Article 13: Domestic Regulation
> 13.1. Notwithstanding any other provisions of the Agreement and of this Annex, in order to prevent or to solve a serious economic or financial disturbance, parties may take *reasonable* measures to safeguard the integrity of the financial system, *provided that these measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination against financial services providers of other parties*. Measures taken in accordance with this Article shall be consistent with the party's rights and obligations under the Articles of the Agreement of the International Monetary Fund. Insofar as such measures impose restrictions on operations liberalised under this Annex, such measures shall be notified to the PARTIES. (emphasis added)

[17] Working Grp. on Fin. Serv. Including Ins., *Communication from the United States*, at 2, MTN.GNS/FIN/W/2 (July 12, 1990) (emphasis added).

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is owed by a financial service provider, or to ensure the integrity and stability of a party's financial system."[18]

4. The SEACEN Countries — The SEACEN countries[19] also proposed a provision that was very similar to the current version except for the absence of an anti-avoidance clause, which provided that "[n]otwithstanding any other provisions in the Agreement, a Party shall not be prevented from taking measures *for prudential reasons*, including for . . . ."[20]

B. The Current Version of the GATS Prudential Exception

Negotiators, in the end, compromised on the current version of the GATS Prudential Exception, which reads:

> 2. Domestic Regulation
> (a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.[21]

Two points are worth highlighting. First, in general, negotiators intended a wider applicability of the GATS Prudential Exception. For instance, they expanded the application scope of the GATS Prudential Exception by settling on an open list of prudential reasons. Specifically, they used "for prudential reasons, 'including' for . . . ", which suggests that the prudential reasons identified therein are non-exhaustive. In addition, they opted for a less stringent nexus requirement by using "for prudential reasons" instead of the "necessary for prudential reasons" as proposed by the United States.

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[18] Trade Negotiations Comm., *Communication from Canada, Japan, Sweden and Switzerland*, at 2, MTN.TNC/W/50 (Dec. 3, 1990) (emphasis added).
[19] SEACEN countries included Indonesia, Malaysia, Thailand, Nepal, Sri Lanka, Korea, Philippine, Singapore, and Myanmar.
[20] Trade Negotiations Comm., *Communication from Malaysia*, at 2, GATT Doc. MTN.TNC/W/52 (Dec. 4, 1990).
[21] General Agreement on Trade in Services, Annex on Financial Services, ¶ 2(a), Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167.

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That said, regarding the control mechanism, negotiators took a rather neutral approach. On the one hand, they preferred more clarity; thus, they used "shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement" instead of a vague term such as "reasonable" as proposed by the EC, the United States, and Canada and others. On the other hand, they preferred some but not much control; thus, they added an anti-avoidance clause but refrained from adopting the "arbitrary or unjustifiable discrimination" control as proposed by the EC.

C. The Interpretative Issues Underlying the GATS Prudential Exception

Despite the above efforts, the vague wording of the GATS Prudential Exception triggers a number of interpretative issues.[22] Two major issues (the nexus requirement and the control mechanism), in particular, stand out.

1. The Nexus Requirement — Commentators debate on how to interpret the term "for prudential reasons" in the GATS Prudential Exception. Some argued that the examination should focus on the subjective motivation of the contested measure[23] while others advocated some objective tests such as a close and genuine relationship test,[24] a means-end test,[25] or a reasonableness test,[26] etc.

Recently, the WTO jurisprudence provided some clarity on this issue. In 2015, in the *Argentina — Financial Services* dispute, the WTO's dispute settlement, for the first time,[27] interpreted the GATS Prudential Exception.[28] The Panel in this dispute took the liberty and interpreted the nexus requirement. It firstly clarified that the nexus requirement under the GATS Prudential Exception amounts neither to a necessity requirement as established in many general exceptions[29] nor to a "relating to" requirement

[22] For a summary and detailed description of these interpretative issues, see generally Yang, *supra* note 4, at 881-86.
[23] Shepro, *supra* note 4, at 37-38.
[24] Jung, *supra* note 4, at 53.
[25] Barbee & Lester, *supra* note 4, at 960.
[26] Shepro, *supra* note 4, at 52; Bismuth, *supra* note 2, at 495.
[27] Before the *Argentina — Financial Services* dispute, the *China – Payment* dispute also entailed the GATS Prudential Exception when dealing the interpretation of China's commitment schedule. The Panel of that dispute, however, did not delve into the interpretation of the GATS Prudential Exception. *See* Panel Report, *China — Certain Measures Affecting Electronic Payment Services*, ¶ 7.569, WTO Doc. WT/DS413/R (adopted Aug. 31, 2012).
[28] It should be noted that, in addition to WTO's dispute settlement, other international dispute settlement forums have occasionally dealt with disputes related to financial services. Notable instances are international investment tribunals and international human right tribunals. For the related discussion, see generally Federico Lupo-Pasini, *Financial Disputes in International Courts*, 21 J. INT'L ECON. L. 1 (2018).
[29] *Argentina — Financial Services* Panel Report, *supra* note 5, ¶ 7.884.

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as established in GATT Article XX(g).[30] Instead, it defined the nexus requirement here as a requirement of "*rational relationship of cause and effect*" between the contested measure and the claimed prudential reasons.[31] It further emphasized that the central aspect of this nexus requirement is the "*adequacy* of the measure to the prudential reason, that is, whether the measure, through its design, structure and architecture, *contributes to* achieving the desired effect."[32] Although the Panel's such interpretation risks some potential confusion,[33] it at least more or less clarified this issue.

2. The Anti-Avoidance Clause — Commentators also debate on how to interpret the second sentence of the GATS Prudential Exception, "used as a means of avoiding the Member's commitments or obligations under the Agreement." This sentence undisputedly aims at preventing measures that are "purely or primarily protectionist in effect,"[34] but how to further substantiate it is controversial. Some argued that this anti-avoidance clause parallels the GATT Article XX or GATS Article XIV chapeaus, that is, the concepts of "arbitrary or unjustifiable discrimination" and "disguised restriction on trade in services."[35] Others have, in contrast, argued that it embodies the international law principle of *abus de droit* and thus reflects a good faith obligation.[36]

This issue remains unresolved after the *Argentina — Financial Services* dispute. The Panel missed the opportunity to clarify this issue because it exercised judicial economy in that dispute and did not continue examining the issues related to the anti-avoidance clause.[37] This leaves the interpretation of the anti-avoidance clause completely open.

D. Summary

In sum, a clear framework for operating the GATS Prudential Exception remains absent. Such absence is problematic. On the one hand, it might under-deter the abuse of the GATS Prudential Exception by some economies, which may hinder the liberalization of world financial services. On the other hand, it might over-deter the proper use of the GATS Prudential Exception by other economies, which may create prudential concerns in these economies.

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[30] *Id.* ¶ 7.885.
[31] *Id.* ¶ 7.891.
[32] *Id.* (emphasis added).
[33] For a brief comment of the potential problems underlying the Panel's such interpretation, see Yang, *supra* note 4, at 885 n.173.
[34] Council for Trade in Serv., Comm. on Trade in Fin. Serv., *Financial Services – Background Note by the Secretariat*, ¶ 30, S/C/W312, S/FIN/W/73 (Feb. 3, 2010).
[35] Barbee & Lester, *supra* note 4, at 960-61; Delimatsis & Sauvé, *supra* note 4, at 300.
[36] Cantore, *supra* note 4, at 1234, 1243-44; Shepro, *supra* note 4, at 39-49; Cottier & Krajewski, *supra* note 2, at 278.
[37] *Argentina — Financial Services* Panel Report, *supra* note 5, ¶ 7.945.

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III. THE PRUDENTIAL EXCEPTIONS IN REGIONAL TRADE AGREEMENTS

In this part, I examine how other models of prudential exceptions have developed in bilateral RTAs. The results of this investigation suggest that the development of the prudential exception in bilateral settings is far more robust and vibrant.

A. Comparative Study of the Prudential Exceptions in Regional Trade Agreements

The complexity of the GATS Prudential Exception results from the difficult weighing and balancing between financial liberalization and prudential regulations. This balancing problem has become even more acute since the 2008 Global Financial Crisis.[38] After all, due to the difference in the development status, domestic institutions, and domestic industry structure, etc., each economy may need a different way to reach the necessary balance.[39] This is why it is difficult to reach a widely-accepted yet detailed consensus on this issue in a multilateral setting.

Examining the development of prudential exceptions in the bilateral context may provide policymakers with more models for reaching such balance. Therefore, in this part, I investigate all the RTAs and compare their prudential exceptions. This exercise is of merit for at least two reasons. From a legal and interpretative perspective, the related provisions in bilateral agreements are referable interpretative tools. Admittedly, the Appellate Body has not explicitly acknowledged that bilateral agreement provisions can serve as interpretative tools in the form of relevant rules of international law applicable in the relations between the parties under the Vienna Convention on the Law of Treaties (VCLT).[40] In practice, however, WTO case law has referred to bilateral agreement provisions when interpreting WTO provisions,[41] which suggests that these provisions at least possess some implicit reference value. On the other hand, from an economic and functional perspective, this exercise reveals how the

[38] For a summary of how this balancing problem evolved after the Global Financial Crisis, see Yang, *supra* note 4, at 887-88.
[39] *Id.* at 864-67.
[40] Appellate Body Report, *European Communities and Certain Member States — Measures Affecting Trade in Large Civil Aircraft*, ¶¶ 844-45, WTO Doc. WT/DS316/AB/R (adopted June 1, 2011).
[41] For instance, in the *United States — Shrimp* dispute, the Appellate Body referred to the regional trade agreement of the Inter-American Convention as a basis of its interpretation. *See* Appellate Body Report, *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, ¶ 169, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998).

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perception of the GATS Prudential Exception evolves among different economies over time. It further reveals a variety of ways to weigh and balance financial liberalization and prudential regulations. Understanding these ways is helpful for both a law interpreter to reach a proper interpretation in a given context and a policymaker to strike a delicate balance when designing financial policies.

1. The Summary Data of the Investigated RTAs — Chart 1 reports the summary data of the investigated RTAs while Appendix A reports the full list of these RTAs. By the end of June 2018, there were 100 reported RTAs containing a prudential exception (hereinafter "Prudential RTAs"). Chart 1 reports the time series of these RTAs. It shows a steady increase in the number of Prudential RTAs although this trend seems to have slowed down over the last three years.

