Financial Services International Trade Jurisprudence — Revisiting the Prudential Exception and its Implications for Indonesia

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Summary

Developments in financial services trade jurisprudence at the World Trade Organization (WTO) have begun to close the gaps in our understanding of financial services commitments under the General Agreement on Trade in Services. The relatively recent development may also encourage governments to bring financial services trade disputes since the so-called prudential exception for financial services commitments now has been considered by the Dispute Settlement Body for the first time. In that proceeding, the *carte blanche* interpretation of the prudential exception that some governments have previously subscribed to was roundly rejected and a “rational relationship” test was constructed. Because the first application of the rational relationship test for the prudential exception rejected a WTO member’s invocation of the prudential exception, the new “rational relationship” test appears to have real meaning. That meaning may have significant implications for several measures currently in force in Indonesia that restrict cross-border reinsurance access. When the new understanding of the prudential exception is applied to Indonesia’s reinsurance measures that are *prima facie* inconsistent with that country’s international commitments, it is evident that the rational relationship test could translate far beyond the particular circumstances of the initial dispute. Were Indonesia to attempt to justify discriminatory reinsurance trade measures by citing the prudential exception, it likely would fail to do so successfully under the new framework for examining the use of the prudential exception.

Introduction

Services trade jurisprudence, particularly with regard to financial services, has lagged behind other sectors, creating a situation in which it can be difficult to determine the exact bounds of a government’s financial services commitments. The dearth of jurisprudence in financial services trade law is closely linked to the very few trade disputes that have been brought to the World Trade Organization (WTO) dispute settlement body in accordance with the
For example, with the exception of *China – Electronic Payment Services*, the United States has never brought a dispute on financial services to the WTO. Furthermore, the United States has never challenged measures that other WTO members or free trade agreement (FTA) parties have sought to justify by the prudential exception to financial services commitments under the General Agreement on Trade in Services (GATS) or FTAs. Like the “chicken or the egg,” the scarcity of financial services cases has led to little jurisprudential development, which in turn may discourage WTO member governments from launching financial services cases. Governments may be unsure of what result a dispute would create, and what that result could mean for the latitude of domestic financial regulators to take measures for prudential reasons.

However, the outcome of a recent WTO dispute, *Argentina – Measures Relating to Trade in Goods and Services*, marked a step toward a thorough examination of key commitments and exceptions for financial services trade law, creating a clearer framework through which measures taken by governments can be examined for their consistency with their WTO commitments.

This paper will examine the Argentina dispute, and then use the jurisprudence from that dispute to consider whether measures taken by Indonesia that restrict reinsurance trade are inconsistent with Indonesia’s commitments, even if Indonesia were to invoke the exceptions available to it in its international trade commitments. By considering whether the jurisprudence developed in the Argentina dispute can be applied to the example or *prima facie* violative

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measures in Indonesia, this paper will demonstrate that the implications of the Argentina dispute extend beyond that particular dispute.

**Understanding key financial services trade commitments and exceptions**

The first international trade agreement to introduce binding financial services trade commitments was the *Free Trade Agreement Between Canada and the United States* (“U.S.-Canada FTA”), which entered into force on January 1, 1989. Chapter 17 of the agreement was devoted to financial services trade commitments between the two parties. As the first trade agreement to include such requirements, the financial services commitments have been described as “quite limited in that it essentially consisted in an exchange of specific market access concessions … and did not provide for a binding dispute settlement mechanism.”\(^3\) Reflecting trepidation in making international commitments in a sector that is tied to the overall stability of a national economy, the U.S.-Canada FTA commitments on financial services “were only cautious initial steps on the matter of trade in financial services.”\(^4\) The early 1990s saw the United States and other governments take additional steps toward the liberalization of trade in financial services, through the *North American Free Trade Agreement Between the Government of Canada, the Government of the United Mexican States and the Government of the United States of America*, better known as the North American Free Trade Agreement (“NAFTA”), and the GATS. The negotiation of NAFTA, which entered into force on January 1, 1994, and the GATS, which entered into force on January 1, 1995, overlapped, with the GATS going beyond the commitments in NAFTA. As Eric Laroux argues, “NAFTA confirmed that it was possible to

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\(^3\) Eric H. Leroux, *Trade in Financial Services under the World Trade Organization*, 36 J. World Trade 413 (2002), [hereinafter Leroux]

\(^4\) *Id.* at 413
subject the somewhat unique sector of financial services to trade-liberalizing principles such as national treatment and most-favoured nation (‘MFN’) treatment.” Laroux also said NAFTA “capitalized on the work that has already been done in the context of the Uruguay Round” from which the WTO and the GATS were created. In turn, the conclusion of the trilateral NAFTA positively influenced “the integration of the financial services into the WTO Agreement.”

The WTO multilateral rules on trade in financial services were codified in three linked legal instruments: the GATS itself, which sets out rules for all services sectors; the Annex on Financial Services (“Annex”); and the Understanding on Financial Services (“Understanding”). The Annex and Understanding complement or modify the GATS rules, reflecting the parties’ desire to treat financial services differently from other sectors with sector-specific rules and exceptions.

The definition of financial services under the GATS is broad, as is the case with insurance services. The Annex states that:

For the purposes of this Annex:

(a) A financial service is any service of a financial nature offered by a financial service supplier of a Member. Financial services include all insurance and insurance-related services, and all banking and other financial services (excluding insurance). Financial services include the following activities:

**Insurance and insurance-related services**

(i) Direct insurance (including co-insurance):

(A) life

(B) non-life

(ii) Reinsurance and retrocession;

(iii) Insurance intermediation, such as brokerage and agency;

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5 Id. at 414
6 Id. at 414
7 Id. at 414

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(iv) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.8

The three “core” commitments on financial services in the GATS that have been subject to recent WTO disputes are Article II “Most-Favoured Nation” (“MFN”)9, Article XVI “market access,”10 and Article XVII “national treatment.”11 The way in which these commitments are applied to measures taken by parties varies, giving the GATS a so-called “hybrid” nature.12 Under the GATS, a WTO member is bound by MFN in all measures affecting trade in services. There are, however, specific exemptions in the Annex on Article II Exemptions that a WTO member could negotiate at the time the GATS entered into force or upon its accession to the WTO. These exceptions were intended to be in place for only ten years.13 National treatment and market access commitments are treated differently, however. Measures affecting trade in services are subject to national treatment and market access obligations only if a member has taken specific commitments listed in that member’s Schedule of Specific Commitments (“Schedule”).14

Most-Favoured Nation

The MFN obligations of the GATS seek to ensure that a WTO member does not give preference to the service providers of a fellow WTO member over a third WTO member. As the WTO Secretariat states, MFN “amounts to a prohibition, in principle, of preferential treatment in trade.”

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9 GATS, Art. II
10 GATS, Art. XVI
11 GATS, Art. XVII
12 See Laroux, 415
13 GATS, Art. II (2)
14 See Laroux, 416
arrangements among groups of Members in individual sectors or of reciprocity provisions which confine access benefits to trading partners granting similar treatment.”\textsuperscript{15} Article II of the GATS states that:

> With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.\textsuperscript{16}

The key concepts of MFN that are tested in dispute settlement, as described in *Argentina – Measures Relating to Trade in Goods and Services*, are “treatment no less favourable” and “like services and services suppliers.”

**National Treatment**

National treatment creates an obligation that is somewhat similar to MFN, but is significantly different in that it imposes neutrality between the measures a member imposes on its domestic services and services suppliers and those of other WTO members. As the WTO Secretariat states, “A commitment to national treatment implies that the Member concerned does not operate discriminatory measures benefiting domestic services or service suppliers. The key requirement is not to modify, in law or in fact, the conditions of competition in favour of the Member’s own service industry.”\textsuperscript{17} In relevant part, GATS Article XVII states:

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers. [footnote omitted]
2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.


\textsuperscript{16} GATS, Art. II

\textsuperscript{17} World Trade Organization, *The General Agreement on Trade in Services (GATS): objectives, coverage and disciplines*, https://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm
3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.\(^{18}\)

Though the way in which a member takes on commitments on national treatment differs from MFN, where a commitment exists, the analysis of a measure’s consistency with national treatment will focus on the concepts of “treatment no less favourable” and “like services and services suppliers,” as is the case with MFN.

**Market access commitments**

Market access commitments in Article XVI are another key commitment for enabling financial services trade where a country has made commitments. As is the case with national treatment, market access commitments apply only when a member has made specific obligations in a particular services sector. As a result, many WTO members made limited or no financial services market access commitments. Article XVI states that a member “shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.”\(^{19}\) Article XVI states that a member’s laws or regulations may not include:

(a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
(b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
(c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
(d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
(e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and

\(^{18}\) GATS, Art. XVII

\(^{19}\) GATS, Art. VI(1)
(f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

Of significance to the Argentina dispute, the Understanding provides additional clarifications on the type of insurance services for which members can schedule cross-border insurance services commitments. Known as “Mode 1,” these clarifications are as follows:

**Cross-border Trade**

3. Each Member shall permit non-resident suppliers of financial services to supply, as a principal, through an intermediary or as an intermediary, and under terms and conditions that accord national treatment, the following services:

(a) insurance of risks relating to:

   (i) maritime shipping and commercial aviation and space launching and freight (including satellites), with such insurance to cover any or all of the following: the goods being transported, the vehicle transporting the goods and any liability arising therefrom; and

   (ii) goods in international transit;

(b) reinsurance and retrocession and the services auxiliary to insurance as referred to in subparagraph 5(a)(iv) of the Annex;

(c) provision and transfer of financial information and financial data processing as referred to in subparagraph 5(a)(xv) of the Annex and advisory and other auxiliary services, excluding intermediation, relating to banking and other financial services as referred to in subparagraph 5(a)(xvi) of the Annex.”