CHART 1: The Number of Prudential RTAs in Time Series

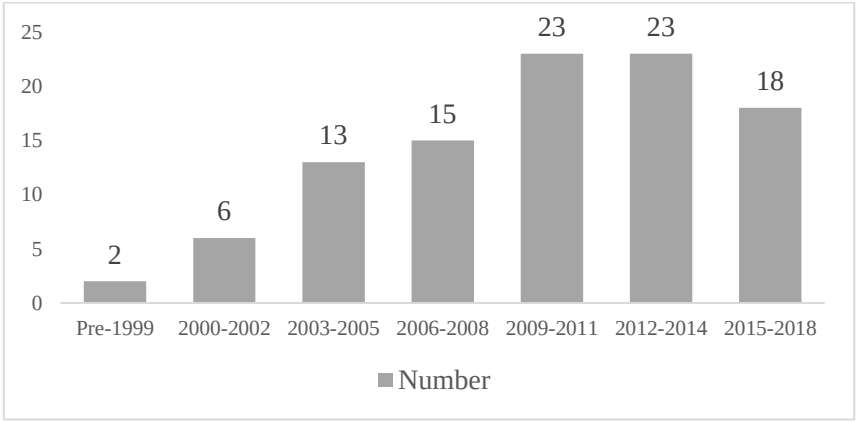


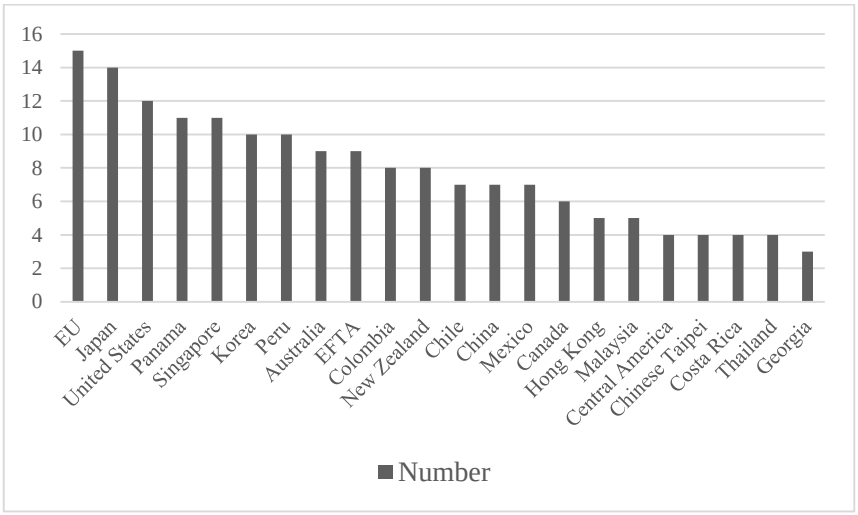
Chart 2 reports the economies that have entered into three or more Prudential RTAs. Among them, the European Union (hereinafter "EU") is the largest and has entered into fifteen Prudential RTAs. Europe's influence is even larger if we include the other 9 RTAs entered into by the members to the Convention Establishing the European Free Trade Association (hereinafter "EFTA"), which, together, account for 24% of the total RTAs under investigation. Due to this high exposure, Europe has been influential in innovating new rules for the prudential exception, which will be discussed later. The next four giants are Japan (14), the United States (12), Panama (11), and Singapore (11).

In addition to Europe, the other region that has been influential in innovating new prudential exceptions is Latin America. Many leading parties to Prudential RTAs belong to this region, including Panama (11), Peru (10), Colombia (8), Chile (7), Mexico (7), Costa Rica (4), and Central

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America (4). These economies have entered into many Prudential RTAs with each other with relatively uniform content, which will be discussed later.

CHART 2: The Main Consumers of Prudential RTAs



2. Methods for the Analysis — To detect how prudential exceptions have evolved in the bilateral context, I focus on three aspects: (i) the nexus requirement between a prudential measure and the claimed prudential reasons, (ii) the control mechanism that controls the abuse of the prudential exception, and (iii) other special provisions that adjust the rights or obligations of Members to adopt prudential measures.

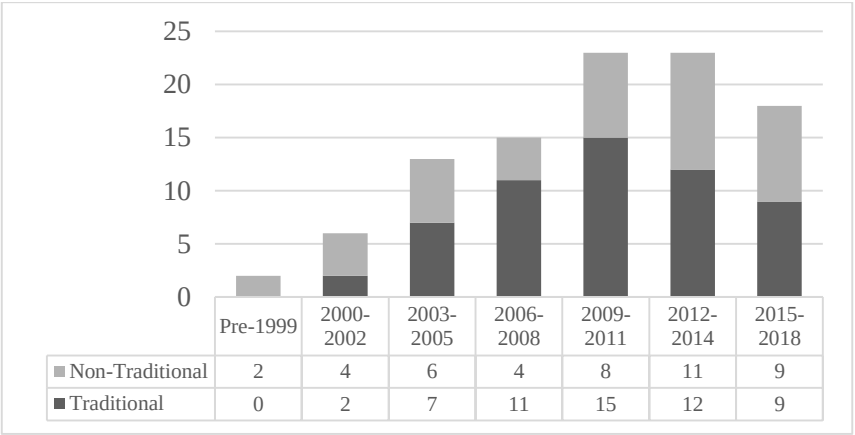
The investigation exhibits a relatively surprising result. Among the 100 investigated RTAs, forty-four of them adopt a prudential exception that does not fully follow the GATS Prudential Exception. I term the provisions following the GATS Prudential Exception the "traditional provisions" and those departing from the GATS Prudential Exception "non-traditional provisions." Among these forty-four RTAs, twenty-eight of them revise the nexus requirement, thirty-nine of them revise the control mechanism, and thirty-two of them introduce other specific variations. This result suggests that a significant group of economies does not fully appreciate the GATS Prudential Exception and has taken steps to revise it in bilateral settings.

Chart 3 summarizes the evolution of prudential exceptions over time. As the chart shows, before the Global Financial Crisis of 2008, the traditional provision had become increasingly popular. The relative share of the traditional provision had increased from 33.33 percent in 2000-2002 to 73.33 percent in 2006-2008. In contrast, since the Global Financial Crisis,

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non-traditional provisions have become more popular. The relative share of non-traditional provisions has increased from 34.78 percent in 2009-2011 to 50 percent in 2015-2018. This suggests an increasing dissatisfaction with the traditional provision.

CHART 3: The Use of Traditional vs. Non-Traditional Prudential Exception over Time



	Pre-1999	2000-2002	2003-2005	2006-2008	2009-2011	2012-2014	2015-2018
Non-Traditional	2	4	6	4	8	11	9
Traditional	0	2	7	11	15	12	9

We may further observe the attitude of major economies. Chart 4 summarizes the relative use of traditional versus non-traditional provisions by major economies. The investigation illustrates mixed results. Many economies still tend to use the traditional provision: Japan (11 out of 14), the United States (11 out of 12), Singapore (10 out of 11), Korea (7 out of 10), Australia (6 out of 9), New Zealand (7 out of 8), and Canada (5 out of 6) all tend to adopt the traditional provision. Note that Japan, the United States, and Canada used to propose different prudential exceptions during the negotiation of the GATS Financial Annex. This suggests that the traditional provision is well-received among these economies, including those who held a different position during the negotiations.

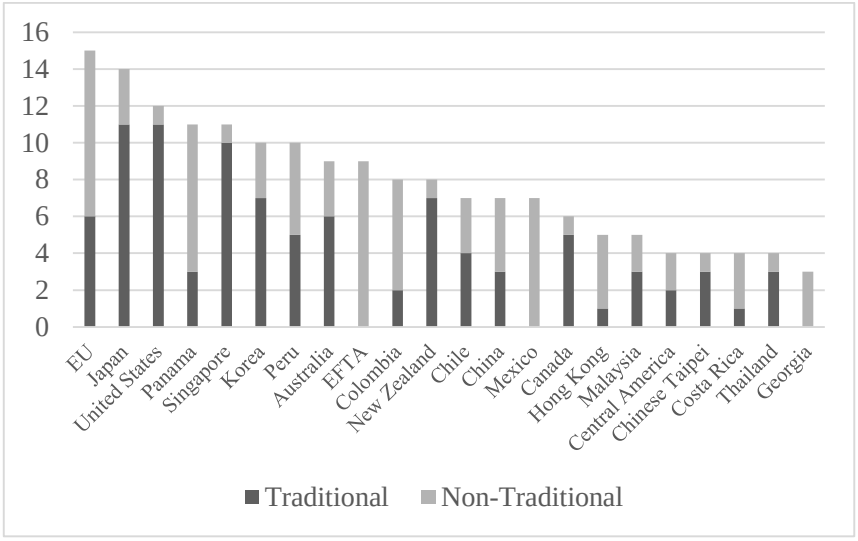
That said, two regions stand out as the major promoters of non-traditional provisions, that is, Europe (in particular, EFTA) and Latin America (in particular, Mexico). In respect of Europe, 9 out of 15 of the EU's Prudential RTAs adopt non-traditional provisions. EFTA is even more aggressive: all of its nine Prudential RTAs adopt non-traditional provisions. In respect of Latin America, Mexico appears to be the major promoter: all of its seven Prudential RTAs adopt non-traditional provisions. Panama (8 out of 11), Peru (5 out of 10), Colombia (6 out of 8), and Costa Rica (3 out of 4) also support non-traditional provisions strongly. Other than Europe

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and Latin America, China appears to be the other supporter of non-traditional provisions (4 out of 7).[42]

These results suggest that some economies consistently challenge the traditional provision. Europe gives less cause for surprise considering that the EC, Switzerland, and Sweden used to propose different versions of prudential exceptions during the negotiations of the Financial Annex. Latin America, in contrast, is more of a surprise considering that it appeared less involved in the negotiation of the GATS Financial Annex.

CHART 4: The Use of Traditional vs. Non-Traditional Prudential Exception by Economy



Below I examine these non-traditional provisions in detail. To conduct the analysis, I examine the non-traditional provisions based on three aspects. The first aspect relates to the nexus requirement, in which I examine how they design and require the level of nexus between a measure and its claimed prudential reason. The second aspect relates to the control mechanism, in which I examine what criteria they adopt to determine if a Member abuses its right to adopt prudential measures. The third aspect relates to other special provisions that add or diminish the rights or obligations for a Member to adopt prudential measures.

[42] Two economies also use non-traditional provisions more: Hong Kong (4 out of 5) and Georgia (3 out of 3). This, however, could be because their RTAs involve EU, EFTA, or China.