Importantly, the obligations created by the Understanding on cross-border insurance services include reinsurance. Reinsurance is a product that is often described as “insurance for insurance companies” because through a reinsurance contract an insurer “cedes” (passes on)

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certain risks that it insures to another insurance company, known as the reinsurer. Because a multitude of risks can frequently be created by a single cause in a geographic area (a severe natural disaster, for example), reinsurance has become an important tool to mitigate exposure to a particular event by spreading risk globally. As a result, reinsurance has an inherent role as a cross-border risk mitigation tool and reinsurance is one of the few types of financial services trade for which there are cross-border commitments in the GATS.

Dispute settlement

Under the DSU, when a member believes that the measure or measures maintained by another member are not consistent with its WTO commitments, it is to enter into consultations with the member it believes has violated its commitments. If the members fail to resolve the matter through consultation, then the establishment of a panel to make a decision on the dispute would be requested. If one of the members involved in the dispute wishes to do so, it can appeal issues of law and legal interpretations in the panel’s decision to the Appellate Body. If the panel (or the Appellate Body if there is an appeal) determines that a member is violating an obligation, it will recommend that the member come into compliance. If the violating member does not bring its measures into compliance with its commitments, it can lead to suspension of the benefits of WTO membership in another sector in what is known as “cross retaliation.” For example, if a WTO member fails to bring its measures into compliance with its services

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23 FIO Report, 28
24 GATS, Art. XXII(1),(2), and XXIII(1) and DSU, Art, 4
25 DSU, Art. 17(6)
26 DSU, Art. 19
obligations, another WTO member could be permitted to retaliate against parts of that member’s agricultural, manufacturing, or services sectors.27

**Key exceptions**

One oft-cited but rarely explained exception to WTO financial services commitments is included in the Annex under “Domestic Regulation”28 that has been dubbed the prudential exception, or more derisively, “the prudential carve out.” Paragraph 2(a) of the Annex states:

> 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.29

This financial services-specific exception reflects the need for governments to pursue legitimate policies for the prudential soundness of their financial sector, due to the important role the sector plays in national economies, and destructive role it can play if there is a financial market failure. Until the Argentina dispute, there had not been any cases at the WTO that covered the contours and limits of the prudential exception, and the exact meaning and scope of use of the prudential exception remained a topic of debate at the WTO Committee on Trade in Financial Services.30

Many scholars also attempted to clarify the scope of the prudential exception in the absence of jurisprudence from the WTO dispute settlement body (“DSB”),31 a fact that was excellently

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27 GATS Art XXIII(2) and DSU, Art. 22  
28 Annex, Art.2  
29 Annex, Art. 2(a)  
cataloged by Vu Nhu Thang in his 2007 paper “Applicability of GATS Prudential Exception to Insurance Services: Some Interpretive Issues.”32 Before the Argentina dispute, others noted that the prudential exception is “the most controversial clause of the GATS”33 and that because “of the lack of a definition to the substance of prudential regulation, monitoring compliance with GATS in financial services has proved difficult.”34 In fact, prior to the Argentina dispute’s consideration of the prudential exception, some felt that “[i]t is unlikely and unrealistic to presume that it will be brought to the dispute settlement system of the WTO for interpretation” due to reticence of financial regulators to challenge one another’s requirements.35

In the view of some industry representatives, before the Argentina dispute, the imprecise wording and absence of prior disputes regarding the prudential exception gave rise to widely diverging views of its scope,36 and a sense that governments may be abusing the exception to justify GATS-inconsistent regulations. Some trade policy experts have voiced concerns that the ambiguity around the prudential carveout shielded governments from challenges to protectionist measures that were inconsistent with their obligations under the GATS.37 For example, the Chinese government reportedly threatened that it would respond to any WTO legal challenge to its measures in insurance that accord favorable treatment to domestic insurance suppliers by

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32 Vu Nhu Thang, Applicability of GATS Prudential Exception to Insurance Services: Some Interpretive Issues, 4 Manchester J. Int’l Econ. L. 88, 93 (2007)
34 Ibid page 640
35 Ibid, page 640
invoking the GATS prudential carve-out. Some scholars have noted that “[i]t is possible that [WTO] members will abuse the prudential carve out to apply entry barriers that do not comply with the criteria of commitments.”

By comparison, the “General Exceptions” of the GATS provide more clarity about the limits of their applicability by subjecting it to a “necessity” requirement and other clearer delineations of applicability. Article XIV states that “[s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement” of measures necessary to protect public health, morals, safety, order, privacy, to prevent deceptive or fraudulent practices or to deal with the effects of a default on services contracts, or “necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement.” The “public order” exception is further limited by Footnote 5, which states, “The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.”

Furthermore, the WTO dispute settlement body determined that whether a measure is “necessary” for purposes of Article XIV requires a determination as to the reasonable availability of a less WTO-inconsistent measure.

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40 GATS Article XIV
41 GATS Article XIV
42 GATS Art XIV, Footnote 5
Developments in WTO “Jurisprudence”

The Argentina dispute was a watershed moment for WTO jurisprudence, explaining for the first time the contours around the prudential exception and building upon MFN and national treatment jurisprudence from *EC – Bananas* and *China – Electronic Payment Services*. While the arms of the WTO DSB are not required to follow precedence or “stare decisis” as is the case in U.S. courts, international trade law scholars agree – and the records of dispute decisions confirm – that prior WTO decisions influence the decisions taken in later disputes. In that regard, WTO rulings form a body of trade jurisprudence, though it is not a firm as in some national legal systems. As an Appellate Body has stated, there are “legitimate expectations” that “similar matters would be handled similarly.”

The initial complaint in the Argentina dispute was made by Panama on December 12, 2012, which was followed by consultations with Argentina per Article IV of the DSU. Subsequent consultations on February 5, 2013 failed to resolve the dispute, and a panel was established on June 25, 2013. The panel released its decision on September 30, 2015. This dispute concerned eight financial, taxation, foreign exchange, and registration measures imposed by Argentina, primarily on services and service suppliers from countries which Argentina considers to be tax havens, or “countries not cooperating for tax transparency purposes” (“non-cooperative countries”). Panama, which was determined by Argentina to be a “non-cooperative country” at the time it launched the dispute, challenged what it considered to be

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44 Japan- Taxes on Alcoholic Beverages, WT/DSB 8, 10 & 11/AB/R, pp. 12-14, Appellate Body Report adopted by the DSB on November 1, 1996  
47 Panel Report, 15
retaliatory measures applied to non-cooperative countries in Argentina’s Decree No. 589/2013. Importantly, for financial services trade jurisprudence, Measure 5 affected “trade in reinsurance and retrocession services” and Measure 6 impacted “trade in financial instruments.”

Specific to the requirements relating to reinsurance services (Measure 5), through insurance regulation SSN Resolution No. 35.615/2011 and subsequent regulations, Argentina permitted only foreign reinsurers from cooperative jurisdictions to provide reinsurance services on a cross-border basis or through a branch in Argentina without additional restrictions. Reinsurers from non-cooperating countries were permitted to operate in Argentina only if their national insurance supervisor agreed to share information and cooperate with the Argentine insurance regulator and agreed to meet certain anti-money laundering and anti-terrorism financing measures set forth by the Financial Action Task Force (FATF). Panama argued that the restriction on reinsurance services from non-cooperating countries was a violation of Argentina’s GATS Article II:1 MFN commitments because it altered the conditions of competition between reinsurance service suppliers of non-cooperating countries and those of cooperating countries.

Specific to the requirements for access to the Argentine capital market (Measure 6), Argentina required that stock market intermediaries from non-cooperating countries be regulated by a securities regulatory body in their home country that has functions similar to the Argentine National Securities Commission (“CNV”). It also required that the home-country securities regulator have a memorandum of understanding on cooperation and

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48 Panel Report, 17
49 Panel Report, 21-24
50 Panel Report, 215
exchange of information with the CNV.\(^{51}\) This requirement, found in SSN Resolution No. 35.615/2011, was not placed on stock market intermediaries from cooperating countries, and thus Panama argued that this measure was inconsistent with Argentina’s MFN obligations under GATS Article II:1 because it accorded less favorable treatment to stock market intermediaries from non-cooperating countries seeking access to the Argentine capital market than that accorded to like service suppliers of cooperating countries.

**MFN and National Treatment**

Panama had challenged all eight measures as inconsistent with MFN.\(^{52}\) Parts of the Panel’s findings on MFN and national treatment were appealed by both Argentina and Panama, so this paper will focus on the Appellate Body’s findings on both. Though Panama did not challenge either Measure 5 or 6 as inconsistent with Argentina’s national treatment commitments,\(^{53}\) the Appellate Body’s findings on national treatment for Measures 2, 3, and 4 could be instructive for future disputes related to financial services.

Key to both MFN and national treatment is the concept of “likeness,” which the Appellate Body tied to a competitive relationship between services and services providers. Both Article II:1 and Article XVII of the GATS concern treatment of “like services and service suppliers.” The Appellate Body began its analysis by recalling previous panel decisions concerning “likeness,” including those in *China – Electronic Payment Services*, which “held that Article XVII seeks to ensure equal competitive opportunities for like services of other Members, and that services are therefore ‘like’ when they are in a competitive relationship with

\(^{51}\) Panel Report, 21-24; SSN Resolution No. 35.615/2011


\(^{53}\) AB Report, para 6.9
each other” and measures that modify competitive conditions can be inconsistent with national treatment “only if the foreign and domestic services at issue are indeed in a competitive relationship.”