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B. The Models of the Nexus Requirement

I examine the nexus requirement first, which reveals four main ways to design the nexus requirement: (i) the traditional "for prudential reasons" requirement, (ii) the slightly more aggressive "prudential measure" requirement (iii) the more aggressive necessity requirement, and (iv) the "relating to" requirement.

1. Model 1: "For Prudential Reasons" — Most RTAs adopt the language of "for prudential reasons" to stipulate the nexus requirement, which follows the GATS Financial Annex. Taking the Free Trade Agreement between China and Georgia for instance, its prudential exception provides that:

> Notwithstanding any other provisions of this Chapter, a Party shall not be prevented from adopting or maintaining reasonable measures for prudential reasons, including for:
> (a) the protection of investors, depositors, policy-holders, policy-claimants, persons to whom a fiduciary duty is owed by a financial service supplier, or any similar financial market participants; or
> (b) ensuring the integrity and stability of that Party's financial system.[43]

As mentioned previously, this language is not without confusion. That said, most RTAs prefer to leave this issue open.

2. Model 2: "Prudential Measures" — In contrast to the majority approach, nine RTAs use "prudential measures" instead of "measures for prudential reasons" when describing prudential measures. Taking the Free Trade Agreement between Panama and Taiwan for instance, its prudential exception provides that, "[n]othing in this Chapter shall be construed to prevent a Party from adopting or maintaining prudential measures such as: . . . ."[44]

Latin America, especially Panama and Mexico, is the major promoter of this model. Among the nine RTAs adopting this model, Panama accounts for six of them and Mexico accounts for another two. The only one unrelated to Panama and Mexico is the Eurasian Economic Union (EAEU).

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[43] Free Trade Agreement Between the Government of the People's Republic of China and the Government of Georgia, China-Geor., Annex 8-A, art. 3.1, May 13, 2017, http://fta.mofcom.gov.cn/georgia/annex/xdzw_en.pdf (emphasis added).

[44] Free Trade Agreement Between the Republic of China and the Republic of Panama, Taiwan-Pan., ch. 12, art. 12.09(1), Aug. 21, 2003 [hereinafter Taiwan–Panama FTA], https://www.trade.gov.tw/App_Ashx/File.ashx?FileID=AD8E2E61816DEA99 (emphasis added).

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Notably, the term "prudential measures" bears a different meaning to the traditional term "measures for prudential reasons." As the Panel of *Argentina — Financial Services* has clarified, these two concepts do not have the same effect. When the Financial Annex uses "measures for prudential reasons" instead of "prudential measures," it is the *reason* that must be prudential and not the *measure* per se. Measures for prudential reasons thus need not be "characterized as *specifically* prudential, such as those usually cited in the context of the standards defined by the Basel Committee on Banking Supervision."[45] Following the Panel's logic, the scope of "prudential measures" is narrower than that of "measures for prudential reasons." It is even likely that in determining whether a measure is prudential in nature, a law interpreter needs to take into account the related international norms as a guide instead of deferring completely to the self-determination of the adopting member.[46]

3.Model 3: The Necessity Requirement — Fourteen RTAs adopt the more aggressive necessity requirement. This model, in turn, contains three sub-groups.

(a) Model 3.1: Featuring a Replacement Effect — This sub-group is the most aggressive one. It completely sets aside the "for prudential reason" model and replaces it by a necessity requirement. So far, there is only one RTA that falls into this sub-group, that is, the EFTA, which provides that:

> In respect of financial services, this Chapter does not prejudice the right of the Member States to adopt measures necessary for prudential grounds in order to ensure the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed, or to ensure the integrity and stability of the financial system.[47]

(b) Model 3.2: Featuring a Quasi-replacement Effect — This sub-group is more delicate. It maintains the use of "for prudential reasons" but adds the necessity requirement. Taking the amended Economic Partnership, Political Coordination and Cooperation Agreement between the EU and Mexico in 1995 for instance, its relevant part provides that:

> 1. Nothing in this Chapter shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: . . . .

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[45] *Argentina — Financial Services* Panel Report, *supra* note 5, ¶ 7.861.
[46] *See id.*
[47] Convention Establishing the European Free Trade Association, ch. X, art. 31(1), June 21, 2001 [hereinafter EFTA Convention], http://www.efta.int/sites/default/files/documents/legal-texts/efta-convention/Vaduz%20Convention%20Agreement.pdf (emphasis added).

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> 2. These measures shall not be more burdensome than necessary to achieve their aim, and shall not discriminate against financial service suppliers of the other Party in comparison to its own like financial service suppliers.[48]

The exact level of the nexus requirement under this provision is less than clear. It uses "for prudential reasons" in the first paragraph to describe the measures entitled to the prudential exception. That said, by adding the first sentence of the second paragraph, a measure entitled to the prudential exception needs to be not only "for prudential reasons" but also "not more burdensome than necessary" to achieve the claimed prudential reasons. In form, such a design preserves the use of "for prudential reasons," but in substance, it raises the required level of nexus to that similar to Model 3.1. Accordingly, I consider this sub-group featuring a "quasi-replacement effect."

Ten RTAs adopt this model, in which the EU and EFTA play an influential role. All these RTAs involve either the EU or the EFTA,[49] which suggests that the EU and EFTA consciously promoted the use of this model. That said, the EU and EFTA also fail to adopt this model in many RTAs: 9 out of 15 EU's RTAs[50] and 4 out of 9 EFTA's RTAs[51] do not adopt Model 3 (including Models 3.1 and 3.2). In addition, the EFTA itself seems to have slowed down the promotion; since 2011, it has stopped adopting Model 3: it signed four more RTAs since then but none of them adopted Model 3.

(c) Model 3.3: Featuring a Selective Supplement Effect — This sub-group is less ambitious. Instead of applying the necessity requirement on all prudential measures, it only applies the requirement to a narrow set of prudential measures. Taking the Economic Partnership Agreement between Japan and Thailand for instance, its relevant part provides that:

> Notwithstanding any other provisions of this Chapter, a Party shall not be prevented from taking:

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[48] Decision No. 2/2001 of the EU–Mexico Joint Council of 27 February 2001 Implementing Articles 6, 9, 12(2)(b) and 50 of the Economic Partnership, Political Coordination and Cooperation Agreement, ch. III, art. 19, 2001/153/EEC, 2001 O.J. (L 70) 7, 13 (EC) (emphasis added).

[49] They include EFTA–Mexico (2001), EU–Mexico (2002), EFTA–Singapore (2003), EFTA–Korea (2006), EU–Korea (2011), EFTA–Colombia (2011), EU–Colombia-Peru (2013), EU–Moldova (2014), EU–Georgia (2014), and EU–Colombia–Peru–Ecuador (2017).

[50] They include EU–Chile (2005), EU–Cariforum States (2008), EU–Macedonia (2009), EU–Albania (2009), EU–Montenegro (2010), EU–Serbia (2013), EU–Central America (2013), EU–Bosnia and Herzegovina (2016), and EU–Canada (2017).

[51] They include EFTA–Ukraine (2012), EFTA–Hong Kong (2012), EFTA–Central America (2014), and EFTA–Georgia (2017). It should be noted that these four RTAs all took place later than the other five EFTA's RTAs that adopt Model 3, which suggests that EFTA might be slowing down its pace in promoting the use of Model 3 in recent years.

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(a) Measures for prudential reasons, including for . . . ; or
(b) Measures to ensure the stability of the macroeconomy or the exchange rate.
Note: The measures referred to in subparagraph (b) above include measures relating to monetary policy or measures to deter speculative capital flows. Such measures shall be no more than necessary to meet the objectives of ensuring the stability of the macroeconomy or the exchange rate. Measures to ensure the stability of the macroeconomy or the exchange rate do not cover measures relating to promotion or protection of a particular sector.[52]

This design adopts a dual-track approach. Ordinary prudential measures still apply the "for prudential reason" standard. Only measures "to ensure the stability of the macroeconomy or the exchange rate" apply the necessity requirement. Such a dual-track design thus singles out the macroeconomic stability measures and exchange rate stability measures and applies a narrower exception in these cases. Later RTAs adopt this sub-group model mainly in cases involving exchange rate stability.[53]

Model 3.3 seems to be an East Asian phenomenon. Among the three RTAs that adopt this model, all the parties involved are economies in East Asia (including Oceania): Japan–Thailand in 2007, ASEAN–Australia–New Zealand in 2010, and Korea–Vietnam in 2016. These cases, however, seem to be rather sporadic. The economies involved here signed many other RTAs but did not adopt the same clause.[54] Moreover, these economies have not continued adopting this clause among themselves: Japan entered into an RTA with Vietnam in 2009, and Korea entered into an RTA with Australia

[52] Agreement Between Japan and the Kingdom of Thailand for an Economic Partnership, Japan-Thai., ch. 8, art. 109(1), Apr. 3, 2007, https://www.mofa.go.jp/region/asia-paci/thailand/epa0704/agreement.pdf (emphasis added).

[53] Two more RTAs adopt this model: Agreement Establishing the ASEAN–Australia–New Zealand Free Trade Area, Annex on Financial Services, art. 3(1)(b), Apr. 8, 2010, http://www.asean.org/storage/images/2013/economic/afta/AANZFTA/Agreement%20Establishing%20the%20AANZFTA.pdf (applying the necessity requirement to "measures to ensure the stability of the exchange rate" and further requiring these measures to be "phased out when conditions no longer justify their institution or maintenance") and Vietnam–Korea Free Trade Agreement, Viet.-S. Kor., Annex 8-A, ¶ 2(a)(ii), May 5, 2015 [hereinafter Vietnam–Korea FTA], http://wtocenter.vn/other-agreement/vkfta-full-content (similar to the above by providing that "for measures to ensure the stability of the exchange rate including to prevent speculative capital flows, such measures shall be no more than necessary, and shall be phased out within one year or when conditions no longer justify their institution or maintenance").

[54] For example, Japan had had four RTAs before the one with Thailand and nine RTAs after that, while Thailand had had two RTAs before that and one RTA after that, but none of these sixteen RTAs adopt Model 3.3. Similarly, Korea had had nine RTAs before the one with Vietnam, Australia had four RTAs before the one with ASEAN and New Zealand and four others after that, and New Zealand had had three RTAs before that and four RTAs after that, but none of them adopt Model 3.3.

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in 2014 and New Zealand in 2015, but none of these RTAs adopted Model 3.3.

4. Model 4: The "Relating to" Requirement — Instead of adopting the necessity requirement, which is more stringent, thirteen RTAs adopt the "relating to" requirement applied to a narrow range of measures. Taking the North America Free Trade Agreement (hereinafter "NAFTA") for instance, the relevant part provides that:

> 1. Nothing in this Part shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: . . . .
> 4. Notwithstanding . . . , a Party may prevent or limit transfers by a financial institution or cross-border financial services provider to, or for the benefit of, an affiliate of or person related to such institution or provider, 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 providers.[55]

This model again adopts a dual-track approach. Ordinary measures still apply the "for prudential reason" standard. Only measures that prevent or limit the cross-border affiliate transfers by financial service providers apply the "relating to" requirement, meaning that these measures must "relate to" the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers. It is further worth noting that this model appears to adopt an exhaustive list, rather than an open list, of eligible prudential reasons, which differs from the traditional provision.

Model 4 is most popular with Latin America. All the thirteen RTAs adopting this model involve a Latin American economy. Panama and Mexico are again the two most dedicated economies to this approach. 7 out of 11 of Panama's Prudential RTAs[56] and 4 out of 7 of Mexico's Prudential RTAs,[57] adopt this model. This finding suggests that Latin American developing economies have special concerns over affiliate transfer measures.

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[55] North American Free Trade Agreement, Can.-Mex.-U.S., art. 1410, Dec. 17, 1992 [hereinafter "NAFTA"], https://www.nafta-sec-alena.org/Home/Texts-of-the-Agreement/North-American-Free-Trade-Agreement (emphasis added).

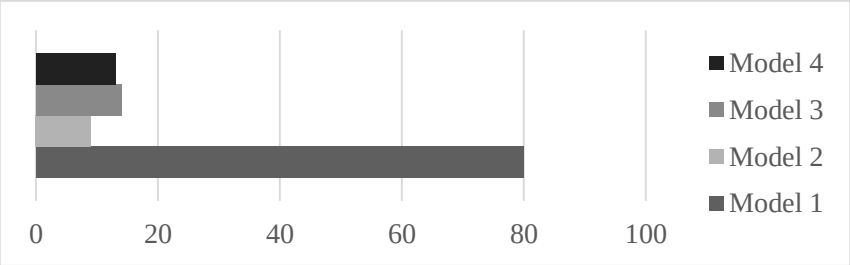
[56] The rest four that do not adopt this model are concluded with EFTA, Canada, the United States, and Singapore, respectively. It is likely that Panama failed to continue its practice because of the stronger negotiating power of the counterparties.

[57] The rest three that do not adopt this model are concluded with Japan, EU, and EFTA. It is likely that Mexico faced the same negotiating dilemma as Panama did.

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5. Summary — Chart 5 below reports the relative use of each model of nexus requirements. Among the 100 investigated RTAs, Model 1 has overwhelmingly dominated. Eighty RTAs adopt Model 1, including three RTAs which also adopt the necessity requirement and five RTAs which also adopt the "relating to" requirement in a narrow scope. That said, Models 2, 3, and 4 have also gained unneglectable support. More importantly, each model has its own group of faithful supporters: Latin American economies such as Panama and Mexico support Models 2 and 4 while European economies support Model 3.

CHART 5: The Relative Use of Each Model of Nexus Requirements



Two observations are worth highlighting. First, the economies unsatisfied with the traditional nexus requirement generally prefer a more stringent rule. All the non-traditional models adopted here, be it the "prudential measure" requirement, the "necessity" requirement, or the "relating to" requirement, impose a more stringent nexus requirement than the current "for prudential reasons" requirement. This suggests a general trend toward a narrower application scope of the prudential exception.

Second, compared to developing economies, developed economies appear to prefer an even more stringent rule. Among the non-traditional models, the necessity requirement (i.e. Model 3) is obviously more stringent than others. This model, as mentioned previously, has been mainly adopted by European economies which have been relatively more developed. In contrast, the less stringent non-traditional models, such as the "prudential measure" requirement or the "relating to" requirement, are mainly adopted by Latin American developing economies. This observation echoes the general impression that developed economies advocate more financial liberalization and prefer a narrowly applied prudential exception.

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C. The Models of Control Mechanisms

I examine the different models of control mechanisms, with five models standing out: (i) the traditional model featuring the anti-avoidance clause, (ii) the "reasonableness" control, (iii) the "disguised restriction" control, (iv) the "equitable and non-discriminatory" control, and (iv) no control.

1. Model 1: An Anti-avoidance Clause — Most RTAs have followed the GATS Financial Annex and adopted the anti-avoidance clause to control the abuse of the prudential exception. Taking the Chile-Thailand FTA for instance, its prudential exception provides that:

> Nothing in this Agreement shall prevent a Party from adopting or maintaining measures for prudential reasons, including for . . . . Where such measures do not conform with the provisions of this Chapter, they shall not be used as a means of avoiding the Party's commitments or obligations under this Chapter.[58]

2. Model 2: The Reasonableness Requirement — Plagued by the ambiguity of the anti-avoidance clause, seventeen RTAs have adopted the reasonableness standard which received considerable support during the negotiation of the GATS Financial Annex.[59] We can further divide these RTAs into three sub-groups.

(a) Model 2.1: Reasonableness Substitutes the Anti-avoidance Clause — Eight RTAs adopt the reasonableness standard to control the use of the prudential exception while setting aside the anti-avoidance clause altogether.[60] The most representative case is the Comprehensive Economic and Trade Agreement between EU and Canada (hereinafter "CETA"), which provides that:

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[58] Free Trade Agreement Between the Government of the Republic of Chile and the Government of the Kingdom of Thailand, Chile-Thai., ch. 10, art. 10.9, Oct. 4, 2013, https://www.direcon.gob.cl/wp-content/uploads/2015/11/FTA-Chile-Thailand-english.pdf (emphasis added).

[59] I classify the reasonableness standard as a control mechanism instead of a nexus requirement because the reasonableness requirement as applied here concerns less the relationship between the adopted measure and the claimed prudential reason. Instead, it examines whether a Member adopts a prudential measure, on the premise that such measure is for a prudential reason, in a reasonable instead of protectionist manner. In particular, it examines whether the inconsistent application of a prudential measure is in accordance with reason. To that extent, it serves the function of controlling the potential abuse of the prudential exception and is thus a control mechanism. For a related discussion, see Yang, *supra* note 4, at 905-07.

[60] They are Colombia–Mexico (1995), EFTA–Mexico (2001), EU–Mexico (2002), Peru–Mexico (2012), EFTA–Ukraine (2012), EFTA–Hong Kong (2012), CETA (2017), and EFTA–Georgia (2017).

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> 1. This Agreement does not prevent a Party from adopting or maintaining reasonable measures for prudential reasons, including: . . . .
> 2. Without prejudice to other means of prudential regulation of cross-border trade in financial services, a Party may require the registration of cross-border financial service suppliers of the other Party and of financial instruments.
> 3. Subject to Articles 13.3 and 13.4, a Party may, for prudential reasons, prohibit a particular financial service or activity. Such a prohibition shall not apply to all financial services or to a complete financial services sub-sector, such as banking.[61]

Note that this is a relatively straightforward reasonableness standard. Other than the word "reasonable" preceding to the term "measures for prudential reasons," no further provision acts as a control mechanism. This approach seems to be popular among European economies and Mexico: among the 8 RTAs that have adopted this model, six of them involve either the EU or the EFTA while 4 of them involve Mexico.

(b) Model 2.2: Reasonableness Parallels the Anti-avoidance Clause —Six other RTAs are less aggressive.[62] While adopting the reasonableness standard as a check, they also preserve the anti-avoidance clause. Consequently, this model subjects a prudential measure to two layers of scrutiny, i.e. a reasonableness test and an anti-avoidance test, which is logically more stringent. The representative case is the EFTA–Korea FTA, which provides that:

> Nothing in this Chapter shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, including for: . . . .
> Where such measures do not conform with the provisions of this Chapter, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions. Such measures shall not be more burdensome than necessary to

[61] Comprehensive Economic and Trade Agreement (CETA) Between Canada, of the One Part, and the European Union and Its Member States, of the Other Part, EU-Can., ch. 13, art. 13.16, Oct. 30, 2016 [hereinafter CETA], http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154329.pdf (emphasis added).

[62] They include E.U.–Chile FTA (2005), EFTA–Korea FTA (2006), EFTA–Central America FTA (2014), Hong Kong–Chile FTA (2014), Australia–China FTA (2016), and China–Georgia FTA (2018). Note that the last two RTAs also belong to the next group.

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achieve their aim.[63]

(c) Model 2.3: Reasonableness parallels other control mechanisms — Some RTAs have innovated control mechanisms other than the anti-avoidance clause or the reasonableness standard. Among them, seven RTAs attach the reasonableness requirement to these other control mechanisms.[64] Two of these seven RTAs even include three layers of control: an anti-avoidance clause, a reasonableness standard, and a new control method.[65] I will discuss these later.

3. Model 3: A Disguised Restriction Test — Some RTAs introduce another familiar control mechanism, that is, the "disguised restriction on trade" mechanism. Currently, five RTAs adopt this approach in parallel with other control mechanisms. One of them, the Malaysia–Australia FTA, couples it with the anti-avoidance clause, which provides that:

> 1. Notwithstanding any other provisions of this Agreement, a Party shall not be prevented from taking measures for prudential reasons, including for . . . Where such measures do not conform with the provisions of this Agreement, they shall not be used as a means of avoiding the Party's commitments or obligations under this Agreement.
> 2. These measures shall not constitute a means of arbitrary or unjustifiable discrimination against financial service suppliers or financial institutions of the other Party in comparison to its own like financial service suppliers or financial institutions, or a disguised restriction on trade in services.[66]

Two RTAs, the EFTA–Singapore FTA and the EFTA–Colombia FTA, couple it with the reasonableness requirement. The EFTA–Singapore FTA, for instance, provides that:

> 1. Nothing in Chapter III and its Annexes shall be construed to prevent a Party from adopting or maintaining reasonable

[63] Free Trade Agreement Between the EFTA States and the Republic of Korea, EFTA-S. Kor., ch. 4, art. 4.8(2), Dec. 15, 2005, http://www.efta.int/free-trade/free-trade-agreements/korea (emphasis added) [hereinafter EFTA–Korea FTA].