It stated, “In other words, if the services being compared are not in a competitive relationship, the conditions of competition cannot be affected.”

Though it used national treatment commitments to establish the competitive basis of “likeness,” the Appellate Body also saw it as applicable to MFN, stating that “also in the context of Article II of the GATS, the determination of ‘likeness’ of services and service suppliers must focus on the competitive relationship of the services and service suppliers at issue.”

It concluded, “notwithstanding their textual differences, both of these provisions are concerned with ‘prohibiting discriminatory measures’ and ensuring ‘equality of competitive opportunities’ between products that are in a competitive relationship.”

Also leaning on jurisprudence developed previously, the Appellate Body pointed out that “services providers” were like “to the extent that entities provide these like services” as was found in EC – Bananas III. However, the Appellate Body noted that in China – Electronic Payment Services the Panel considered that, “while this may be so in some cases, in other cases an inquiry into the likeness of service suppliers may be called for” beyond whether they provide “like services.”

Considering the earlier jurisprudence, the Appellate Body in this case established “how a panel should proceed in assessing the ‘likeness’ of services and service suppliers in the particular context of Article II:1 and Article XVII:1 of the GATS.”

The Appellate Body set forth two

54 AB Report, para 6.23; citing Panel Report, China – Electronic Payment Services, para. 7.700
55 AB Report para 6.23
56 AB Report para 6.24
57 AB Report para 6.24, citing Appellate Body Report, EC – Seal Products, para 5.82
60 AB Report, para 6.31
approaches for assessing the “likeness” of services and services providers: the origin-based “presumptive approach” and a factor-based “detailed approach.”

In conducting the factor-based “detailed approach,” the Appellate Body suggested an adapted analysis of “likeness” established in the context of the General Agreement on Tariffs and Trade (GATT).\(^{61}\) under which an Appellate Body employed four general criteria for analyzing “likeness” for goods: (i) the properties, nature, and quality of the products; (ii) the end-uses of the products; (iii) consumers’ tastes and habits or consumers’ perceptions and behaviour in respect of the products; and (iv) the tariff classification of the products.\(^{62}\) The criteria for assessing “likeness” for trade in goods can be used for assessing “likeness” for trade in services when “adapted as appropriate to account for the specific characteristics of trade in services,” the Appellate Body stated.\(^{63}\)

The origin-based “presumptive approach” allows for a presumed “likeness” where a measure differentiates between services and services suppliers \textit{exclusively} based on their country of origin. The Appellate Body wrote that “where a measure provides for a distinction based exclusively on origin, there will or can be services and service suppliers that are the same in all respects except for origin and, accordingly, ‘likeness’ can be presumed and the complainant is not required to establish ‘likeness’ on the basis of the relevant [four] criteria set out above” in the “detailed approach.”\(^{64}\) The “presumption approach” would make it significantly easier to establish the “likeness” or services or services suppliers, but the Appellate Body noted that in each analysis of “likeness” in a given dispute, “the scope of this presumption is more limited

\[^{61}\] AB Report, para 6.38
\[^{63}\] AB Report, para 6.31
\[^{64}\] AB Report, para 6.38
than in trade in goods.”\textsuperscript{65} It added, “Whether and to what extent such complexities have an impact on the determination of whether a distinction is based exclusively on origin in a particular case will depend on the nature, configuration, and operation of the measure at issue and the particular claims raised.”\textsuperscript{66} Furthermore, under the “presumption approach,” “in keeping with the general rule that the burden of proof rests upon the party that asserts the affirmative of a particular claim”\textsuperscript{67} the complainant “bears the burden of making a \textit{prima facie} case that a measure draws a distinction between services and service suppliers based exclusively on origin,”\textsuperscript{68} an argument that may be rebutted by the respondent.\textsuperscript{69}

Regarding the legal standard of “treatment no less favourable,” the Appellate Body again applied the same standard to both MFN and national treatment.\textsuperscript{70} Related to “likeness” being tied to whether services or services suppliers are in competition, the Appellate Body determined that “treatment no less favourable” has occurred where “the measure modifies the conditions of competition to the detriment of like services or service suppliers of any other Member.”\textsuperscript{71} Looking to prior disputes, the Appellate Body pointed out that “the fact that a measure modified the conditions of competition to the detriment of services or service suppliers of any other Member was, in itself, sufficient for a finding of less favourable treatment under Articles II:1 and XVII of the GATS.”\textsuperscript{72}

The Appellate Body not only affirmed the primary components of a MFN and national treatment analysis, it clarified aspects of their application in light of several competing

\begin{itemize}
\item[\textsuperscript{65}] AB Report, para 6.41
\item[\textsuperscript{66}] AB Report, para 6.41
\item[\textsuperscript{68}] AB Report, para 6.42
\item[\textsuperscript{69}] AB Report, para 6.44
\item[\textsuperscript{70}] AB Report, para 6.105
\item[\textsuperscript{71}] AB Report, para 6.111
\item[\textsuperscript{72}] AB Report, para 6.106
\end{itemize}
interpretations. The Panel had adopted an approach to member regulations that gave them broad
dereference to be inconsistent with their GATS commitments. The Appellate Body disagreed with
the Panel that the preamble of the GATS was intended to give a member more leeway in
adopting measures that are inconsistent with their commitments than what is provided in the
various exceptions. The preamble to the GATS references “national policy objectives,” stating
that, in at least one instance, that the members recognize “the right of Members to regulate, and
to introduce new regulations, on the supply of services within their territories in order to meet
national policy objectives.”

73 The Panel said the GATS does not enumerate the “national policy objectives” and that the “relatively few” exceptions do not reflect the entirety of the “national policy objectives” permitted under the GATS.74 The Appellate Body rejected the Panel’s view that the preamble creates an expansive set of exceptions. It agreed in part that “the scope of the ‘national policy objectives’ referred to in the preamble is broader than the objectives listed in the exceptions” and read the preamble to mean “[a]s long as Members comply with their GATS obligations and commitments, they are free to pursue national policy objectives that they consider appropriate.”

Departing from the Panel’s erroneous “regulatory aspects” approach, the Appellate Body
rejected an assertion that, in effect, a member could employ measures that change the conditions
of competition with another member in order to compensate for regulatory advantages of the
other member. The Panel adopted Argentina’s assertion that measures 2, 3, and 4 “are essential
tools for equalizing the conditions of competition on the international market for financial and
other services.” In supporting its position, the Panel pointed to documents from international

73 GATS preamble
74 AB Report, para 6.116
75 AB Report, para 6.117
organizations such as the G-20, the Global Forum, and the Organization for Economic Development and Cooperation (OECD) that show “support for Argentina’s statement concerning the importance of access to tax information for equalizing the conditions of competition.”\textsuperscript{76} In rejecting that view, the Appellate Body stated that “under Article XVII of the GATS, a measure either modifies the conditions of competition in the marketplace, thus according less favourable treatment, or it does not.”\textsuperscript{77} The Appellate Body saw the Panel as employing “a standard whereby certain regulatory aspects, as alleged by a Member in a particular dispute, could ‘convert’ a measure that accords less favourable treatment, and is therefore inconsistent with Article XVII of the GATS, into a measure that is GATS-consistent.”\textsuperscript{78} In the Appellate Body’s view, this interpretation veered too far from the text of the GATS.

The Appellate Body also clarified the meaning of “Footnote 10.” Footnote 10 states that commitments assumed under Article XVII:1 “shall not be construed to require any Member to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant services or service suppliers.”\textsuperscript{79} The United States, in a third-party submission, argued that “supplying a service on terms that tax authorities will not be able to verify […] is a disadvantage from the perspective of law-abiding Argentine customers and Panamanian suppliers that seek to comply with Argentine laws.”\textsuperscript{80} Thus, according to the United States, “Argentina would not be required to modify its tax measures to compensate for the competitive disadvantages of services or service suppliers resulting from the level of tax transparency of their

\textsuperscript{76} AB Report, para 6.138, citing Panel Report, para 7.509-7.513  
\textsuperscript{77} AB Report, para 6.139  
\textsuperscript{78} AB Report, para 6.139  
\textsuperscript{79} GATS Art.XVII(1) Footnote 10  
\textsuperscript{80} WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010, United States’ Third Participant’s Submission, para 48
home regulatory regimes.”81 The Appellate Body rejected this interpretation of footnote 10, arguing “[t]he ‘inherent competitive disadvantages’ under footnote 10 … must be distinguished from the measure’s impact on the conditions of competition in the marketplace.”82 It added that the “inherent competitive disadvantages” referenced in footnote 10 “do not include, and should not mask, the detrimental impact that is genuinely attributable to the contested measure.”83 For the Appellate Body, the disadvantages envisaged by the footnote must be inherent, and must not be caused by the measure in question that that affects trade in services.