[64] These RTAs include Colombia–Mexico FTA (1995), NAFTA (1995), EFTA–Singapore FTA (2003), EFTA–Colombia FTA (2011), Peru–Mexico FTA (2012), Australia–China FTA (2016), and China–Georgia FTA (2018).

[65] These two RTAs are Australia–China FTA (2016), and China–Georgia FTA (2018).

[66] Malaysia–Australia Free Trade Agreement, Malay.-Austl., Annex on Financial Services, art. 5, May 22, 2012, https://dfat.gov.au/trade/agreements/in-force/mafta/Pages/malaysia-australia-fta.aspx (emphasis added).

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measures for prudential reasons, such as: . . .
2. These measures shall not be more burdensome than necessary to achieve their aim, and shall not constitute a means of arbitrary or unjustifiable discrimination against financial service suppliers of another Party in comparison to its own like financial service suppliers, or a disguised restriction on trade in services.[67]

The other two RTAs, the Australia–China FTA and China–Georgia FTA, even combine it with both the anti-avoidance clause and the reasonableness requirement, introducing a three-layer control. The Australia–China FTA, for instance, provides that:

1. Notwithstanding any other provisions of this Chapter, a Party shall not be prevented from adopting or maintaining reasonable measures for prudential reasons, including for: . . . .
2. Where such measures do not conform with the provisions of this Chapter, they shall not be used as a means of avoiding that Party's commitments or obligations under this Chapter. Such measures shall not constitute a disguised restriction on trade in services and shall not discriminate against financial services or financial service suppliers of the other Party in comparison to the Party's own like financial services or like financial service suppliers.[68]

4. Model 4: An Equitable and Non-discriminatory Test — Thirteen RTAs instead adopt the "equitable and nondiscriminatory" requirement as the control mechanism. Take the Taiwan–Panama FTA for instance, the relevant part provides that:

1. Nothing in this Chapter shall be construed to prevent a Party from adopting or maintaining prudential measures such as: . . . .
4. Notwithstanding Article 12.17(1), (2) and (3), a Party may prevent or limit transfers by a financial institution or cross-border financial service provider to, or for the benefit

[67] Agreement Between the EFTA States and Singapore, EFTA-Sing., annex VIII, art. 3, June 26, 2002, http://www.efta.int/free-trade/free-trade-agreements/singapore (emphasis added) [hereinafter EFTA–Singapore FTA].
[68] Free Trade Agreement Between the Government of Australia and the Government of the People's Republic of China, Austl.-China, annex 8, art. 3, June 17, 2015, https://dfat.gov.au/trade/agreements/in-force/chafta/Pages/australia-china-fta.aspx (emphasis added).

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> of, an affiliate of or person related to such institution or service provider, through the equitable, and non-discriminatory application of measures relating to maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers. This paragraph does not prejudice any other provision of this Agreement that permits a Party to restrict transfers.[69]

Two points are worth noting. First, this provision requires certain prudential measures to be applied in an "equitable and non-discriminatory" manner. This is a rather innovative way to design a control mechanism. That said, such "equitable and non-discriminatory" requirement is not without vagueness; specifically, it is unclear whether and how this standard differs from the above "disguised restriction to trade" control. Secondly, this provision does not contain other control mechanisms. Specifically, prudential measures that do not prevent or limit affiliate transfers are not subject to any further control.

Another leading case that adopts this equitable and non-discriminatory requirement is NAFTA.[70] NAFTA, however, differs in the above two points. First, in addition to the equitable and non-discriminatory requirements, NAFTA also requires prudential measures to be applied in a "good faith" manner. Secondly, unlike the Taiwan–Panama FTA, NAFTA maintains the reasonableness requirement to control all other prudential measures.

5. Model 5: No Control — The last model is relatively surprising. Ten RTAs do not adopt any control mechanism. They do not contain any anti-avoidance clause, reasonableness requirement, disguised restriction control, or equitable and non-discriminatory requirement. The most

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[69] Taiwan–Panama FTA, *supra* note 44, art. 12.09 (emphasis added).

[70] The relevant part of the NAFTA provides that:

> 1. Nothing in this Part shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: . . . .
> 4. Notwithstanding Article 1109(1), (2) and (3), as incorporated into this Chapter, and without limiting the applicability of Article 1109(4), as incorporated into this Chapter, a Party may prevent or limit transfers by a financial institution or cross-border financial services provider to, or for the benefit of, an affiliate of or person related to such institution or provider, 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 providers. This paragraph does not prejudice any other provision of this Agreement that permits a Party to restrict transfers.

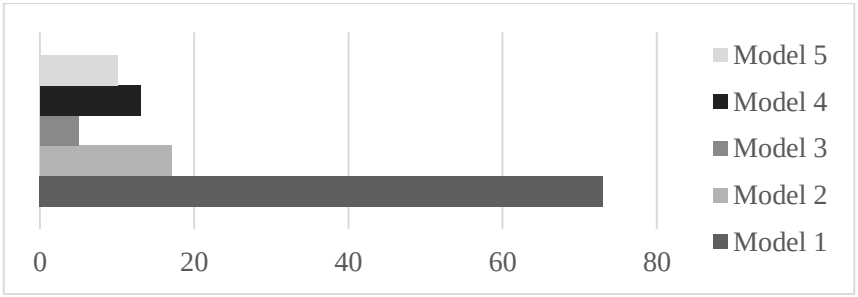
NAFTA, *supra* note 55, art. 1410 (emphasis added).

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representative case is the Japan–Mexico FTA, which provides that, "Notwithstanding the provisions of this Chapter, Chapter 7 and Chapter 8, a party shall not be prevented from adopting or maintaining measures for prudential reasons with respect to financial services, including for . . . ."[71] Under this provision, a measure can apply the prudential exception as long as it is for prudential reasons, and nothing further controls its use. This model leaves ample space for prudential measures.

6. Summary — Chart 6 below shows the relative use of each control mechanism model in the investigated RTAs, which reveals the following observations:

CHART 6: The Relative Use of Each Model of Control Mechanisms



(a) Model 1 Dominates — As the chart illustrates, Model 1, i.e. the traditional anti-avoidance clause, remains the mainstream. 73 out of 100 RTAs have contained an anti-avoidance clause. That said, 11 out of these 73 RTAs have also adopted other control mechanisms: four contain a reasonableness requirement, four contain an equitable and non-discriminatory requirement, one contains a disguised restriction control, and two contain a reasonableness requirement and a disguised restriction control. Therefore, in effect, only 62 out of 100 RTAs have full faith in the anti-avoidance clause and adopt it as the only control mechanism.

(b) Multiple Ways to Substitute Model 1 — The above investigation also reveals multiple designs for the control mechanism. 27 out of 100 RTAs have opted out of the anti-avoidance clause. Among them, six RTAs resort solely to the reasonableness requirement, six RTAs resort solely to the equitable and non-discriminatory requirement, six RTAs resort to both the reasonableness requirement and the disguised restriction control, three RTAs resort to both the reasonableness requirement and the equitable and non-discriminatory requirement, and eleven RTAs prefer not to set any

[71] Agreement Between Japan and the United Mexican States for the Strengthening of the Economic Partnership, Japan-Mex., art. 110, Sept. 17, 2004, https://www.mofa.go.jp/policy/economy/fta/mexico.html.

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control. Other than the above, ten RTAs maintain the anti-avoidance clause but couple it with other clauses. These results reveal the following observations.

Firstly, the reasonableness requirement remains the major competitor to the anti-avoidance clause. As Chart 4 illustrates, seventeen RTAs have contained the reasonableness requirement, which is the second most used control mechanism. The EU and EFTA, again, play an influential role in the popularity of the reasonableness requirement: 11 out of 17 of these RTAs involve either the EU or the EFTA. This finding is less surprising considering that EC proposed the reasonableness requirement during the negotiation of the GATS Financial Annex.

Secondly, in addition to the reasonableness requirement, the equitable and non-discriminatory requirement is also unneglectable. Thirteen RTAs contain it, making it the third most used control mechanism. Latin American economies, especially Panama and Mexico, play an influential role here considering that all these RTAs involve Latin American economies. In addition, since this equitable and non-discriminatory requirement only applies to prudential measures that prevent or limit affiliate transfers, it suggests again that Latin American developing economies have special concerns over affiliate transfer measures.

Thirdly, the finding suggests an observed tendency toward using multiple control mechanisms at once. 16 out of 100 RTAs contain more than one control mechanism. Among them, four RTAs combine the anti-avoidance clause with the reasonableness requirement,[72] four RTAs combine the anti-avoidance clause with the equitable and non-discriminatory requirement,[73] two RTAs combine the reasonableness requirement with the disguised restriction clause,[74] three RTAs combine the reasonableness requirement with the equitable and non-discriminatory requirement,[75] one RTA combines the anti-avoidance provision with the disguised restriction clause,[76] and two RTAs further combine the anti-avoidance clause, the reasonableness requirement, and the disguised restriction clause.[77] Moreover, both developed and developing economies are parties to these RTAs. This finding suggests that many economies prefer

[72] These include EU–Chile FTA (2005), EFTA–Korea FTA (2006), EFTA–Central America FTA (2014) and Hong Kong–Chile FTA (2014).
[73] These include the Costa Rica–Colombia FTA (2016), the Pacific Alliance (2016), the Panama–Peru FTA (2012), and Dominican Republic–Central America FTA (2001).
[74] These include the Peru–Mexico FTA (2012) and NAFTA (1995).
[75] These include the EFTA–Singapore FTA (2013) and the EFTA–Colombia FTA (2011).
[76] This is the Malaysia–Australia FTA (2013).
[77] These include Australia–China FTA (2016) and China–Georgia FTA (2018).

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to impose more control over the use of the prudential exception, which means more financial liberalization.[78]

Last but not the least, the finding also suggests that there is also an observed tendency toward the extreme of having no control mechanism. 10 out of 100 RTAs do not put in place any control mechanism whatsoever. To be sure, five of these RTAs, all involving the EU or EFTA, adopt other special obligations to discipline prudential measures, which will be introduced later.[79] That said, the other five RTAs do not incorporate other disciplines at all. Among them, China, Hong Kong, and Macao play an influential role here since they adopt this no control model in the FTA between each other, which contributes to three such RTAs.[80]

D. Other Variations

In addition to altering the nexus requirement and the control mechanism of the prudential exception, many RTAs introduce different ways to impose or relax regulations upon prudential measures. Below I summarize the five major variations as found in the RTAs.