Rebuking the Panel, the Appellate Body found that “the Panel employed an erroneous legal standard with regard to ‘treatment no less favourable.’”84 It continued, “In its analysis regarding the ‘regulatory aspects’, the Panel essentially relied on what it perceived to be the regulatory objective of Measures 2, 3, and 4 to convert ‘less favourable treatment’ under these measures into ‘treatment no less favourable’. The Panel’s approach finds no basis in the text or Article XVII, its context, or the object and purpose of the GATS.”85

The prudential exception86

The Argentina dispute was the first case in which the WTO dispute settlement body considered the prudential exception. Unlike the Panel’s finding on MFN and national treatment, the Panel’s analysis that sets forth the process and structure for examining a claim of the

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81 WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010, United States’ Third Participant’s Submission, paras 47-48
82 AB Report, para 6.104
83 AB Report, para 6.146
84 AB Report, para 6.147
85 AB Report, para 6.147
86 While this section of the paper will provide an overview of the differing views of Argentina and Panama as is necessary for understanding the decision reached by the Panel, the primary focus will be on the Panel’s decision rather than on the views of Argentina and Panama. The Panel Report succinctly describes the arguments of both governments regarding the meaning of the prudential exception.
prudential exception was not challenged to the Appellate Body, so the Panel’s decision on those matters is the only authoritative decision to date. As a defense, Argentina said that if the Panel were to find Measure 5 to be inconsistent with its MFN\(^{87}\) and market access commitments\(^{88}\) and Measure 6 to be inconsistent with its MFN commitments,\(^{89}\) the prudential exception under paragraph 2(a) of the Annex should absolve the measures.\(^{90}\) Argentina argued that paragraph 2(a) provides an exception for GATS-inconsistent measures that are taken for prudential or precautionary purposes, arguing an expansive concept of what constitutes a prudential purpose.\(^{91}\)

The Panel, in making its decision on the application of the prudential exception, noted in its report that “[i]t should be stressed that this is the first time that a Member has invoked [the prudential exception] in a WTO dispute,”\(^{92}\) adding “[i]t therefore falls to us to undertake the arduous task of interpreting it for the first time.”\(^{93}\) The Panel began its analysis by examining the wording of paragraph 2(a) of the Annex, confirming that it is an “exception” under the GATS.\(^{94}\) It being an exception, “the burden of proof lies with [respondent] Argentina, which must therefore demonstrate that its measures 5 and 6 are covered by that provision.”\(^{95}\) The Panel noted that, as a threshold matter, a measure in question must affect trade in services.\(^{96}\) It also concluded a member invoking the prudential exception “must demonstrate that two requirements have been met in order to avail itself of the exception, namely: (i) that the measure in question

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\(^{87}\) GATS Art. II(1)  
\(^{88}\) GATS Art. XVI(1) and Article XVI(2a)  
\(^{89}\) GATS Art. II(1)  
\(^{90}\) WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010, Argentina’s First Written Submission, para 551. See also Argentina’s response to Panel question No. 85(a); Panel report 188  
\(^{91}\) WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010, Argentina’s First Written Submission, para 553; Panel Report, 188  
\(^{92}\) Panel Report, 196  
\(^{93}\) Panel Report, 196  
\(^{94}\) Panel Report, 196  
\(^{95}\) Panel Report, 197  
\(^{96}\) Panel Report, 197
was taken for prudential reasons and (ii) that the measure is not being used as a means of
avoiding its commitments or obligations under the GATS,”97 it concluded.

The Panel then turned to the question of whether Measures 5 and 6 were taken for
prudential reasons, delineating the contours of the requirement. The Panel wrote, “The crux of
the matter is therefore what is meant by a measure taken ‘for prudential reasons.’”98 In starting
its analysis, the Panel addressed an issue raised by Panama regarding whether a measure in
question had to be a “prudential measure,” such as those defined by the Basel Committee on
Banking Supervision, or whether measures that might fall under the exception more broadly
could be “measures for prudential reasons.”99 Looking to the text of paragraph 2(a), the Panel
confirmed the latter, stating that “the exception makes it possible to exempt or exonerate any
measure affecting the supply of financial services that has been taken ‘for prudential
reasons.’”100 While the Panel gave wide latitude to governments to take measures for prudential
reasons, the motivation behind the measure is key to determining whether it legitimately was
taken for prudential reasons.

On the meaning of prudential reasons, the Panel examined the “ordinary meaning” of
equivalent terms in English, French, and Spanish, eventually understanding prudential reasons to
refer to “preventive or precautionary reasons,” which it found also was consistent with the non-
exclusive, illustrative list of the types of measures in paragraph 2(a) that could be taken for
prudential reasons.101 Furthermore, the Panel noted that the meaning of prudential reasons is
fluid, stating that “the meaning and importance that Members attach to these prudential reasons

97 Panel Report, 197
98 Panel Report, 205
99 Panel Report, 205
100 Panel Report, 205
101 Panel Report, 206
may vary over time, depending on different factors, including the perception of the risk prevailing at different points in time.” Suggesting a deferential and expansive view of prudential reasons, the Panel continued, “The nature and scope of financial regulation at different times reflect the knowledge, experience and scales of values of governments at the moment in question. We therefore consider that WTO Members should have sufficient freedom to define the prudential reasons that underpin their measures, in accordance with their own scales of values.”¹⁰² The panel also asserted the “evolutionary nature” of the concept of prudential reasons is in keeping with the views expressed by other WTO members through third-party submissions, as well as the views of other international organizations such as the G-20.¹⁰³ Considering the broad, expansive, and evolutionary view expressed by the Panel in its report until that point, a reader could be forgiven for expecting that the Panel was on track to give governments a near carte blanche for inconsistent financial regulatory measures.

Then, however, the Panel considered the question “of when a measure is taken ‘for’ prudential reasons.”¹⁰⁴ Given their positions in the dispute, Argentina asked for a broader reading than Panama, arguing that “a measure taken ‘for prudential reasons’ is a measure intended to avoid an outcome that conflicts with an objective established or envisaged by the corresponding [national] authority, which may have adverse or pernicious consequences for the rights protected by that authority.” Argentina also argued exception requires a “rational relationship” between the measure and its prudential objective.¹⁰⁵ Panama argued that the measure must have been taken for a “specific cause or reason” and that “it is the prudential

¹⁰² Panel Report, 207
¹⁰³ Panel Report, 208
¹⁰⁴ Panel Report, 209
¹⁰⁵ Panel Report, 209; WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010 Argentina’s Second Written Submission, para 79, and responses to Panel questions No. 53 and 87 and Argentina’s First Written Submission, para 560
nature of the measure taken by the respondent that should be subjected to the closest scrutiny by a panel in this phase of the examination.”  

Panama contended the Panel “should examine whether there is a real risk of imminent injury if that measure is not adopted or its adoption is delayed.”

In making its decision, the Panel noted that “[c]arrying out an appropriate examination to determine whether a measure has been taken for prudential reasons is no easy task.” Comparing the prudential exception to the general exceptions of Article XIV of the GATS and Article XX of the GATT 1994, the Panel noted that the prudential exception does not require that a measure be “necessary” as the general exceptions require, ruling out the application of a “necessity test.” Turning again to an examination “on the basis of the ordinary meaning of its terms, in their context, while taking into account the object and purpose of the GATS,” the Panel rejected Panama’s focus on examining the prudential reason as “transitional, provisional or short term,” instead utilizing the “rational relationship” idea put forth by Argentina. The Panel stated:

[i]t seems to us that the use of the word ‘for’ in the phrase ‘measures for prudential reasons’ denotes a rational relationship of cause and effect between the measure and the prudential reason. Thus, the Member taking the measure in question must demonstrate that in its design, structure or architecture there is a rational relationship of cause and effect between the measure it seeks to justify under paragraph 2(a) and the prudential reason provided.”

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106 Panel Report, 209; WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010 Panama’s response to Panel question No. 87
107 Panel Report, 209; WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010 Panama’s Second Written Submission, para 2.661
108 Panel Report, 210
109 Panel Report, 210
110 Panel Report, 211
111 Panel Report, 211
112 Panel Report, 211
113 Panel Report, 212
The Panel gave some insight as to the nature of the “rational relationship,” stating that a “central aspect of this rational relationship of cause and effect 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.”\textsuperscript{114} The Panel noted an analysis of “whether there is a rational relationship of cause and effect between the measure and the reason, can only be determined on a case-by-case basis, taking account of the particular characteristics of each situation and each dispute.”\textsuperscript{115}

Though each dispute will be analyzed independently, the Panel’s analysis of the Measures 5 and 6 provide some sense of how attenuated the “rational relationship” must be. Argentina explained its reinsurance restriction as a precaution to protect the insured; to ensure the solvency of insurers and reinsurers; to guard against the systemic risk that might arise as a result of the insolvency and failure of reinsurance companies and lead to the collapse of direct insurance companies; and to guarantee the integrity of the market.\textsuperscript{116} Argentina pointed out that SSN Resolution No. 35.615/2011 was intended to regulate solvency and “the fairness and technical reasonableness of the respective contract conditions.”\textsuperscript{117} Argentina claimed the lack of information exchange between its government and Panama’s government justified the measure to “protect the financial consumer […] from the distortions, manipulations and abusive situations that may arise precisely when the institution responsible for reinsuring a particular risk is not known, for lack of an effective exchange of information.”\textsuperscript{118} Argentina argued that “[i]f the reinsurer is located in a non-cooperative jurisdiction, the Argentine authorities will not have

\textsuperscript{114} Panel Report, 212
\textsuperscript{115} Panel Report, 212
\textsuperscript{116} Panel Report, 214; WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010 Argentina’s First Written Submission, para 563; and Second Written Submission, para 86-90
\textsuperscript{117} Panel Report, 214; WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010 Argentina’s First Written Submission, para 568, and Exhibits PAN-36 / ARG-27
\textsuperscript{118} Panel Report, 212
access to information on, among other things, the effective ownership of the reinsurer, whether it is adequately capitalized, whether its sources of funds are legitimate, or whether there is any risk of the transaction being used to launder money,” creating the potential for solvency risks.119 Argentina claimed that, as a result, “measure 5 is directly and specifically related to the need to preserve, as fittingly as possible, the soundness of the Argentine financial system.”120 Argentina also noted that the failure of a foreign reinsurer “could lead to the failure of the original insurer and thus produce a ‘domino effect’ on the Argentine insurance market.”121 Measure 5, to Argentina, therefore was intended to “compensate for the lack of direct and effective access to information.”122