1. Variation 1: Adding the Most-Favoured-Nation Requirement — Two RTAs have introduced the most-favoured-nation (hereinafter "MFN") requirement to discipline prudential measures.[81] These include the Vietnam–Korea FTA and the ASEAN–Australia–New Zealand FTA. Taking the former for instance, the relevant part of the Vietnam–Korea FTA provides that:

> Notwithstanding any other provision of this Agreement, a Party shall not be prevented from taking measures for prudential reasons, including for . . . .
> (iii) for measures to ensure the stability of the exchange rate including to prevent speculative capital flows, such measures shall be applied on a Most-Favored-Nation basis.[82]

[78] China is worth flagged out. It is involved in two of these RTAs, which is not a huge number. What is impressive, however, is that both of China's RTAs impose three layers of controls, suggesting China's inclination toward controlling the abusive use of the prudential exception.

[79] These include the EFTA (2002), EU–Colombia-Peru FTA (2013), EU–Moldova FTA (2014), EU–Georgia (2014), and EU–Colombia–Peru–Ecuador FTA (2017). While they do not adopt any control mechanism, they do impose the necessity requirement as well as national treatment obligation upon prudential measures.

[80] The other two such RTAs are the Japan–Mexico FTA (2005) and the EU–Cariforum States EPA (2008).

[81] In a broader sense, one can also consider the MFN requirement here as a special control mechanism that identifies a specific type of the abuse of the prudential exception. To avoid complicating the comparison of different control mechanisms, I single out the MFN requirement and discuss it separately in the section of Other Variations.

[82] Vietnam–Korea FTA, *supra* note 53, annex 8-A, ¶ 2(a) (emphasis added).

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Two points are worth highlighting here. First, the MFN requirement here differs with the traditional MFN obligation under GATS Article II. Traditional MFN obligations are subject to the prudential exception. The MFN requirement here, however, seems to form an outer boundary of the prudential exception, that is, a measure cannot be justified through the prudential exception if the measure is not applied on an MFN basis. Secondly, the MFN requirement does not apply to all financial measures. Rather, the provision limits it to a narrow scope, i.e. measures "to ensure the stability of exchange rate." This suggests that these economies are particularly concerned about exchange rate stability measures and prefer to restrict them more.

2. Variation 2: Adding a National Treatment Requirement — Twelve RTAs have instead introduced a national treatment (hereinafter "NT") requirement to discipline prudential measures.[83] The EU and EFTA contribute to the popularity of this variation: 9 out of 12 these RTAs involve either the EU or the EFTA.[84] Take the EFTA–Mexico FTA, for instance, the relevant part provides that,

> 1. Nothing in this Section shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: . . . .
> 2. These measures shall not be more burdensome than necessary to achieve their aim, and shall not discriminate against financial service suppliers of another Party in comparison to its own like financial service suppliers.[85]

Similar to the above MFN requirement, the NT requirement here differs with the NT obligation under GATS Article XVII in that it seems to form the outer boundary of the prudential exception. Unlike the above MFN requirement which is applied to a limited set of measures, however, the NT requirement here applies to all prudential measures. This echoes the general impression that developed economies prefer to restrict the use of the prudential exception.

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[83] In a broader sense, one can also consider the NT requirement here as a special control mechanism that identifies a specific type of the abuse of the prudential exception. To avoid complicating the comparison of different control mechanisms, I single out the NT requirement and discuss it separately in the section of Other Variations.

[84] The rest three are China–Georgia FTA (2018), Australia–China FTA (2016), and Malaysia–Australia FTA (2013).

[85] Free Trade Agreements between the EFTA States and the United Mexican States, EFTA-Mex., Sec. 3, art. 36, Nov. 27, 2000, http://www.efta.int/free-trade/free-trade-agreements/mexico (emph asis added).

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3. Variation 3: Incorporating International Best Practices — Three RTAs have turned to international best practices to discipline prudential measures.[86] They all involve at least a developed party to the RTA.[87] All of them focus on the best banking practices prepared by the Basel Committee, best insurance practices prepared by the International Association of Insurance Supervisors (IAIS), and best securities practices prepared by the International Organisation of Securities Commissions (hereinafter "IOSCO"). One RTA, the Japan–Switzerland FTA, even refers to the best practices prepared by the Organization for Economic Cooperation and Development ("OECD"). For instance:

> 1. Notwithstanding any other provisions of Chapter 6, including any of its Annexes, a Party shall not be prevented from adopting or maintaining measures for prudential reasons, including for: . . . .
> Where such measures do not conform with the provisions of Chapter 6, they shall not be used as a means of avoiding the Party's obligations under that Chapter. The Parties confirm that they are required under the Organization for Economic Cooperation and Development to implement the Code of Liberalisation of Current Invisible Operations.
> 2. Each Party shall make its best endeavours to ensure that the Basel Committee's "Core Principles for Effective Banking Supervision", the standards and principles of the International Association of Insurance Supervisors and the International Organisation of Securities Commissions' "Objectives and Principles of Securities Regulation" are implemented and applied in its Area.[88]

Notably, the wording contained in these provisions, especially Paragraph 2, is relatively soft. Paragraph 2 only imposes a *best effort* obligation upon the parties to observe the best practices of the Basel Committee, IASA, and IOSCO. That said, the incorporation of many international best practices at least builds a bridge between the prudential exception and other international financial laws. This finding also echoes

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[86] In a broader sense, one can also consider the international best practice requirement here as a special nexus requirement that identifies a specific way for the adopting Member to ensure that its measure is for prudential reasons. To avoid complicating the comparison of different nexus requirements, I single out the international best practice requirement and discuss it separately in the section of Other Variations.

[87] These are EFTA–Singapore FTA (2003), Japan–Switzerland FTA (2009), and EFTA–Colombia FTA (2011).

[88] Japan–Switzerland Economic Partnership Agreement, Japan-Switz., annex 6, art. VI, Feb. 19, 2009, https://www.mofa.go.jp/policy/economy/fta/switzerland.html (emphasis added).

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the general impression that developed economies prefer to introduce other international best practices to discipline the use of the prudential exception.

4. Variation 4: Escorting Some Prudential Measures — Fearing that the restriction under the prudential exception might prevent the adoption of some crucial prudential measures, sixteen RTAs have adopted explicit provisions to escort some prudential measures. Specifically, these RTAs aim to escort the prudential measures related to "monetary and related credit policies or exchange rate policies."[89] Taking the NAFTA for instance, the relevant part provides that "[n]othing in this Part applies to *non-discriminatory measures of general application* taken by any public entity *in pursuit of monetary and related credit policies or exchange rate policies*."[90] Under this provision, any measure that is non-discriminatory and pursues monetary and related credit policies or exchange rate policies are automatically permitted, which means that they do not need to apply the prudential exception.

Latin America is the major promoter of this variation. Among the 16 RTAs adopting this variation, thirteen of them involve a Latin American economy.[91] Panama takes part in seven of them, Mexico takes part in 4 of them, Costa Rica, Peru, and Colombia also take part in 3 of them. This finding also echoes the general impression that developing economies prefer to maintain discretion in adopting monetary and related credit measures and exchange rate measures.

5. Variation 5: Ensuring Some Minimum Level of Financial Liberalization — Last but not least, to impose adequate discipline on prudential measures, nine RTAs have drawn some red lines to set restricted areas for the prudential exception.[92] The most common restricted area relates to the registration of cross-border financial service suppliers: all nine RTAs have contained this clause which reads that "[w]ithout prejudice to other means of prudential regulation of cross-border trade in financial services, a Party may require the registration of cross-border financial service suppliers of the other Party and of financial instruments."[93] Under this provision, cross-border financial service suppliers or financial instruments have the right to be registered in other economies. Although

[89] To clarify, the nature of this special carve-out is more than a nexus requirement or a control mechanism. It is more a carve-out provision to the prudential exception, which identifies a specific group of measures, that is, monetary, credit, and exchange rate measures, and carves them out from the examination scope of the prudential exception.

[90] NAFTA, *supra* note 55, art. 1410(2) (emphasis added).

[91] The rest three RTAs, on the other hand, relate to China, Hong Kong, and Macao: their RTA with each other all contain this variation.

[92] They are Dominican Republic–Central America (2001), EU–Korea FTA (2011), Panama–Peru (2012), EU–Colombia–Peru FTA (2013), Pacific Alliance (2016), Costa Rica–Colombia (2016), Korea–Vietnam FTA (2016), EU–Columbia–Peru–Ecuador FTA (2017), and EU–Canada FTA (2017).

[93] *See, e.g.*, CETA, *supra* note 61, art. 13.16(2) (emphasis added).

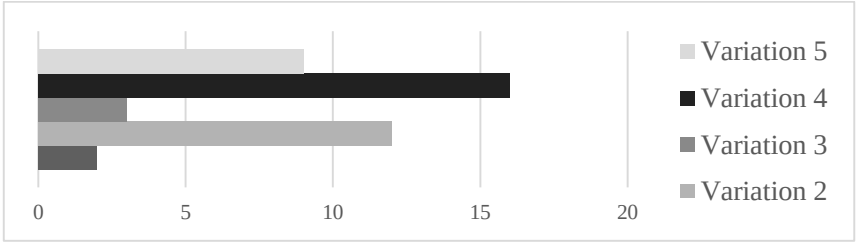
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such a right is subject to other means of prudential regulation, which means that the host member remains entitled to refuse the registration for prudential reasons, but the host member may not deny registration of financial service suppliers or financial instruments from other economies in the absence of prudential reasons. This, at least, declares the willingness of the parties to limit their discretion in refusing the registration of cross-border financial activities.

In addition to the above, CETA also contains another restricted area related to sectoral prohibition. It provides that, "subject to Articles 13.3 and 13.4, a Party may, for prudential reasons, prohibit a particular financial service or activity. Such a prohibition shall not apply to all financial services or to a complete financial services sub-sector, such as banking."[94] Under this provision, an economy may prohibit certain financial services or activities due to prudential concerns, but such a prohibition cannot be a complete prohibition of all financial services or a sub-sectoral prohibition. In other words, prudential concerns cannot justify a complete or sub-sectoral prohibition.

6. Summary — In sum, 32 of the 100 Prudential RTAs have adopted at least a variation of the traditional provision. Chart 7 below details the relative use of each variation. Variation 4 is the most popular due to its wide use by Latin American economies as well as China. Variation 2 is the second most popular due to its usage by the EU and EFTA. Variation 5 is the third most popular due to its partial support from European and Latin American economies.