For its analysis of determining whether Measure 5 was taken “for prudential reasons,” the Panel established a two-stage process: “First, we will analyse whether the reasons identified by Argentina with respect to Measure 5 are ‘prudential’ within the meaning of [the prudential exception]. That is to say, whether the issue is one of ‘causes’ or ‘reasons’ that prompt the regulatory authorities of the insurance sector to act to forestall a risk, injury or danger.”123 The second step, assuming the reasons are found to be “prudential,” was “to analyse whether the measure was taken ‘for’ the said prudential reasons, that is, whether there exists a rational relationship of cause and effect between measure 5 and the prudential reasons identified by Argentina.”124

119 Panel Report, 212; WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010 Argentina’s Second Written Submission, para 88
120 Panel Report, 212; WTO, Participants and Third Participants in Appeals for Which an Appellate Body Report was Circulated in 2010 Argentina’s Second Written Submission, para 89
121 Panel Report, 213
122 Panel Report, 213
123 Panel Report, 213-214
124 Panel Report, 213-214
Citing statements from the Association of Latin American Insurance Supervisors (ASSAL) and the International Association of Insurance Supervisors about reinsurance and systemic risk, in the first stage of its analysis, the Panel determined that reasons identified by Argentina, to protect the insured, to ensure the solvency of insurers and reinsurers, and to avoid the possible systemic risk of the insolvency and failure of direct insurance companies, were prudential in nature and “in conformity with our interpretation of the expression ‘prudential reasons.’”125 The Panel agreed with Argentina that “a crisis in the insurance and reinsurance sector involving a loss of insurance or reinsurance capacity might occur within a short period of time and harm financial stability and the real economy,” a view shared by the IAIS.126

In determining whether Measure 5 was taken for those prudential reasons, the Panel stated “We recall that a central aspect of this rational relationship of cause and effect is the adequacy of the measure to the prudential reason, that is, whether the measure contributes to achieving the desired effect.”127 It also noted “a central aspect of the rational relationship of cause and effect is the adequacy of the measure to the prudential reason, that is to say, whether the measure, through its design, structure and architecture, contributes to achieving the desired effect.”128

The Panel noted several significant problems with the mechanism for determining whether a country is cooperative (or, un-cooperative by default of not being found cooperative), however. It established that under Argentine Decree No. 589/2013, for a country to be considered “cooperative,” it had to meet certain conditions, “namely: (i) to have signed with Argentina a tax information exchange agreement or an international double taxation convention

125 Panel Report, 215
126 Panel Report, 215-216
127 Panel Report, 215
128 Panel Report, 216
with a broad information exchange clause, provided that the information is effectively exchanged; or (ii) to have initiated with Argentina the negotiations necessary for concluding such an agreement and/or convention.”\textsuperscript{129} It was in that process that the Panel identified a “crucial problem” in the rational relationship between the prudential reason for the measure and the prudential effect of the measure.\textsuperscript{130} Under Measure 5, Argentina could grant “cooperative country status to countries that are in the negotiating process, with respect to which it does not have access to tax information given that there is as yet no agreement or convention in place.”\textsuperscript{131} As the Panel states, “This means that jurisdictions with which Argentina is in the process of negotiating tax information exchange agreements are considered cooperative despite the fact that Argentina continues to have no access to tax information, the exchange of which is the raison d’être of its defensive measures.”\textsuperscript{132} Argentina grants “cooperative” status to countries that fall short of its standard requirements under circumstances that vary country-by-country. In fact, by merely launching negotiations – but without putting in place an information sharing agreement – Panama was later listed as a “cooperative” country.\textsuperscript{133}

Furthermore, in addition to the inconsistency of Argentina’s granting of cooperative status and the prudential justification for the requirements put on non-cooperative countries, the Panel pointed out that “the periodicity with which the list of cooperative countries is updated […] creates other problems.”\textsuperscript{134} The list of cooperative countries is updated only annually, and as a result at a given point in time two countries that are both in negotiations for an information exchange agreement could be treated differently by Argentina depending on when they launched

\textsuperscript{129} Panel Report 215; Article 1 of Decree No. 589/2013, (Exhibit PAN-3 / ARG-35
\textsuperscript{130} Panel Report, 216
\textsuperscript{131} Panel Report, 217
\textsuperscript{132} Panel Report, 217
\textsuperscript{133} Panel Report, 217
\textsuperscript{134} Panel Report, 217
those negotiations. Specifically, the Panel pointed out that “Panama, which, according to Argentina, initiated negotiations with Argentina in November 2013, is on the list of cooperative countries. However, other jurisdictions (Belarus, Cameroon, Côte d’Ivoire, Cyprus, Gabon, Gibraltar and Hong Kong (China)) with which Argentina initiated negotiations in the course of 2014, still do not have the status of cooperative countries.”\textsuperscript{135} The Panel concluded its point by stating that “[T]hese jurisdictions are in the same situation as Panama – they are negotiating, according to Argentina, but presumably not exchanging information. However, given that Panama was included in the list, Panamanian reinsurance companies are treated differently, for the purposes of Measure 5, from reinsurance companies established and registered in any of the other jurisdictions mentioned.”\textsuperscript{136} The Panel summarized its reasons for finding that Measure 5 is not covered by the prudential exception as follows: “In view of the foregoing, we consider that measure 5, and in particular the fact that Argentina does not require relevant information from the insurance regulators of jurisdictions which are officially cooperative but have not concluded an information exchange agreement or effectively exchanged information, does not have a rational relationship of cause and effect with the prudential reasons identified by Argentina.”\textsuperscript{137}

Regarding Measure 6, the Panel wrote, “Moreover, we have concluded that measure 6, and in particular the fact that it does not impose specific requirements on persons that order or effect stock market operations in Argentina and come from jurisdictions that are officially cooperative but have not concluded an information exchange agreement or effectively exchanged information, does not have a rational relationship of cause and effect with the prudential reasons identified by Argentina.”\textsuperscript{138}

\textsuperscript{135} Panel Report, 217
\textsuperscript{136} Panel Report, 217-218
\textsuperscript{137} Panel Report, para 7.919
\textsuperscript{138} Panel Report, para 7.948
The Panel noted that, had Measures 5 and 6 been taken for prudential reasons, an additional step of inquiry would be required to determine whether the measures were used “as a means of avoiding [Argentina’s] commitments or obligations under the GATS.” However, since the Panel decided that the measures were not taken for prudential reasons, it decided it was “unnecessary to continue our examination under paragraph 2(a) of the Annex on Financial Services and, therefore, we will not examine whether Argentina has demonstrated that Measures 5 and 6 have not been used as a means of avoiding Argentina’s commitments or obligations under the GATS.”\footnote{Panel Report, para 7.945} Though the Panel did not examine the measures under this step, it is instructive to note that in future cases such an analysis would be required if future measures are determined to be taken for prudential reasons.

Argentina-Panama conclusion

In the first instance in which the WTO dispute settlement bodies addressed the prudential carve out, they determined that a measure taken by a WTO member to block cross-border reinsurance from another member was not taken for prudential reasons. To be clear, the Panel gave WTO members wide latitude for the types of measures they can take for prudential reasons, not limiting them to a set list of “prudential measures.” But the Panel also made it clear that the true motivation behind the measure must be prudential, as demonstrated by a rational relationship between the measure and the stated prudential aim. Merely stating that the measure was taken for prudential reasons without first stating a legitimate prudential motivation and demonstrating that there is a rational relationship between the measure and the motivation would therefore not be sufficient to successfully invoke the prudential exception. Furthermore, because it was unnecessary to do so having already found Argentina’s measures failed to be justifiably
prudential in nature, the Panel did not address the additional requirement that a measure not be taken in order to avoid one’s commitments – a further limiting requirement on the ability of governments to invoke the prudential exception. Clearly, the prudential exception is not the carte blanche that some government had hoped it would be.

**Indonesia’s WTO commitments**

In light of the outcome of the Argentina dispute, it is likely that several measures currently in force by the Indonesian government that restrict cross-border reinsurance access are inconsistent with that country’s WTO commitments. In analyzing Indonesia’s measures and stated objectives for the measures in light of the Argentina dispute outcome, it is unlikely that Indonesia’s reinsurance measures are *prima facie* consistent with its WTO commitments and it is unlikely that the measures would be protected by the prudential exception or other exceptions.

**Indonesia’s Commitments in the Reinsurance Sector**

Under the GATS, Indonesia took broad commitments to allow foreign reinsurers access to its domestic market through cross-border channels with guarantees of national treatment. Indonesia’s schedule appears as follows:

<table>
<thead>
<tr>
<th>Sector or Sub-sector</th>
<th>Limitations on Market Access</th>
<th>Limitations on National Treatment</th>
<th>Additional Comments</th>
</tr>
</thead>
</table>
| Reinsurance Services | (1) Reinsurance supplier from other member must be rated minimum as BBB by Standard & Poor’s, or equivalent  
(2) Reinsurance supplier from other member must be rated minimum as BBB by | (1) none  
(2) unbound |                     |
Under those commitments, Indonesia allowed for full market access for foreign reinsurance suppliers so long as they are rated BBB by Standard & Poor’s or equivalent rating agencies. Under the national treatment column in its schedule, Indonesia inscribed “none,” which means that it has committed without limitation to GATS national treatment provisions. As a result, Indonesia committed to allowing foreign reinsurers (rated BBB or better) to provide reinsurance to Indonesian insurers in all regulations and laws with “treatment no less favourable than that it accords to its own [Indonesian] like services and service suppliers.”