CHART 7: The Relative Use of Each Variation



E. Summary

In sum, the investigation demonstrates that although the majority RTAs maintain the traditional prudential exception, a significant number of RTAs have developed non-traditional provisions that supplement or even replace the traditional one. Specifically, these non-traditional provisions adopt

[94] *Id.* art. 13.16(3) (emphasis added).

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changes in the nexus requirement, the control mechanism, or other areas, which provide a variety of models of prudential exceptions for policymakers to take reference from to balance financial liberalization and the need of prudential regulation.

IV. LESSONS FROM THE BILATERAL OBSERVATIONS

A. Exploring a Variety of Possible Models

As summarized previously, 44 of 100 invested RTAs have adopted non-traditional prudential exceptions. This, in turn, results in three additional models of the nexus requirement, four additional control mechanism models, and five additional special variations. This finding provides policymakers with rich resources to reflect on when designing the prudential exception.

This finding can be even more inspiring if we note the complementarity between each element of a prudential exception. The EFTA's experience, for instance, may provide an inspiring insight. As mentioned previously, all of the EFTA's nine RTAs have adopted non-traditional provisions. The content of these RTAs, however, varies over time, resulting in the following phases of evolution.

1. A Liberalized Stance in 2002 — The EFTA itself, which entered into effect in 2002, imposes a necessity requirement and an additional NT obligation on prudential measures while maintaining no control mechanism.[95] This provision adopts a narrower application scope, and it controls abuse by substantiating the abstract anti-avoidance clause into specific NT obligations. In general, it restricts the use of the prudential exception and adopts a liberalized stance.

2. An Extremely Liberalized Stance in 2003 — The EFTA went further to restrict the use of the prudential exception in its FTA with Singapore in 2003. In addition to the necessity requirement and the NT obligation, the prudential exception thereunder further includes the reasonableness and disguised restriction controls as well as the best effort obligation to implement international best practices.[96] These clauses render the prudential exception of the EFTA–Singapore FTA extremely restrictive, which is understandable considering that the EFTA and Singapore are both financially liberalized.[97]

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[95] EFTA Convention, *supra* note 47.

[96] EFTA–Singapore FTA, *supra* note 67, annex VIII, art. 3.

[97] EFTA adopted this extremely liberalized stance again with Colombia in 2011. Free Trade Agreement Between the Republic of Colombia and the EFTA States, Colom.-EFTA, annex XVI, art. 6, Nov. 25, 2008 [hereinafter Colombia–EFTA FTA], http://www.efta.int/free-trade/free-trade-a

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3. A Mildly Liberalized Stance in 2006 — The EFTA lifted many of the above restrictions three years later when it concluded an FTA with Korea in 2006. The prudential exception thereunder sets aside many of the above restrictions, preserving only the necessity requirement and the reasonableness control; it also retrieves the anti-avoidance clause.[98] To the extent that it sets aside the NT obligation, it is less liberalized than the previous two versions. That said, to the extent that both the necessity requirement and the dual controls are restrictive, this provision still adopts a relatively liberalized stance.

4. A Neutral Stance Since 2012 — After the Global Financial Crisis, surprisingly, the EFTA returned to the extremely liberalized stance in 2011 when concluding an FTA with Colombia.[99] But after that, the EFTA changed its approach and largely relaxed the restrictions, especially by setting aside the necessity requirement. In two FTAs concluded in 2012, one with Ukraine and the other with Hong Kong, the EFTA returned to the "for prudential reason" standard and controlled the use of prudential exceptions by the reasonableness requirement.[100] It also followed this model in its FTA with Georgia in 2017.[101] This huge shift might result from the fact that the idea of financial liberalization has become less popular after the Global Financial Crisis.

5. A Slightly Liberalized Stance in 2014 — Finally, in the EFTA's FTA with Central America in 2014, the prudential exception thereunder followed the above neutral stance except that it also incorporated the anti-avoidance control.[102] This provision, in effect, is slightly more restrictive to the extent that it adopts dual controls. That said, it remains less liberalized than the provisions used before the Global Financial Crisis.

From this timeline, one can observe various ways of designing a prudential exception. In general, the EFTA favors financial liberalization, but it also adjusts the degree of liberalization over time. Specifically, the EFTA gradually sets aside its insistence on the necessity requirement and

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greements/colombia. This is more surprising considering that it took place after the Global Financial Crisis, an era when financial liberalization was less favourable, and the party involved was a developing economy, *i.e.*, Colombia.

[98] EFTA–Korea FTA, *supra* note 63, art. 4.8.

[99] Colombia–EFTA FTA , *supra* note 97.

[100] Free Trade Agreement Between the EFTA States and Ukraine, EFTA-Ukr., art. 4.8, June 24, 2010, http://www.efta.int/free-trade/free-trade-agreements/ukraine; Free Trade Agreement Between the EFTA States and Hong Kong, China, EFTA-H.K., art. 4.6, June 21, 2011, http://www.efta.int/free-trade/free-trade-agreements/hong-kong.

[101] Free Trade Agreement Between the EFTA States and Georgia, EFTA-Geor., art. 6.6, June 27, 2016, http://www.efta.int/free-trade/free-trade-agreements/georgia.

[102] Agreement Between the States of the European Free Trade Association (Iceland, Liechtenstein, Norway and Switzerland) and the Central American States, annex VII, art. 5, June 24, 2013, http://www.efta.int/free-trade/free-trade-agreements/central-american-states.

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the NT obligation and shifts its focus to the control mechanism. This shift also echoes the change in global finance after the Global Financial Crisis.

B. Identifying the Trend of the Future Prudential Exception

Based on the above findings, we can further map out the evolutionary trend of future prudential exceptions. I will first address the development in general cases, i.e. rules applicable to all prudential measures, and then address the development in special cases, i.e. rules applicable to specific prudential measures.

1. A General Trend Toward the More Restrictive Use of the Prudential Exception — In general, the above findings suggest a general trend toward the more restrictive use of the prudential exception in the past two decades. Developed economies, Europe being the most representative instance, clearly take this approach, but developing economies, Latin America being representative of this, also seem to be moving in this direction.

This trend is most clearly observable in the case of nexus requirements. 80 percent of the Prudential RTAs maintain the traditional provision, indicating that the majority is content with the traditional nexus requirement, *i.e.*, for prudential reasons. For the other cases adopting non-traditional provisions, all attempt to enhance the level of nexus requirement by adopting either a stringent necessity requirement (in the case of Europe)[103] or a slightly more stringent prudential measure requirement (in the case of Latin America).[104] It seems that both developed and developing economies agree that the current nexus requirement is either acceptable or too loose. In any case, it is clearly not too stringent.

This trend is less observable but is still visible in the case of control mechanisms. The major problem of the traditional anti-avoidance clause is that it is a rather unfamiliar concept in world trade law. In light of this concern, world economies, especially developed economies, seem to focus on *clarifying* the control mechanism. For instance, Europe took the lead in adopting the reasonableness requirement, a relatively familiar concept under world trade law,[105] to replace the anti-avoidance clause.[106] It further attempts to introduce the NT obligation[107] or international best practices[108] to discipline the use of the prudential exception. To the extent that these changes establish a clearer control mechanism, they help to strengthen the control over, thus discipline, the use of the prudential exception. Not to

[103] *See supra* Part III.B.3.
[104] *See supra* Part III.B.2.
[105] For a discussion of the concept of reasonableness under WTO laws, see Yang, *supra* note 4, at 906-07.
[106] *See supra* Part III.C.2.
[107] *See supra* Part III.D.2.
[108] *See supra* Part III.D.3.

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mention that, as mentioned above, many Prudential RTAs, involving both developed and developing economies, adopt multiple control mechanisms. This also suggests a trend toward an enhanced control over the use of prudential measures.

The caveat is that we also observe a reverse stance in sporadic cases. As mentioned previously,[109] in the case of control mechanisms, five Prudential RTAs do not maintain an effective control mechanism at all, which seemingly favor rather than restrict the use of the prudential exception. China, Hong Kong, and Macao play a major role here, but Japan, Mexico, EU, and the Cariforum States are also involved in these cases. That said, considering the limited number of economies taking this stance, it could merely be a ripple against the general trend toward more financial liberalization.

2. Some Partial Adjustments in Specific Prudential Measures — Despite the general trend toward liberalization, the above findings also exhibit some partial adjustments aimed at specific prudential measures. This illustrates the flexibility of the prudential exception in the bilateral context.

(a) Partial Adjustments in Favour of More Liberalization — Some partial adjustments pursue further liberalization. The most representative one involves the right of cross-border financial service suppliers and financial instruments to register. As mentioned previously,[110] nine RTAs, distributed among developed and developing economies, have endeavored to ensure that cross-border financial service suppliers and financial instruments are entitled to be registered. Some RTAs, such as CETA, further forbid the prohibition of a specific financial sector or sub-sector out of prudential concerns. This suggests that world economies while acknowledging the government's right to regulate out of prudential concerns, have also started to consider the right to register a fundamental right of cross-border financial service suppliers and financial instruments.

The other representative case involves prudential measures that prevent or limit affiliate transfers. As mentioned previously,[111] led by Latin American economies, thirteen RTAs have singled out the prudential measures that "prevent or limit transfers by a financial institution or cross-border financial service provider to, or for the benefit of, an affiliate of or person related to such institution or service provider" and required such measures to be "relating to maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers" and applied in an "equitable and non-discriminatory" manner. Considering that the prudential reasons here

[109] *See supra* Part III.C.5.
[110] *See supra* Part III.D.5.
[111] *See supra* Parts III.B.4. & III.C.4.

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are exhaustive, that the "relating to" requirement is slightly more stringent than the "for" requirement, and that the "equitable and non-discriminatory" is more expansive than the anti-avoidance clause, such a design is effectively more restrictive on affiliate transfer measures. This suggests that, on such prudential measures, developing economies appear more willing to take a liberalized stance.