Indonesia’s measures relating to reinsurance

In November 2015, the Indonesian regulator (Otoritas Jasa Keuangan - OJK) issued its “own retention and domestic reinsurance support regulation,” to be enforced from January 1, 2016. While the regulation covered multiple aspects of insurers’ reinsurance arrangements, those measures that specifically delineate between domestic and foreign (cross-border) reinsurers. Under the measures, with some narrow exceptions, insurers are required to cede all

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140 GATS art. XVII(1): “[E] member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.”
141 Regulation No. 14/POJK.05/2015 on Self-Retention and Domestic Reinsurance Support (“OJK Regulation No. 14”) on 10 November 2015 which was followed by its implementing regulation OJK Circular Letter No. 31/SEROJK.05/2015 on Self-Retention Limitation, Portion of Reinsurance Support and Reports on Reinsurance and Retrocession Program (“OJK Circular Letter No. 31”)
142 Exceptions as listed in Article 8 include: The insurance product is deemed to be a worldwide insurance product; the insurance product was designed specifically for a multinational company; the insurance product is new and its
reinsured risks of motor, health, personal accident, credit, life and surety business (so-called “simple risks”) to domestic reinsurers, prohibiting them from obtaining reinsurance from non-Indonesian reinsurers.\textsuperscript{143} For other insurance business (so-called “non-simple risks”), a minimum of 25 percent of the reinsurance must be ceded to domestic reinsurers.

Even where a risk legally could be ceded to a foreign reinsurer, they must be first offered to a domestic reinsurer.\textsuperscript{144} Specifically, for general (property and casualty) insurance, automatic reinsurance must be obtained from two local reinsurers. If the company cannot fulfill this requirement, automatic reinsurance support must be obtained from at least one local reinsurer and another general local insurance company in Indonesia. Only if those requirements cannot be fulfilled, may the company obtain automatic reinsurance from an offshore reinsurer.

On its face, this regulation and the implementing circular letter have created a situation in which non-Indonesian reinsurers legally are put at a substantial disadvantage relative to their Indonesian competitors.

**Indonesia’s inconsistency with national treatment and market access commitments**

Applying the same analytical steps that the WTO Appellate Body applied in the Argentina reinsurance dispute, the Indonesian reinsurance measures can be demonstrated to be inconsistent with Indonesia’s commitments to accord national treatment to foreign reinsurers offering reinsurance services on a cross-border basis. As noted, Indonesia made a commitment to allow foreign reinsurers to provide reinsurance to insurers in Indonesia in accordance with development was supported by offshore reinsurer; the insurance company has not been able to obtain automatic reinsurance support from all local reinsurers and two local general insurance companies.

\textsuperscript{143} OJK Regulation No. 14/POJK.05/2015, Article 7
\textsuperscript{144} OJK Regulation No. 14/POJK.05/2015, Articles 12(2)b, 13(2)b, 14(2)b, 15(2)b, 19(2)b, 20(2)b, 21(2)b, and 22(2)b
national treatment. That is, Indonesia committed to reinsurers of other WTO members, 
“treatment no less favourable than that it accords to its own like services and service suppliers.”
In demonstrating the inconsistency of the Indonesian measures, we must consider whether the 
treatment the measures provide is “less favourable” for reinsurers for other WTO members and 
whether the reinsurers are, in fact, “like services and service suppliers.”

“Treatment no less favourable”

Through measures that require mandatory reinsurance cessions to the domestic reinsurers 
for most reinsurance arrangements, and mandatory preferential offers to domestic reinsurers 
where cross-border cessions are permissible, Indonesia clearly provided “less favourable” 
treatment to non-Indonesian reinsurers than domestic reinsurers. The Appellate Body 
determined that “treatment no less favourable” has occurred where “the measure modifies the 
conditions of competition to the detriment of like services or service suppliers of any other 
Member.”145 Looking to prior disputes, the Appellate Body pointed out that “the fact that a 
measure modified the conditions of competition to the detriment of services or service suppliers 
of any other Member was, in itself, sufficient for a finding of less favourable treatment under 
Articles II:1 and XVII of the GATS.”146

Here, by mandating that most reinsurance cessions be made to domestic reinsurers and 
not to reinsurers of other WTO members, and that preferential offers be made to domestic 
reinsurers before engaging foreign reinsurers where cross-border reinsurance is permitted, 
Indonesia’s measures have severely modified the conditions of competition to the detriment of 
reinsurers from other WTO members.

145 AB report, para 6.111
146 AB report, para 6.106
However, the analysis of the inconsistency of those measures must also include consideration of whether they are “like services.”

“Likeness”

In the Argentina dispute, the Appellate Body analyzed whether the petitioner’s services are being offered “in like circumstances” to the services from the country allegedly is receiving preferable treatment. In the case of national treatment violations, the preferred industry would be a domestic industry of the respondent, and in the case of MFN violations the preferred industry would be of a third country. In the Argentina dispute, Panama focused on MFN for reinsurance whereas Indonesia appears to be violating national treatment by offering preferential treatment to its own domestic industry. As noted, however, the Appellate Body in analyzing national treatment in *China – Electronic Payment Services* and MFN in *Argentina – Measures Relating to Trade in Goods and Services* determined that the concept of “likeness” is to be analyzed in the same manner.  

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Competition between services providers is key to whether they are “like,” the Appellate Body has found. The Appellate Body “held that Article XVII [National Treatment] seeks to ensure equal competitive opportunities for like services of other Members, and that services are therefore ‘like’ when they are in a competitive relationship with each other.” It also has determined measures that modify competitive conditions can be inconsistent with national treatment “only if the foreign and domestic services at issue are indeed in a competitive relationship.”  

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147 AP report para 6.24, citing Appellate Body Report, *EC – Seal Products*, para. 5.82 – “notwithstanding their textual differences, both of these provisions are concerned with ‘prohibiting discriminatory measures’ and ensuring ‘equality of competitive opportunities’ between products that are in a competitive relationship.”

It is clear that Indonesia’s domestic reinsurers and reinsurers from other WTO members are “like” for the purposes of the national treatment commitment. As referenced earlier in the context of the Argentina dispute, the Appellate Body can use one of two approaches for assessing the “likeness” of services and services providers: the origin-based “presumptive approach” and a factor-based “detailed approach.” As described earlier, the origin-based “presumptive approach” allows for a presumed “likeness” where a measure differentiates between services and services suppliers exclusively on the basis of their country of origin. Here, the less-intensive origin-based “presumptive approach” confirms the “likeness” of the domestic Indonesian and non-domestic foreign reinsurers since the measure does not differentiate between the reinsurers in any way other than their country of origin.

**Inapplicability of exceptions to Indonesia’s measures**

While this paper has established that Indonesia took commitments to allow reinsurers from other WTO members to provide reinsurance on a cross-border basis under national treatment conditions and that Indonesia’s reinsurance measures are inconsistent with that commitment, two potential exceptions to the commitments must be considered. Those exceptions are the prudential exception and a balance of payments exception. If applicable, those exceptions would exempt from Indonesia’s commitments a measure that is otherwise inconsistent with those commitments.

**Indonesia’s measures and the prudential exception**

As noted in this paper, the decision on Argentina – Measures Relating to Trade in Goods and Services was the first case in which the WTO dispute settlement body considered the
prudential exception. In that case, Argentina claimed that if it the WTO Panel were to find its measures inconsistent with MFN and market access commitments, the prudential exception would apply. Were Indonesia to claim the prudential exception, the burden of proof would be with its government.149 Based on the analysis undertaken by the Panel in the Argentina dispute, the consistency of the measure would hinge on whether a two-step analytical process found that the measures were genuinely motivated150 by prudential considerations.

In order to be covered by the prudential exception, a government “must demonstrate that two requirements have been met in order to avail itself of the [prudential] exception, namely: (i) that the measure in question was taken for prudential reasons and (ii) that the measure is not being used as a means of avoiding its commitments or obligations under the GATS.”151 Demonstrating that the measure was taken “for prudential reasons” requires its own two-step analysis, first that the cited motivation for the measure is a prudential motivation, and second that there is a “rational relationship” between that prudential motivation and the measure itself.

In determining whether there is a rational relationship between a prudential motivation and a measure, the Panel provided the following analysis in the Argentina dispute:

We recall that a central aspect of this rational relationship of cause and effect is the adequacy of the measure to the prudential reason, that is, whether the measure contributes to achieving the desired effect152 and that “a central aspect of the rational relationship of cause and effect is the adequacy of the measure to the prudential reason, that is to say, whether the measure, through its design, structure and architecture, contributes to achieving the desired effect.153

149 Panel report, p. 197
150 Panel report, p. 211: “A measure taken ‘for’ prudential reasons would therefore be a measure with a prudential cause”
151 Panel report, p. 197
152 Panel report, p. 215
153 Panel report, p. 216
In analyzing Indonesia’s measures and stated objectives for the measures, it is unlikely that Indonesia’s reinsurance measures would be protected by the prudential exception.

**Indonesia’s stated motivations**

In the Argentina dispute, the Panel wrote, “[t]he crux of the matter is therefore what is meant by a measure taken ‘for prudential reasons’.” As noted earlier, the scope of “prudential reasons” was left broad in the Argentina dispute but not left entirely to the discretion of the government invoking the exception. Prudential reasons are “preventive or precautionary reasons,” which it found was also consistent with the non-exclusive, illustrative list of the types of measures in paragraph 2(a) that could be taken for prudential reasons.

In the Indonesian reinsurance measures, OJK cited three “considerations” for the measures that explain their motivations. They are:

- Considering: 
  a. that financial soundness of insurance companies, sharia insurance companies, reinsurance companies and sharia reinsurance companies is affected by own retention and reinsurance support;
  b. that in order to encourage national reinsurance growth and capacity optimization of domestic insurance, sharia insurance, reinsurance and sharia reinsurance, it is necessary to adjust the provisions for own retention and reinsurance support;
  c. that based on the consideration referred to in point a and point b, it is necessary to establish a Regulation of the Financial Services Authority on Own Retention and Domestic Reinsurance Support.

Media reports also cite OJK officials stating that the purpose is “advancement and development” of the Indonesian market and “improving and optimising capacity in the country,”

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154 Panel report, p. 205
155 Panel report, p. 207 - “We therefore consider that WTO Members should have sufficient freedom to define the prudential reasons that underpin their measures, in accordance with their own scales of values.”
156 Panel report, p. 206
157 English translation of Regulation of the Financial Services Authority [OJK] Number 14/POJK.05/2015 on Own Retention and Domestic Reinsurance Support By the Grace of God Almighty
158 English translation of Regulation of the Financial Services Authority [OJK] Number 14/POJK.05/2015 on Own Retention and Domestic Reinsurance Support By the Grace of God Almighty, page 1
adding that capacity optimization is a “key part of prudential supervisory and regulatory framework.”\textsuperscript{159}

Another often-cited justification is to reduce a balance of payments. A memorandum from OJK to foreign reinsurers dated December 8, 2014 outlining the soon-to-be-released regulations states that the motivation for the regulations were to address a balance of payments deficit, in addition to a desire to develop local capacity (“local capacity optimisation”).\textsuperscript{160}

Because balance of payment measures are covered under a separate exception, it will not be considered under the analysis of the prudential exception.

Each of the three motivations cited by OJK – “financial soundness of insurance companies [and] reinsurance companies”\textsuperscript{161}; to “encourage national reinsurance growth and capacity optimization of domestic insurance;”\textsuperscript{162} and to address a balance of payments deficit\textsuperscript{163} – will need to be examined in order to determine whether the measures are excused by the prudential exception. That is, Indonesia would have to demonstrate that its actions were taken “for prudential reasons” and were not “being used as a means of avoiding its commitments or obligations under the GATS.”\textsuperscript{164}

\textsuperscript{159} OJK Chief Executive of Nonbank Financial Institutions (NBFI) Firdaus Djaelani at the 21st Indonesia Rendezvous in Bali. MKK Newsletter January 2016
\textsuperscript{160} Memorandum of Firdaus Djaelani, Chief Executive, Non-Bank Financial Service, OJK, December 8, 2014
\textsuperscript{161} English translation of Regulation of the Financial Services Authority [OJK] Number 14/POJK.05/2015 on Own Retention and Domestic Reinsurance Support By the Grace of God Almighty, page 1
\textsuperscript{162} English translation of Regulation of the Financial Services Authority [OJK] Number 14/POJK.05/2015 on Own Retention and Domestic Reinsurance Support By the Grace of God Almighty, page 1
\textsuperscript{163} OJK Chief Executive of Nonbank Financial Institutions (NBFI) Firdaus Djaelani at the 21st Indonesia Rendezvous in Bali. MKK Newsletter January 2016
\textsuperscript{164} Panel report, p. 197
Financial soundness of insurance companies and reinsurance companies

The financial soundness of insurance and reinsurance companies appears to clearly be a prudential objective, as it is closely related to one the examples provided in the indicative list of prudential reasons within the text of the prudential exception itself, namely “to ensure the integrity and stability of the financial system.” Furthermore, the reason stated by OJK can read as a broader but succinct recitation of the reason stated by Argentina that was affirmed by the Panel: “to protect the insured, to ensure the solvency of insurers and reinsurers, and to avoid the possible systemic risk of the insolvency and failure of direct insurance companies.” The Panel agreed with Argentina that “a crisis in the insurance and reinsurance sector involving a loss of insurance or reinsurance capacity might occur within a short period of time and harm financial stability and the real economy,” a view shared by the IAIS. Thus, though an extremely broad prudential reason, financial soundness likely is a legitimate prudential motivation.

It is unlikely, however, that there is a “rational relationship” between the stated motivation and the measures themselves, making the prudential exception inapplicable to the measures based on this reason, even if the reason itself were to be deemed legitimately prudential. While there is some ambiguity in the analysis because OJK has not specified how it views restricting cross-border reinsurance access as supporting the financial soundness of insurers and reinsurers, the burden would be on Indonesia to demonstrate such a relationship. Per the Panel in the Argentina dispute, to demonstrate the “rational relationship” the Indonesian government would have to show that there is a “cause and effect” between the “adequacy of the

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165 paragraph 2(a) of the Annex on Financial Services
166 Panel report, p. 215
167 Panel report, p. 215-216
measure to the prudential reason, that is, whether the measure contributes to achieving the
desired effect.”168 The Indonesian government would have to demonstrate that the set of
reinsurance restrictions, “through its design, structure and architecture, contributes to achieving
the desired effect,”169 contributes to the financial soundness of insurance companies and
reinsurance companies.170

In fact, rather than contributing to the financial soundness of insurance companies and
reinsurance companies, international intergovernmental organizations, including those cited as
the proper sources for prudential standards in the Argentina dispute,171 suggest such measures
have a detrimental effect on the stated prudential motivation, not a positive one. Such measures
are contrary to global prudential best practices and have resulted in the over-concentration of risk
in Indonesia. In its March 2018 Financial Sector Assessment Program (FSAP) report for
Indonesia, the International Monetary Fund (IMF) stated, “The Indonesian insurance sector is
still vulnerable to a number of material risks. … The Indonesian insurance industry is exposed to
significant catastrophic risk with domestic concentrations through mandatory reinsurance
programs.”172 The IMF added, “Indonesia is prone to landslides, floods, storms, earthquakes,
 tsunamis, and volcanic eruptions. Insurers are required to set aside a catastrophe reserve and also
have mandatory reinsurance arrangements with domestic reinsurers. One reinsurer is owned by
all of general insurance companies, thus creating potential contagion in case of significant
catastrophe events.”173

168 Panel report, p. 215
169 Panel report, p. 216
170 English translation of Regulation of the Financial Services Authority [OJK] Number 14/POJK.05/2015 on Own
Retention and Domestic Reinsurance Support By the Grace of God Almighty, page 1
171 Panel report, p. 215
172 March 2018 IMF FSAP “Indonesia: Financial Sector Assessment Program – Detailed Assessment of Observance
– Insurance Core Principles,” p. 4”
173 IMF FSAP, p. 11
In fact, the IMF specifically noted that the Indonesian measures are inconsistent with the IAIS’s Insurance Core Principles, the accepted measure for prudential best practices and a source of expertise cited in the Argentina dispute.\textsuperscript{174} In observing its compliance with prudential best practices on “Macroprudential Surveillance and Insurance Supervision” (ICP 24), the IMF recommended that the OJK “conduct contagion analysis caused by domestic concentration of reinsurance coverage, for example through stress testing with an assumption of catastrophe events and a failure of a large domestic reinsurance company; and … consider the suppression of mandatory reinsurance programs if that could cause contagion among domestic insurers and reinsurers.”\textsuperscript{175}

As a global regulatory standard-setting body, the views of the IAIS likely also would be considered by a WTO panel if Indonesia’s reinsurance restrictions were to be challenged. The IAIS has pointed out the positive effect on the financial stability of geographic risk diversification through cross-border reinsurance. In the Insurance Core Principal 13 (ICP 13) on “Reinsurance and Other Forms of Risk Transfer,” the IAIS states that:

Geographical diversification of risk, which typically involves risk transfer across jurisdictional borders, is a key element of ceding insurer’s and reinsurer’s capital and risk management. Geographical diversification can also have an impact in the jurisdiction of the ceding insurer, in particular jurisdictions exposed to catastrophes. By ceding insurance risk across borders, ceding insurers in the jurisdiction, and the jurisdiction as a whole, can benefit from a reduced concentration of insurance risk exposures at the ceding insurer and jurisdiction level respectively. This may also contribute to the financial stability of the jurisdiction.\textsuperscript{176}

Addressing examples like those of Indonesia where there are restrictions on cross-border reinsurance that can impede risk diversification, the IAIS warned in ICP 13:

\textsuperscript{174} Panel report, p. 215
\textsuperscript{175} IMF FSAP, p. 23
\textsuperscript{176} ICP 13.0.2
Ceding insurers and reinsurers may face external limitations to geographical diversification, for example, in the form of constraints to cross-border risk transfer. The supervisor should be aware of and take into account the potential impacts of such limitations on individual ceding insurers and reinsurers as well as on the soundness and efficiency of the insurance market.\footnote{ICP 13.0.3}

The Organization for Economic Cooperation and Development (OECD) likewise has noted the importance of cross-border reinsurance for geographic risk diversification, and the importance of that diversification for financial stability, by providing capital in the event of a catastrophe and reducing the amount of capital that ceding insurers need to hold in order to meet their obligations. In its 2018 report “The Contribution of Reinsurance Markets to Managing Catastrophe Risk,”\footnote{OECD (2018), The Contribution of Reinsurance Markets to Managing Catastrophe Risk} the OECD presented its own research into the effects of reinsurance and particularly cross-border reinsurance on the stability of national economies and the development of national insurance markets. It found that:

\begin{quote}
The pooling of risks by reinsurers allows for [...] diversification [of risks] (in addition to the diversification of risk realised by primary insurers), providing an additional layer of risk absorption capacity at a lower cost than can be achieved (in aggregate) by insurance companies individually. The global nature of international reinsurance markets also allows for some portion of the losses from an event to be absorbed by international markets (and investors), thereby diversifying the burden away from the domestic financial system.\footnote{OECD report, p 9}
\end{quote}

The OECD concluded, “International property catastrophe reinsurance markets can contribute to risk management by enhancing the capacity of primary insurance markets to provide insurance coverage and supporting the management of catastrophe risks.” The OECD added, “There is also evidence that higher levels of property catastrophe reinsurance coverage have a positive impact in terms of reducing economic disruption in the aftermath of catastrophe events (potentially even more than in the case of primary insurance) and also mitigating the impact of catastrophe events.
on primary insurers and primary insurance market pricing. The OECD said that measures that restrict access to global reinsurance markets “could dampen the diversification benefits provided by risk transfer to international property catastrophe reinsurance markets and could create concentration risks for cedants and the domestic economy.” Addressing the consistency of such measures with international commitments, the OECD concluded that “[s]ome of the restrictions imposed by countries may not be consistent with obligations under the OECD Code of Liberalisation of Current Invisible Operations or with trade liberalisation commitments made in the General Agreement on Trade in Services: Annex on Financial Services,” depending on the specific examples of those measures.