(b) Partial Adjustments in Favour of More Right to Regulate — Some partial adjustments, in contrast, suggest a more reserved stance against liberalization. The most representative case involves monetary and related credit measures as well as exchange rate measures. As mentioned previously,[112] sixteen RTAs, led mainly by Latin American economies and supported by China, have made it clear that the prudential exception does not apply to measures pursuing monetary and related credit policies or exchange rate policies provided that such measures are non-discriminatory and generally applied. This suggests that a significant group of developing economies is concerned with monetary, credit, and exchange rate policies and prefers to preserve a rather independent space for their policymaking in this sphere.[113]

C. Summary

To sum up the above findings, prudential exceptions seem to be evolving toward a more restrictive use of the prudential exception and thus more liberalization. Such an evolution, however, is rather subtle when we examine the details. It should be cautioned that the desired level of liberalization is reducing after the Global Financial Crisis. The tension between financial liberalization and the domestic demand for prudential regulation has become more acute after the Global Financial Crisis exposed the vulnerability of the global financial system. Even the strongest advocate of financial liberalization, such as Europe, has started to adjust its stance. Therefore, policymakers who intend to pursue financial liberalization need to be more careful when pacing the way toward it.

In light of the bilateral experience in the last two decades, policymakers can consider the following approaches for balancing between the demand for financial liberalization and the demand for prudential

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[112] *See supra* Part III.D.4.

[113] A caveat is that some RTAs, to the contrary, have adopted more stringent disciplines on exchange rate measures. As mentioned previously, three RTAs (Japan–Thailand FTA in 2007, ASEAN–Australia–New Zealand FTA in 2010, and Korea–Vietnam FTA in 2016) have imposed the necessity requirement specifically on exchange rate measures and two of them (ASEAN–Australia-New Zealand FTA in 2010 and Korea–Vietnam FTA in 2016) have further imposed the MFN obligations specifically on exchange rate measures. All these RTAs involve East Asian economies, suggesting that East Asia may be a region that has a special perception of exchange rate measures.

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regulation. At the general level, enhancing the nexus requirement, while clarifying rather than enhancing the control mechanism, seems to be a more acceptable approach. If adopting a general revision is less feasible, policymakers may instead consider adopting some partial adjustments aimed at specific prudential measures. For instance, they may identify the right to register cross-border activities and the restriction of affiliate transfer measures as the priority. In contrast, monetary, credit, and exchange rate measures seem to be more sensitive, especially to developing economies. Liberalization in these areas may be, accordingly, in posteriority.

V. CONCLUSION

In international financial laws, the prudential exception plays an influential role in balancing the needs of financial liberalization and prudential regulation. The current GATS Prudential Exception, however, is less than satisfactory in performing this task. In this paper, I investigate the prudential exceptions contained in the reported RTAs and summarize its evolution in the bilateral setting. The investigation results are inspiring for policymakers not only because they exhibit a variety of models for designing a prudential exception but also because they reflect a general trend toward progressive liberalization as well as specific ways to pace it. International finance is complicated and thus requires a delicate balance of financial liberalization and prudential regulation. Pacing matters for reaching such balance!

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APPENDIX: The List of Prudential RTAs

	Party	Date	Nexus[114]	Control[115]	Variation[116]
1	China–Georgia	01-Jan-2018	==	=/=	V
2	Hong Kong, China–Macao, China	27-Oct-2017	==	=/=	V
3	EU–Canada	19-Sep-2017	==	=/=	V
4	Chile–Thailand	2-Sep-2017	==	==	X
5	EFTA–Georgia	29-Aug-2017	==	=/=	X
6	EU–Colombia and Peru–Accession of Ecuador	02-Mar-2017	=/=	=/=	V
7	Costa Rica–Colombia	01-Aug-2016	=/=	=/=	V
8	Japan–Mongolia	01-Jun-2016	==	==	X
9	Pacific Alliance	01-May-2016	=/=	=/=	V
10	Korea, Republic of–Viet Nam	02-Mar-2016	=/=	=/=	V
11	China– Korea, Republic of	01-Mar-2016	==	==	X
12	Australia–China	26-Jan-2016	==	=/=	V
13	EU–Bosnia and Herzegovina	12-Jan-2016	==	==	X
14	Korea, Republic of–New Zealand	21-Dec-2015	==	==	X
15	Gulf Cooperation Council (GCC)–Singapore	30-Jun-2015	==	==	X
16	Canada–Honduras	05-Feb-2015	==	==	X
17	Canada–Korea, Republic of	20-Jan-2015	==	==	X
18	Japan–Australia	12-Jan-2015	==	==	X
19	Korea, Republic of–Australia	22-Dec-2014	==	==	X
20	Eurasian Economic Union (EAEU)	12-Dec-2014	=/=	==	X
21	Hong Kong, China–Chile	15-Oct-2014	==	=/=	X
22	EFTA–Central America (Costa Rica and Panama)	19-Aug-2014	==	=/=	X

[114] == means that the RTA adopts the traditional nexus requirement (i.e. the "for prudential reason" requirement), while =/= means that the RTA adopts a non-traditional one.
[115] == means that the RTA adopts the traditional control mechanism (i.e. the anti-avoidance clause), while =/= means that the RTA adopts a non-traditional one.
[116] V means that the RTA contains a special provision while X means that the RTA does not contain a special provision.

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23	EU–Georgia	02-Jul-2014	=/=	=/=	V
24	EU–Moldova, Republic of	30-Jun-2014	=/=	=/=	V
25	Singapore–Taiwan	22-Apr-2014	==	==	X
26	EU–Serbia	20-Dec-2013	==	==	X
27	New Zealand–Taiwan	25-Nov-2013	==	==	X
28	Costa Rica–Singapore	16-Sep-2013	==	==	X
29	Malaysia–Australia	13-May-2013	==	=/=	V
30	Canada–Panama	10-Apr-2013	==	==	X
31	EU–Central America	26-Feb-2013	==	==	X
32	EU–Colombia and Peru	26-Feb-2013	=/=	=/=	V
33	United States–Panama	29-Oct-2012	==	==	X
34	EFTA–Hong Kong, China	27-Sep-2012	==	=/=	X
35	EFTA–Ukraine	18-Jun-2012	==	=/=	X
36	United States–Colombia	08-May-2012	==	==	X
37	Panama–Peru	01-May-2012	=/=	=/=	V
38	Korea, Republic of–United States	15-Mar-2012	==	==	X
39	Japan–Peru	24-Feb-2012	==	==	X
40	New Zealand–Malaysia	07-Feb-2012	==	==	X
41	Peru–Mexico	01-Feb-2012	=/=	=/=	V
42	Canada–Colombia	07-Oct-2011	==	==	X
43	India–Japan	14-Sep-2011	==	==	X
44	EFTA–Colombia	14-Sep-2011	=/=	=/=	V
45	Peru–Korea, Republic of	09-Aug-2011	==	==	X
46	EU–Korea, Republic of	07-Jul-2011	=/=	==	V
47	Hong Kong, China–New Zealand	03-Jan-2011	==	==	X
48	EU–Montenegro	18-Jun-2010	==	==	X
49	ASEAN–Australia–New Zealand	08-Apr-2010	=/=	==	X
50	Peru–China	03-Mar-2010	==	==	X
51	Panama–Nicaragua (Panama –Central America)	21-Nov-2009	=/=	=/=	V

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52	EU–The former Yugoslav Republic of Macedonia	02-Oct-2009	==	==	X
53	EU–Albania	07-Oct-2009	==	==	X
54	Japan–Viet Nam	01-Oct-2009	==	==	X
55	Japan–Switzerland	01-Sep-2009	==	==	V
56	Canada–Peru	31-Jul-2009	==	==	X
57	Panama–Taiwan	28-Jul-2009	=/=	=/=	V
58	Nicaragua–Taiwan	09-Jul-2009	==	==	X
59	Panama–Guatemala (Panama –Central America)	20-Jun-2009	=/=	=/=	V
60	China–New Zealand	21-Apr-2009	==	==	X
61	Australia–Chile	03-Mar-2009	==	==	X
62	United States–Peru	03-Feb-2009	==	==	X
63	United States–Oman	30-Jan-2009	==	==	X
64	Panama–Honduras (Panama–Central America)	09-Jan-2009	=/=	=/=	V
65	Japan–Philippines	11-Dec-2008	==	==	X
66	Panama–Costa Rica (Panama –Central America)	23-Nov-2008	=/=	=/=	V
67	EU–CARIFORUM States EPA	16-Oct-2008	==	=/=	X
68	Brunei Darussalam–Japan	31-Jul-2008	==	==	X
69	Japan–Indonesia	27-Jun-2008	==	==	X
70	Pakistan–Malaysia	19-Feb-2008	==	==	X
71	Japan–Thailand	25-Oct-2007	=/=	==	X
72	Chile–Japan	24-Aug-2007	==	==	X
73	India–Singapore	03-May-2007	==	==	X
74	Panama–Singapore	04-Apr-2007	==	==	X
75	United States–Bahrain	08-Sep-2006	==	==	X
76	EFTA–Korea, Republic of	23-Aug-2006	=/=	=/=	X
77	Japan–Malaysia	12-Jul-2006	==	==	X
78	Dominican Republic–Central America–United States Free Trade Agreement (CAFTA–DR)	17-Mar-2006	==	==	X
79	Korea, Republic of–Singapore	21-Feb-2006	==	==	X

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80	United States–Morocco	30-Dec-2005	==	==	X
81	Thailand–New Zealand	01-Dec-2005	==	==	X
82	EU–Chile	28-Oct-2005	==	=/=	X
83	Japan–Mexico	31-Mar-2005	==	=/=	X
84	Thailand–Australia	27-Dec-2004	==	==	X
85	United States–Australia	22-Dec-2004	==	==	X
86	China–Macao, China	27-Dec-2003	==	=/=	V
87	China–Hong Kong, China	27-Dec-2003	==	=/=	V
88	United States–Singapore	17-Dec-2003	==	==	X
89	United States–Chile	16-Dec-2003	==	==	X
90	Singapore–Australia	25-Sep-2003	==	==	X
91	Panama–El Salvador (Panama–Central America)	11-Apr-2003	=/=	=/=	V
92	EFTA–Singapore	14-Jan-2003	=/=	=/=	V
93	Japan–Singapore	08-Nov-2002	==	==	X
94	European Free Trade Association (EFTA)	15-Jul-2002	=/=	=/=	V
95	EU–Mexico	21-Jun-2002	=/=	=/=	V
96	Dominican Republic–Central America	04-Oct-2001	=/=	=/=	V
97	New Zealand–Singapore	04-Sep-2001	==	==	X
98	EFTA–Mexico	25-Jul-2001	=/=	=/=	V
99	North American Free Trade Agreement (NAFTA)	01-Mar-1995	=/=	=/=	V
100	Colombia–Mexico	01-Jan-1995	=/=	=/=	V

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