**Indonesia’s market development goal**

The OJK’s second stated goal in introducing the reinsurance restrictions was to develop its domestic market. In the regulations, OJK considered that “to encourage national reinsurance growth and capacity optimization of domestic insurance [and] reinsurance, it is necessary to adjust the provisions for own retention and reinsurance support.” In public remarks, an OJK official said that development of the domestic market is a “key part of [the] prudential supervisory and regulatory framework.”

Whether capacity optimization (or development) can be considered to be a prudential reason is not clear. In fact, the Appellate Body made it clear in its analysis of the Argentina

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180 OECD report, p 63
181 OECD report, p 63
182 OECD (2019), *OECD Code of Liberalisation of Current Invisible Operations*
183 OECD report, p 63
184 English translation of Regulation of the Financial Services Authority [OJK] Number 14/POJK.05/2015 on Own Retention and Domestic Reinsurance Support By the Grace of God Almighty, page 1
185 OJK Chief Executive of Nonbank Financial Institutions (NBFI) Firdaus Djaelani at the 21st Indonesia Rendezvous in Bali. MKK Newsletter January 2016
dispute that merely stating that something is a prudential reason does not make it a prudential reason – even with the broad deference to governments. Though it is illustrative rather than exhaustive, development does not appear to be consistent with the list of examples of prudential motivations the text of the Annex on Financial Services. It is important to remember that the burden of persuasion would be on the Indonesian government in this instance, as well.

Even assuming that development is determined to be a legitimate prudential motivation, however, it would be unlikely that Indonesia could demonstrate that its reinsurance restrictions have a causal relationship to that goal. To the contrary, such restrictions likely inhibit the development of Indonesia’s domestic market. The OECD found that access to global reinsurance markets has a positive effect on many factors that support the development of domestic markets. It said, “International property catastrophe reinsurance markets can contribute to risk management by enhancing the capacity of primary insurance markets to provide insurance coverage.”186 As the OECD noted, “one of the main functions of reinsurance is to allow cedants to write more business as a portion of the risk that they assume is transferred to reinsurers and therefore does not usually need to be covered by reserves or capital to the same extent that it would need to be covered if retained”.187 The OECD added, “Access to reinsurance could also facilitate the entry of cedants into new business lines.”188 The OECD concluded access to global reinsurance markets can reduce “primary insurance market pricing”189 for policyholders, presumably having a positive effect on domestic market development and access.

Taking up the same concerns raised by the OECD, the insurance industry amplified those views in the specific context of Indonesia. Writing to OJK in December 2015, the Global

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186 OECD p 63
187 OECD p 25
188 OECD p 27
189 OECD p 63
Federation of Insurance Associations (GFIA) warned “against the hindrance of competition by protectionist regulation,” which would “have the potential to reduce, if not destroy, the creation of economic value and growth by concentrating risk in the favored participants and limiting innovation by crowding out competitors.” Addressing the prudential implications of the mandatory cession and preference head on, GFIA wrote, “Such measures expose consumers to unnecessary risks, bring about deterioration in quality and service and ultimately lead to increased costs and less available insurance.”

Another industry group, the Global Reinsurance Forum (GRF), also argued Indonesia’s measures would harm the development of its domestic insurance and reinsurance market. In an August 2019 open letter, the GRF said “barriers undermine the efficiency of reinsurance markets and reduce competition, leading to reduced customer choice, higher reinsurance costs and less capacity over the long-term horizon.” That GRF letter accompanied a chart of the most problematic reinsurance barriers globally, which included Indonesia’s.

It also appears the Indonesian government’s motivation was to remedy a balance of payments deficit due to reinsurance premiums being paid to reinsurance groups outside the country. Concerns about balance of payments are subject to a separate exception in the GATS that will be addressed in the Indonesian context below. It seems likely, however, that the balance of payment motivation would not be considered a prudential objective specifically since it is addressed in a different exception.

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190 GFIA letter to OJK, December 1, 2015
191 The Global Reinsurance Forum “is composed of thirteen leading global reinsurers; its main objective is to promote a stable, innovative, and competitive worldwide reinsurance market.” [http://www.grf.info/](http://www.grf.info/), accessed January 4, 2020
192 Open letter of the Global Reinsurance Forum, August 15, 2019
OJK acknowledged their practice of merely retroceding the risk beyond its borders anyway, negating any possible developmental benefits from the measures. In fact, it told the IMF that “risk in excess of domestic reinsurer capacity is retroceded to international reinsurers.”

Whether the measures were a means of avoiding Indonesia’s commitments

Further complicating its potential motivations, the Indonesian government consolidated its position as a player in the reinsurance markets. In October 2015, press reports confirmed that the OJK had approved creation of a new state-owned reinsurer, Indonesia Re, which would benefit from the mandatory local cessions and preferences. Indonesia Re was created by the merger of the two state-owned reinsurers and will have two subsidiaries brought under it.

In light of the creation of the state-owned reinsurance conglomerate, it could be argued that the reinsurance restrictions were put in place in order to financially support a government-owned corporation rather than to achieve the government’s stated motivations. This shadow motivation would suggest that Indonesia also had fallen afoul of the requirement in the prudential exception that the measures “shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement.” That provision of the prudential exception has yet to be tested in the WTO DSB.

Indonesia’s measures and the balance of payments exception

In addition to the prudential exception, it is possible that Indonesia may seek to claim a balance-of-payments exception to justify its measures. It has likely not fulfilled the strict

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194 IMF FSAP, p. 11
195 Annex, Art. 2(a)
procedural requirements set out in Article XII of the GATS, however, which are more defined than those of the prudential exception. WTO members may use difficulties in balance-of-payments to justify national treatment or market access restrictions under GATS. GATS art. XII(1) states:

In the event of serious balance-of-payments and external financial difficulties or threat thereof, a Member may adopt or maintain restrictions on trade in services on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments.

In order for such restrictions to be consistent with GATS, however, they must also “not exceed those necessary to deal with” the financial and balance-of-payments difficulties, and must be “temporary and phased out progressively.”\(^{196}\) Balance-of-payments safeguard measures also require notification and consultations with the relevant WTO committee.\(^{197}\)

Putting aside the doubtful possibility that Indonesia’s measures could meet the requirement that they “not exceed those necessary to deal with” a temporary balance of payments issue, at no point did Indonesia meet the required notification and consultation requirements for the use of the balance of payments exception. As a result, it can be concluded that the exception would not give shelter to Indonesia’s inconsistent measures.

**Conclusion**

While the absence of significant numbers of financial services trade disputes at the WTO leaves some questions about the applicability of the commitments open, jurisprudence at the WTO has begun to close the gap in our understanding of the commitments. The relatively recent jurisprudence appears to be applicable widely, particularly regarding when key exceptions can

\(^{196}\) GATS art. XII(2).

\(^{197}\) GATS art. XII(4)-(5)
and cannot be used to avoid compliance with key cross-border financial services trade commitments.

Most significantly, the Achilles’ heel of challenges to GATS inconsistent measures – the prudential exception – has been better defined in a way that will limit its abuse. A WTO Panel for the first time has established the analytical steps through which the invocation of the prudential exception can be contested. Though the Panel in the Argentina dispute permitted greater latitude for otherwise inconsistent measures under the prudential exception than for the “general exceptions” to GATS commitments by rejecting any assertion of a necessity test, the carte blanche interpretation made by some governments was roundly rejected and was replaced by a “rational relationship” test. Significantly, that the first application of the “rational relationship” test for the prudential exception denied Argentina shelter under the exception suggests that the “rational relationship” test has real meaning. A mere invocation of “measures for prudential reasons” will not allow inconsistent measures to stand. Furthermore, the justification that the Panel employed in striking down Argentina’s use of the prudential exception suggests that the WTO will require a very high level of relation between a measure and the prudential justification for it.

The new jurisprudence around the prudential exception is applicable to existing measures that are *prima facie* inconsistent with the international commitments of the governments that have implemented those measures, notably in the case of Indonesia’s reinsurance measures. Those measures violate Indonesia’s market access and national treatment commitments under the GATS. Were Indonesia to attempt to justify them by citing the prudential exception, it likely would fail to successfully do so under the framework established in the Argentina dispute.
Finally, there is more to the prudential exception that has not been tested at the WTO – most significantly the process for analyzing whether a measure has been taken “as a means of avoiding commitments or obligations under the GATS.” Since that portion of the paragraph 2(a) can only further limit the ability of governments to hide behind the prudential exception, however, it is more likely than not that the prudential exception will be further hemmed in as trade jurisprudence develops.

The importance of the Argentina dispute to the applicability of key commitments to financial services trade measures will be tested in time. Analysis of Indonesia’s measures suggest they could have future implications for trade enforcement.